

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 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, assailed one Italian player, then other Italian players moved to their team-mate.

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 depictions of the incident concur 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 in 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 "less guilty".

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 Coccia
- › 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 I 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 to both teams involved, pronouncing their 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 Appeal composed of the Bureau Liaison as chair 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 Berlin 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 notified 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"*.

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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. FINA indeed has its headquarters 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 appeals 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 is 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 all teams will be notified.

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 FIN 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 FIN believes that the Italian Junior Team was already punished 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 underlines 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 their benches and jumped into the water to join the fight. This version is confirmed in all 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 Championships 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, if it qualified. 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.

(...)

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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 literally 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 Junior 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 Junior Water Polo Championships and barred the appellant from participating in the IX Junior 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 "personalities" 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 their application is arbitrary, or if [page "358"](#) the sanctions provided by the rules can be deemed excessive or unfair on their 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 all those in charge of the 1997 Italian Junior Team (i.e. the coaches) to forewarn and educate their players that brutality will be met with swift and certain punishment similar to that which occurred during the 1995 Junior 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 Junior Water Polo Team, but rather as members of senior teams. In a general way, the Panel believes that the national federations should review their 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 combating 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 FIN 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"](#)

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F I N A L

A W A R D

FINAL

AWARD

IN THE MATTER OF AN UNCITRAL ARBITRATION

between

Ronald S. Lauder

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United States of America

The Claimant

and

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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 Baček 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 a 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, an 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 Josefík'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. Josefík 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

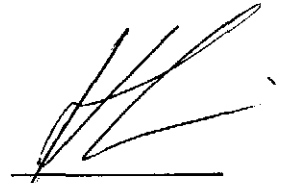
The Arbitral Tribunal



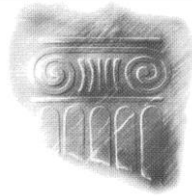
Lloyd Cutler
Lloyd Cutler
Arbitrator



Robert Briner
Robert Briner
Chairman



Bohuslav Klein
Bohuslav Klein
Arbitrator



Arbitration CAS 2009/A/1782 Filippo Volandri v. International Tennis Federation (ITF), award of 12 May 2009

Panel: Mr Efraim Barak (Israel), President; Prof. Luigi Fumagalli (Italy); Prof. Ulrich Haas (Germany)

Tennis

Doping (Salbutamol)

CAS scope of review

Burden of proof

Degree of fault of the player

1. By adopting and implementing the principle of consistency with the WADAC and by adopting the commitment to *“incorporate without any substantive changes”* the provision of the WADAC which recognize inter alia the unrestricted scope of review of the CAS Panel as provided under R57 of the CAS Code, the 2008 ITF Programme actually solves by itself the question of the co-existence of its two apparently conflicting provisions regarding the CAS scope of review. In order to exercise its power of review (as apparently allowed by the 2008 ITF Programme), the CAS must be able to examine the formal aspects of the appealed decisions but also, above all, to evaluate – sometimes even *de novo* – all facts and legal issues involved in the dispute.
2. According to the ITF Programme, the fact that a player has established, on the balance of probabilities, how the specified substance entered his body and has also established, to the comfortable satisfaction of the hearing body, that his ingestion of the specified substance was not intended to enhance his sporting performance or to mask the use of another prohibited substance only allows the player to benefit from the possible elimination or reduction of the period of suspension but is irrelevant with regard to the occurrence or non occurrence of the adverse analytical finding. As the player has not offered any persuasive evidence of how the concentration found in his urine could be the result of the therapeutic use, he has not succeeded in discharging the onus on him and, hence, must be considered as having committed a doping offence.
3. The degree of a player's fault is minor if the threshold of 1,000 ng/mL is just exceeded. Furthermore, the fact that the player has never previously been found guilty of an anti-doping rule violation, and more importantly, the fact that the procedures before the IF were slow and suffered from inconsistencies, with the result that the player was left in a state of uncertainty of over 8 months before formally being charged with a doping offence, must be taken into account to assess the player's degree of fault. Such a long period is unacceptable and incompatible with the intention of the anti-doping regime that matters should be dealt with speedily.

Mr Filippo Volandri, born on 5 September 1981, is a professional tennis player of Italian nationality (the “Player”). He entered the top 50 in the world ranking in 2003 and obtained the best result of his career in 2007, when he reached the 25th place in the ATP world rankings.

The International Tennis Federation (ITF) is the international governing body for sports related to tennis worldwide. It has its registered seat in London, England.

The circumstances stated below are a summary of the main relevant facts, as established on the basis of the written submissions of the parties and the evidence examined in the course of the proceedings. Additional facts may be set out, where relevant, in connection with the legal discussion.

Since his early childhood, Mr Filippo Volandri has suffered from asthma induced by dust-mite, dog epithelium as well as by physical exercise. His treating physician was then Dr Fabrizio Gadducci, presently director of the Bronchopneumology and Respiratory Allergology Section of the Livorno Hospital, Italy.

When he first started his professional career as a tennis player, Mr Filippo Volandri did not take any medication for asthma nor did he seek any specific medical care.

Over the years, the Player’s condition worsened and required notably a treatment in the form of inhalation of Ventolin, a salbutamol-based asthma medicine, achieved through a metered-dose inhaler.

Salbutamol is included in the list of prohibited substances under the World Anti-Doping Code (WADC), which is incorporated in the ITF Tennis Anti-Doping Programme (the “ITF Programme”). The authorisation to take this substance for a legitimate medical need is treated differently depending on whether the 2008 or the 2009 ITF Programme is applicable. In the first case, the administration of salbutamol by inhalation requires an application for an abbreviated Therapeutic Use Exemption whereas in the second case, the submission for a standard Therapeutic Use Exemption is needed. Also, in the first case, salbutamol in a concentration greater than 1,000 ng/mL is a prohibited substance and not a specified substance, whereas in the second case, salbutamol, even in a concentration greater than 1,000 ng/mL, is qualified as a specified substance. However, both the 2008 and 2009 ITF Programmes provide that despite the granting of a Therapeutic Use Exemption (TUE), the presence of salbutamol in urine in excess of 1,000 ng/mL will be considered an adverse analytical finding unless the Athlete proves that the abnormal result was the consequence “*of the therapeutic use of inhaled salbutamol*” or “*of the use of a therapeutic dose of inhaled salbutamol*”.

In respect of his use of salbutamol, Mr Filippo Volandri was granted his first TUE in 2003. Since then he applied for TUEs every year.

Regarding the year 2006, Mr Filippo Volandri filed a submission for a TUE for the use of salbutamol by inhalation. This document is dated 8 December 2005 and the indicated dosage strength was 100 mcg to be administered by a metered-dose inhaler *“if necessary”*. On the application form, the box marked *“once only”* and the box marked *“emergency”* were ticked. The space provided to *“indicate all relevant information to explain the emergency or the insufficient time to submit the TUE application”* was filled in with the words *“weezing e/o dispnea”*.

On 8 December 2005, the International Doping Tests and Management of Lindigö, Sweden (IDTM) confirmed the receipt of Mr Filippo Volandri’s application, accepted it without reservation and drew the Player’s attention on the fact that *“the dose, method and frequency of administration as it has been notified have to be followed meticulously!”*.

On 1 December 2006, Mr Filippo Volandri applied for a TUE covering the year 2007 and permitting the use of salbutamol by inhalation. The indicated dosage strength was 200 mcg to be administered three times a day. On the application form, the box marked *“once only”* and the box marked *“emergency”* were also ticked. It is not disputed that this document was eventually accepted by the IDTM.

On 21 November 2007, Mr Filippo Volandri and Dr Fabrizio Gadducci signed a TUE application form for the year 2008. The prohibited substances concerned were formoterol and albuterol, which is another name for salbutamol. Regarding this last drug, the treatment foreseen consisted in two puffs of 100 mcg to be administered by inhalation twice daily. On the application form, the box marked *“once only”* and the box marked *“emergency”* were also ticked and the space provided to *“indicate all relevant information to explain the emergency or the insufficient time to submit the TUE application”* was filled in with the words *“2 puffs if necessary”*.

It is accepted by the parties as well as by the lower instance that the present case must be examined in the light of the content of the TUE application form signed by the Player on 21 November 2007 (the *“TUE of November 2007”*). It is undisputed that the subsequent management of this document by the IDTM is irrelevant.

On 19 November 2008, Mr Filippo Volandri signed a TUE, seeking permission to take montelukast, budesonide and salbutamol. With regard to the last substance, the indicated dosage strength was 2 puffs of 100 mcg to be administered by inhalation. The box related to the *“frequency”* of administration was filled with the words *“Rescue”* and *“al bisogno”*.

On 24 November 2008 and following his application, Mr Filippo Volandri received from the IDTM an approval for the therapeutic use of budesonide and salbutamol. This document is a fix-term authorisation for two years, effective from 21 November 2008 to 22 November 2010 and allows the Player to use salbutamol in a dosage of 200 mcg by inhalation, *“as needed”*. It is also stipulated that the dose, method and frequency of administration as notified have to be followed meticulously.

At the end of the year 2008, Mr Filippo Volandri was referred to an asthma specialist, Mr Pierluigi Paggiaro, Professor in Respiratory Medicine, at the University of Pisa, Italy, and member of the

executive committee of the Global Initiative for Asthma. In a written statement made on 8 December 2008, Professor Pierluigi Paggiaro confirmed among other things that *“In the last months, symptoms are present every day (2-3 times daily use of rescue medication) particularly during physical activity. (...) Therefore, we conclude for **“Bronchial asthma with severe bronchial hyperresponsiveness”** and we recommended the following therapeutic regimen: Budesonide. Viatris 400 mcg, one inhalation in the morning and in the evening. Montelukast 10 mg, one tablet in the evening. Rescue salbutamol, 2 puffs when needed. Periodic evaluations of pulmonary function are recommended”*.

In March 2008, Mr Filippo Volandri was participating in an ATP Tour tournament, which took place in Indian Wells, California, United-States.

In the morning of 13 March 2008, at about 2:30, Mr Filippo Volandri was awakened by what he says to be the most serious asthma attack of his life. This happened just a few hours before his first match in the tournament, which was scheduled for the early afternoon of the same day.

Some details of this incident can be found in the transcript of the hearing held before the ITF Independent Anti-Doping Tribunal on 7 January 2009:

Filippo Volandri

I used Ventolin every 20 minutes up to the situation getting back to normal.

Jonathan Taylor

Do you remember how many puffs you had to take to get the situation back to normal?

Filippo Volandri

No, I don't recall the number exactly.

(...)

Jonathan Taylor

I'm not asking you exactly for how many puffs you think it took to get you back to normal, but one can try and narrow the range, so would it have been more than four?

Filippo Volandri

I don't feel I can answer that question because I don't remember when exactly it happened when I wake up, so I'm not really entirely awake yet and I can't actually count them sometimes. It was a situation which started during the night.

Jonathan Taylor

...any range, it would have been something between zero and ten, it would have been something between 20 and 30, or you just simply can't say?

Filippo Volandri

I cannot say, but it's between zero and ten, I would say (...)”.

Transcript: pages 48 and 49

“Filippo Volandri

What I remember was that this attack began in the middle of the night as usually happens. It was perhaps half past two/three o'clock in the morning I woke up due to this attack. The attack woke me up and I wasn't breathing well. I didn't wake up to say go to the toilet and then realise that I wasn't breathing well. I woke up because I was not breathing well. I began using Ventolin as had been explained to me by my physician, one or two puffs every 15 to 20 minutes. I was a little concerned about the situation, I called my trainer because it was the first time that such a serious attack had taken place, and apart from the fact that my trainer could not help me, he came to me for support. I continued using Ventolin, he came to my room approximately an hour later because we were sleeping in different hotels. I continued with the Ventolin, also following his own advice, he noticed that my medical situation was not normal, and around four/half past four in the morning the situation normalised and my trainer left my room. One of his pieces of advice was, 'Let's call a doctor,' then luckily there was no need for this.

(...)

Jonathan Taylor

First of all you say you were taking – would it be two puffs every 15 to 20 minutes?

Filippo Volandri

Yes.

Jonathan Taylor

In this period did you do that throughout? So in every 15/20 minutes you took two puffs, or were there sometimes longer gaps?

Filippo Volandri

There were some longer gaps when the situation went back to normal, and then perhaps I had another small attack, but I'd say 15/20 minutes, or maybe when my coach arrived it was a longer gap, one hour, for instance. What I want you to understand is that in a situation like this, looking at the watch to see how long the gap is, is a bit unrealistic.

Jonathan Taylor

I'm trying to see if there's any way for us to getting the parameters of how many puffs. Let me see if I've got this right. The period lasted from about 2.30 to three, to four to 4.30, so that would be a maximum of two hours about?

Filippo Volandri

More or less, yes.

Jonathan Taylor

And during that time the trainer came and there was a gap then of about an hour when you didn't need to take any puffs? Did I understand that correct?

Filippo Volandri

More or less, yes. I repeat that it's hard to remember exactly because this happened last March, not last week, so it's difficult to remember the times. I can give you a general timeframe, but I cannot be more precise than this".

In the briefs filed on behalf of Mr Filippo Volandri with the ITF Independent Anti-Doping Tribunal and with the Court of Arbitration for Sport, it is stated that when his coach joined the Player in his hotel room, he found the latter "gasping for breath".

On 13 March 2008, just after the loss of his first game in two straight sets, Mr Filippo Volandri was subject to in-competition doping testing. On the doping control form, the Player indicated the correct number of his TUE as well as the use of Ventolin.

It is undisputed that the WADA-accredited laboratory in Montreal, Canada, was instructed to conduct the analysis of Mr Filippo Volandri's urine sample and that, on 9 April 2008, it identified in the Player's A sample the presence of salbutamol in a concentration of 1,167 ng/mL (without taking into account the measurement uncertainty of 87 ng/mL).

It is only on 25 July 2008 (three and a half months after the finding on the A sample and four and a half months after the doping test), that Mr Stuart Miller, the ITF technical manager, notified in writing the Player of the result of the A sample analysis and asked him documented explanations with regard to the said concentration of 1,167 ng/mL.

The same day, the Player sent to Mr Stuart Miller an e-mail with the following justification: *"the reason why the level of salbutamol on my urine collected during the last Indian Wells was a bit higher, is that due to a strong attack of allergy caused by the dust of the carpet I had to use more Ventolin, the inhalation spray with salbutamol. I use as therapeutic treatment. I had to do that because I couldn't breath well, especially with that hot temperature"*.

It then took the ITF another almost two months to refer to the Player's letter. By courier dated 18 September 2008, Mr Stuart Miller acknowledged receipt of the Player's e-mail and explained that his clarifications were insufficient. On this letter, that was sent six months after the event, Mr Miller requested Mr Filippo Volandri to provide details on a) the time at which he last urinated prior to providing sample on 13 March 2008, b) the time(s) at which he used his inhaler on 13 March 2008 and c) the number of puffs he took on each of those occasions. In particular, Mr Stuart Miller stated that *"if the Review Board finds that you have no case to answer, you will be informed and no further action will be taken. If the Review Board finds that you have a case to answer, then you will be charged with commission of a Doping Offence under Article C.1 of the Programme"*.

On 22 September 2008, the Player answered to Mr Stuart Miller by e-mail, referring to his TUE and confirming notably the following:

"I wouldn't be honest, Dr Stuart, if I try to answer to the 3 questions you sent me in the letter, as I have no chance to remember when I urinated before the one connected to the fact, or the times I used the inhaler on 13 March 2008.

The only thing I can perfectly remember is that the temperature at the tennis centre was terrible, and I had to use the inhaler several times in those days, also during the night because of the dust of the carpet in my room. I had so many problems to breath and sleep.

I had to do that otherwise I would have called the hospital”.

In a letter dated 8 October 2008 and addressed to Mr Filippo Volandri, Mr Staffan Sahlström of IDTM, presented himself as the Anti-Doping Programme Administrator of the ITF Programme appointed by the ITF “to administer various aspects of the Programme”. Mr Staffan Sahlström informed the Player that a confirmatory analysis was going to be carried out on his B sample. He also reported to the Player that he or his representative could attend the opening of the B sample. The letter also reads as follow:

“No Provisional Suspension

For the avoidance of any doubt, (1) you have not yet been formally charged with the commission of a Doping Offence; and (2) unless and until you are charged and you have formally admitted committing a Doping Offence, or you have been found by Anti-Doping Tribunal to have committed a Doping Offence, you will not be deemed to have committed such an offence. Nor will any provisional period of ineligibility be imposed upon you and you will remain free to compete. (See Article J.4.1 of the Programme).

However, in the event that you are subsequently found to have committed a Doping Offence, and a period of Ineligibility is imposed, any period after the date of receipt of this letter during which you have voluntarily foregone any form of involvement in Competitions will be credited against the total period of any Ineligibility that you have to serve. (See Article M.8.3 of the Programme)”.

On 16 October 2008, the WADA accredited laboratory in Montreal, Canada, conducted the confirmatory analysis on the Player’s B sample and corroborated the presence of salbutamol in a concentration of 1,192 ng/mL.

By letter dated 13 November 2008, Mr Stuart Miller notified Mr Filippo Volandri that he was charged with commission of a doping offence within the meaning of article C.1 of the ITF Programme. The letter also indicates the potential consequences of a doping offence: Disqualification of the results obtained at the Indian Wells tournament; disqualification of the results obtained in Covered Events since 13 March 2008; imposition of ineligibility for a period of two years.

Between the period following the 2008 edition of the Indian Wells tournament and the notice of charge dated 13 November 2008, Mr Filippo Volandri took part in several tennis tournaments and was selected for three doping controls:

Event	Date	Event Points	Prize Money	Concentration of salbutamol found after deduction of the measurement uncertainty
ATP Master Series Miami	27.03.08	5	[...]	
ATP Masters Series Monte Carlo	20.04.08	35	[...]	
Barcelona	28.04.08	15	[...]	
ATP Masters Series Rome	05.05.08	5	[...]	634
ATP Masters Series Hamburg	11.05.08	5	[...]	978
Roland Garros	25.05.08	5	[...]	
Warsaw	09.06.08	0	[...]	
Wimbledon	23.06.08	5	[...]	937
Turin	30.06.08	0	[...]	
Bastad	07.07.08	0	[...]	
Umag	14.07.08	15	[...]	
San Marino	21.07.08	80	[...]	
Cordenons	28.07.08	80	[...]	
Manerbio	18.08.08	31	[...]	
Como	25.08.08	0	[...]	
Bucharest	08.09.08	0	[...]	
Naples	22.09.08	14	[...]	
Vienna	06.10.08	0	[...]	
St. Petersburg	20.10.08	0	[...]	

On 7 January 2009, a hearing was held before the ITF Independent Anti-Doping Tribunal (the “ITF Tribunal”).

On 15 January 2009, the ITF Tribunal passed a decision (the “Appealed Decision”), in which it concluded that the ITF had sufficiently established the objective elements of a violation of the applicable ITF Programme, *i.e.* the presence of salbutamol in the Player’s A sample in a concentration of 1,167 ng/mL, which amounts to an adverse analytical finding.

In its decision, the ITF Tribunal held that *“Our best estimate on the basis of the evidence we have is that [Mr Filippo Volandri] probably took between 10 and 20 puffs overall. It was common ground that one puff corresponds to 100 mcg of salbutamol. Therefore the amount taken corresponds, in our estimation, to between 1,000 and 2,000 mcg”*. Based on these findings, it concluded that the Player took too much salbutamol. It was fortified in its conclusion *“by the fact that the player did not adduce any scientific evidence to show that the amount of salbutamol which he took, according to his best estimate, could have produced a concentration of 1,167 ng/ mL in his urine 8-18 hours later”*.

The ITF Tribunal accepted that Mr Filippo Volandri inhaled salbutamol and did not ingest it in any other way. However, it held that the Player did not meet his burden of proof that his use of salbutamol on 13 March 2008 was therapeutic or in compliance with the TUE of November 2007,

according to which salbutamol was to be administered daily with 2 times two puffs of 100 mcg, plus “2 puffs if necessary”. The ITF Tribunal found that the reference to inhalation of salbutamol “if necessary” must be interpreted in line with an objective approach, which requires treating as therapeutic only doses of salbutamol which do not exceed what is regarded as necessary and appropriate treatment, according to accepted medical opinion. The ITF Tribunal held that the appropriate treatment is to be found in the guidelines issued by the Global Initiative for Asthma, as revised in 2007, known as the “GINA guidelines”. In the view of the circumstances and in the presence of a severe asthma attack qualified by the Player himself as life threatening, the ITF Tribunal was of the opinion that the GINA guidelines commended the Player to seek care in a clinic or a hospital. *“He decided not to do so. Instead, he called his coach and opted to deal with the situation by inhaling salbutamol, apparently without imposing any limit on himself. (...) If this were acceptable, the player himself would become the judge of what is therapeutic, even though he is not medically qualified. We do not think that can be right. The issue must be judged by reference to accepted medical opinion, not the player’s subjective and medically uninformed view of what dose is therapeutic”.*

With regard to the sanction imposed upon Mr Filippo Volandri, according to the 2009 ITF Programme, the ITF Tribunal, applying the *lex mitior* principle, accepted that salbutamol is a specified substance and that it had not been used to enhance sport performance or to mask the use of a performance enhancing substance. It held that the Player was at fault for inhaling too much salbutamol. It found fair not to disqualify the Player’s results (including ranking points and prize money) obtained before the Manerbio tournament, as he was not aware of any problem arising from the test done at the 2008 edition of the Indian Wells tournament. *“However, by 18 August 2008 when the player next competed at Manerbio, he had had sufficient time to obtain some advice about the adverse A sample result, including on the question of whether to cease competing. [The ITF Tribunal] consider[s] that fairness does not require his results in competitions from then onwards to remain undisturbed”.*

On 15 January 2009, the ITF Tribunal decided the following:

“Accordingly, for the reasons given above, the Tribunal:

- (1) confirms the commission of the doping offence specified in the notice of charge set out in the ITF’s letter to the player dated 13 November 2008; namely that a prohibited substance, salbutamol, has been found to be present in the urine sample that the player provided at Indian Wells on 13 March 2008;*
- (2) finds that the player has failed to establish on the balance of probabilities that the abnormal test result was the consequence of the player’s therapeutic use of inhaled salbutamol;*
- (3) orders that the player’s individual result must be disqualified in respect of the Indian Wells tournament, and in consequence rules that the prize money and ranking points obtained by the player through his participation in that event must be forfeited;*
- (4) orders, further, that the player’s individual results (including ranking points and prize money) in competitions including and subsequent to the Manerbio competition on 18 August 2008 shall be disqualified and all prize money and ranking points in respect of those competitions shall be forfeited;*
- (5) orders, however, that the player’s results (including ranking points and prize money) in all competitions subsequent to the Indian Wells tournament up to and including the Cordenons competition on 28 July 2008 shall remain undisturbed;*

(6) finds that the player has succeeded in establishing to the comfortable satisfaction of the Tribunal that his use of the prohibited substance leading to the positive test result in respect of the sample taken on 13 March 2008 was not intended to enhance his sport performance;

(7) declares that the player shall be ineligible for a period of three months (i.e. calendar months) starting on 15 January 2009 and expiring at midnight London time on 14 April 2009 from participating in any capacity in any event or activity (other than authorised anti-doping education or rehabilitation programmes) authorised by the ITF or any national or regional entity which is a member of or is recognised by the ITF as the entity governing the sport of tennis in that nation or region”.

On 4 February 2009, Mr Filippo Volandri filed a statement of appeal and, on 13 February 2009, an appeal brief with the Court of Arbitration for Sport (CAS). It challenged the Appealed Decision of the ITF Tribunal, submitting the following request for relief:

“Appellant prays the Court:

***principally:** to acquit Filippo Volandri of the charge of having committed a doping offence as specified in the charge dated 13 November 2008, and as a consequence revoke the period of disqualification imposed, and declare that the player’s results (including ranking points and prize money), which have been revoked, be declared to be valid;*

***alternatively:** in the unlikely event that the player were still to be considered guilty of having committed a doping offence, to backdate the period of disqualification imposed, counting the period of voluntary suspension observed by the athlete, and as a result, declare that all of the player’s results (including ranking points and prize money) which have been revoked, be considered valid, and in any case, to reduce the period of disqualification, because it is excessive”.*

On 9 March 2009, the ITF submitted an answer containing the following prayers for relief:

“For the reasons set out above, the ITF respectfully submits that the Player has failed to make out any grounds for disturbing the Decision and that therefore the appeal should be dismissed in its entirety”.

A hearing was held on 26 March 2009 at the CAS premises in Lausanne.

LAW

CAS Jurisdiction

1. The jurisdiction of the CAS, which is not disputed, derives (a) from article 33 of the Articles of Association of ITF Limited, (b) from section O of the 2008 ITF Programme and (c) from article R47 of the Code of Sports-related Arbitration (the “CAS Code”). It is further confirmed by the order of procedure duly signed by the parties.
2. It follows that the CAS has jurisdiction to decide the present dispute.

Applicable law

3. Article R58 of the CAS Code provides the following:

“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-related body which has issued the challenged decision is domiciled or according to the rules of law, the application of which the Panel deems appropriate. In the latter case, the Panel shall give reasons for its decision”.

4. In the present case, it results from their respective submissions that the parties agree that the matter under appeal is governed by the rules and regulations of the ITF. In this respect and on 28 December 2007, Mr Filippo Volandri signed an agreement confirming that he would comply with and be bound *“by all provisions of the 2008 ATP OFFICIAL RULEBOOK and the ATP Tour, Inc’s (“ATP”) By-Laws (the “ATP Rules”), including, but not limited to, all amendments to the ATP Rules”.*

5. The 2009 ITF Programme reads as follows where relevant:

“A.5 The effective date of this Programme is 1 January 2009 (the “Effective Date”)

A.6 Transitional provisions:

A.6.1 The Programme shall apply in full to all cases where the alleged Doping Offence occurs after the Effective Date.

*A.6.2 Any case pending prior to the Effective Date, or brought after the Effective Date but based on a Doping Offence that occurred before the Effective Date, shall be governed by the predecessor version of the Programme in force at the time of the Doping Offence, subject to any application of the principle of *lex mitior* by the Anti-Doping Tribunal hearing the case”.*

6. It appears that the 2009 ITF Programme contains an express transitional provision, which clearly indicates that the 2008 ITF Programme remains applicable in the present proceedings because Mr Filippo Volandri’s case was pending before the 2009 ITF Programme came into force on 1 January 2009. However, article A.6 of the 2009 ITF Programme allows the ITF Independent Anti-Doping Tribunal as well as the CAS Panel to apply the *lex mitior* principle, *i.e.* the principle whereby a disciplinary regulation applies as soon as it comes into force if it is more favourable to the accused. This is a fundamental principle of law applicable and accepted by most legal regimes and which applies by analogy to anti-doping regulations in view of the quasi penal or at the very least disciplinary nature of the penalties that they allow to be imposed (CAS 2005/C/841, page 14; CAS 94/128, in Digest of CAS Awards (1986-1998), p. 477 at 491).
7. It follows that the ITF regulations, in particular the 2008 ITF Programme (subject to more favourable provisions to Mr Filippo Volandri under the 2009 ITF Programme) are applicable.

8. Article A.10 of the 2008 ITF Programme provides that it is governed by and shall be construed in accordance with English law, subject to article A.8, which requires the ITF Programme to be interpreted in a manner that is consistent with the WADC. The WADC prevails in the event of a conflict between its provisions and those of the ITF Programme.
9. The application of the (rules of) law chosen by the parties has its confines in the *ordre public* (Zürcher Kommentar zum IPRG/HEINI, 2nd edition 2004, Art. 187 marg. no. 18; see also KAUFMANN-KOHLER/RIGOZZI, Arbitrage International, 2006, marg. no. 657). Usually, the term *ordre public* is thereby divested of its purely Swiss character and is understood in the sense of a universal, international or transnational sense (KAUFMANN-KOHLER/RIGOZZI, Arbitrage International, 2006, margin no. 666; Zürcher Kommentar zum IPRG/HEINI, 2nd edition 2004, Art. 187 margin no. 18; cf. also PORTMANN, *causa sport 2/2006* pp. 200, 203 and 205). The *ordre public* proviso is meant to prevent a decision conflicting with basic legal or moral principles that apply supranationally. This, in turn, is to be assumed if the application of the rules of law agreed by the parties were to breach fundamental legal doctrines or were simply incompatible with the system of law and values (TF 8.3.2006, 4P.278/2005 marg. no. 2.2.2; Zürcher Kommentar zum IPRG/HEINI, 2nd edition 2004, Art. 190 margin no. 44; CAS 2006/A/1180, no. 7.4; CAS 2005/A/983 & 984, no. 70).

Admissibility

10. The appeal was filed within the deadline provided by article O.4.1 of the 2008 ITF Programme. Furthermore, it complied with all other requirements of article R48 of the CAS Code.
11. It follows that the appeal is admissible.

Procedural motions – scope of review of the CAS

12. Article R57 of the CAS Code provides that “*the Panel shall have full power to review the facts and the law*”. Under this provision, the Panel’s scope of review is basically unrestricted. It has the full power to review the facts and the law and may even request the production of further evidence. In other words, the Panel not only has the power to establish whether the decision of a disciplinary body being challenged was lawful or not, but also to issue an independent decision (CAS 2004/A/607; CAS 2004/A/633; CAS 2005/A/1001; CAS 2006/A/1153).
13. The CAS Code contemplates a full hearing *de novo* of the original matter.
14. However, in the present case, the ITF submits a) that the power of review of the CAS Panel is limited by the applicable ITF regulations and b) that article R57 of the CAS Code applies only to the extent agreed by the parties, which did not accept the rules of arbitration fixed by the CAS Code in whole. The ITF alleges that the scope of review of the CAS is restricted to

determining whether the Player has established that the ITF Tribunal's findings were erroneous based on all of the evidence before it at first instance.

15. To support its opinion, the ITF refers to article O.5.1 of the 2008 ITF Programme, which reads as follows:

“Where required in order to do justice (for example to cure procedural errors at the first instance hearing), appeals before CAS pursuant to this Article O shall take the form of a re-hearing de novo of the issues raised by the case. In all other cases such appeals shall not take the form of a de novo hearing but instead shall be limited to a consideration of whether the decision being appealed was erroneous. The CAS Panel shall be able to substitute its decision for the decision being appealed where it considers that decision to be erroneous or procedurally unsound”.

16. The CAS Panel observes that the situation is not clear because of the confusion generated (a) by the apparent conflict between article O.2 and O.5.1 of the 2008 ITF Programme and (b) by the unclear wording of article O.5.1 of the 2008 ITF Programme. However, the Panel is of the opinion that this unclear situation is actually and practically solved by the ITF Programme itself, as will be explained hereunder, by reference to other articles of the ITF Programme which leads to the conclusion that the unrestricted scope of review of the CAS Panel as provided under R57 of the CAS Code does not seem to be limited by article O.5.1 of the 2008 ITF Programme.

A. The apparent conflict between the 2008 ITF Programme articles

17. Pursuant to article O.2.1 of the 2008 ITF Programme *“A decision that a Doping Offence has been committed, a decision imposing Consequences for a Doping Offence, a decision that no Doping Offence has been committed, a decision by the Review Board that there is no case to answer in a particular matter, a decision that the ITF lacks jurisdiction to rule on an alleged Doping Offence or its Consequences, may be appealed by any of the following parties exclusively to CAS, in accordance with CAS's Procedural Rules for Appeal Arbitration Procedures (...)”.*
18. Article O.2.1 of the 2008 ITF Programme refers to the CAS Code without any restrictions or limitations, whereas article O.5.1 of the same Programme seems to limit, in certain circumstances, the CAS Panel's scope of review. At a first glance, the 2008 ITF Programme seems to offer no indication as to which of those two provisions should prevail or as to how they should co-exist. However, as will be further explained, this question is indeed solved within the framework of the 2008 ITF Programme itself.
19. This possible confusion was obviously noticed by the ITF which amended its 2009 ITF Programme by suppressing the reference to the *“CAS's Procedural Rules for Appeal Arbitration Procedures”* in its new article O.2.1.
20. Moreover, the ITF is a signatory to the WADC. Its 2008 Programme was adopted and implemented pursuant to the mandatory provisions of the WADC (Article A.2 of the 2008 ITF Programme). According to article A.8 of the 2008 ITF Programme, *“The Programme shall*

be interpreted in a manner that is consistent with the [WADC] (...). In the case of a conflict between the Programme on the one hand and the mandatory provisions of the [WADC] (as referenced in the Introduction to the [WADC]) on the other hand, the mandatory provisions of the [WADC] shall prevail”.

21. In its Part One, the applicable WADC (the version approved in 2003 and effective 1 January 2004 to 31 December 2008) reads as follows where relevant: *“While some provisions of Part One of the [WADC] must be incorporated essentially verbatim by each Anti-Doping Organization in its own anti-doping rules, other provisions of Part One establish mandatory guiding principles that allow flexibility in the formulation of rules by each Anti-Doping Organization or establish requirements that must be followed by each Anti-Doping Organization but need not be repeated in its own anti-doping rules. The following Articles, as applicable to the scope of anti-doping activity which the Anti-Doping Organization performs, must be incorporated into the rules of each Anti-Doping Organization without any substantive changes (allowing for necessary non-substantive editing changes to the language in order to refer to the organization’s name, sport, section numbers, etc.); Articles 1 (Definition of Doping), 2 (Anti-Doping Rule Violations), 3 (Proof of Doping), 9 (Automatic Disqualification of individual Results), 10 (Sanctions on Individuals), 11 (Consequences to Teams), 13 (Appeals) with the exception of 13.2.2, 17 (Statute of Limitations) and Definitions”.*
 22. Article 13 of the WADC sets forth the appeal process applicable in case of decisions made under the WADC or rules adopted pursuant to the WADC. It specifies in great detail which decisions may be subject to appeal, and who is entitled to file an appeal. Pursuant to article 13.2.1 of the WADC, *“In cases arising from competitions in an international Event or in cases involving International-Level Athletes, the decision may be appealed exclusively to the Court of Arbitration for Sport (“CAS”) in accordance with the provisions applicable before such court”* (emphasis added).
 23. It is therefore the view of the CAS Panel that Art. A.8 of the 2008 ITF Programme, by adopting and implementing the principle of consistency with the WADAC and the ITF’s commitment hereunder to *“incorporate (...) without any substantive changes”*, *inter alia*, article 13 (Appeals) of that Code, actually solves by itself the question of the co-existence of these two articles and establishes the supremacy of Art. O.2.1. over Art. O.5.1.
- B. *The ambiguous wording of article O.5.1 of the 2008 ITF Programme*
24. The wording of article O.5.1 of the 2008 ITF Programme is ambiguous and leaves the Panel in a state of perplexity:
 - on the one hand, the said provision allows the CAS to review the appeal in the form of a *de novo* hearing only *“where required in order to do justice”*.
 - on the other hand, in all the other cases (*i.e.* where *not* required in order to do justice), the CAS must limit its scope of review to a *“consideration of whether the decision being appealed was erroneous”*.
 25. The concept of *“in order to do justice”* is illustrated in the Programme with just one example (*i.e.* *“for example to cure procedural errors at first instance hearing”*), which does not help to understand

why the CAS Panel does not “*justice*” when/if it considers that the “*decision being appealed was erroneous*”.

26. However, the Panel is a fortiori allowed to review the Appealed Decision if it is arbitrary, *i.e.* if it severely fails to consider fixed rules, a clear and undisputed legal principle or breaches a fundamental principle. A decision may be considered arbitrary also if it harms in a deplorable way a feeling of justice or of fairness or if it is based on improper considerations or lacks a plausible explanation of the connection between the facts found and the decision issued. Likewise, the Panel is of the opinion that it must be able to review the Appealed Decision with regard to the fundamental rights of the Player. Any other interpretation would lead to possible abuse of process and of authority, which would be absolutely unacceptable and would represent a substantial and specific danger to sporting spirit. Furthermore, any agreement between the parties to restrict the powers of this Panel would have to be viewed critically in the light of the limitations imposed by the Swiss *ordre public*. Agreements between athletes and international federations are – in general terms – not concluded voluntarily on the part of the athletes but rather imposed upon them unilaterally by the federation (ATF 133 III 235, 242 *et seq.*). There is, therefore, a danger that a federation acts in excess of its powers unless the contents of the agreement does take sufficiently into account also the interests of the athlete. The Panel has some doubts whether a provision that restricts the Panel’s power to amend a wrong decision of a federation to the benefit of the athlete balances the interests of both parties in a proportionate manner.
27. In order to exercise such a review (as apparently allowed by the 2008 ITF Programme), the CAS must be able to examine the formal aspects of the appealed decisions but also, above all, to evaluate – sometimes even *de novo* – all facts and legal issues involved in the dispute.
28. The Panel wonders if the purpose of article O.5.1 of the 2008 ITF Programme is to prohibit the parties to bring before the CAS Panel new evidence which has not been presented to the ITF Tribunal. In this respect, the Panel observes that all the parties – including ITF – have filed various submissions and evidence after the hearing before the ITF Tribunal. Moreover, in the case at hand, there was no “evidential ambush” which might have given unfair advantages to one or the other party.
29. In the view of all the above and under the circumstances of the case and the findings of the Panel as explained hereunder, the unrestricted scope of review of the CAS Panel as provided under R57 of the CAS Code does not seem to be limited by article O.5.1 of the 2008 ITF Programme. Furthermore, at the present case, it is the view of the Panel that there are sufficient grounds to resolve the issue at stake (*i.e.* its scope of review) even within the framework of article O.5.1 as is.

Merits

30. In the view of the above, the main issues to be resolved by the Panel are:
 - a) Has a doping offence been committed?

- b) If the first question is answered in the affirmative, are the sanctions imposed by the ITF Tribunal upon the Player appropriate?

A. *Has a doping offence been committed?*

31. The following is undisputed:
- Mr Filippo Volandri suffers from asthma.
 - The presence of salbutamol in a concentration of 1,167 ng/mL was found in Mr Filippo Volandri's A sample collected on 13 March 2008. The analysis on the Player's B sample confirmed the presence of salbutamol in a concentration of 1,192 ng/mL.
 - The accuracy of the testing methods or the test results and positive findings are not contested. Mr Filippo Volandri did not try to allege the possible occurrence of a breach in the chain of custody.
 - The presence of salbutamol in urine in excess of 1,000 ng/mL is considered an adverse analytical finding unless the player proves that the abnormal result was the consequence "*of the therapeutic use of inhaled salbutamol*" or "*of the use of a therapeutic dose of inhaled salbutamol*".
 - The present case must notably be examined in the light of the content of the TUE of November 2007 irrespective of the subsequent management of this document by the IDTM. In this respect, it is not disputed that the indication "*2 puffs if necessary*" on the TUE of November 2007 must be interpreted in accordance with the GINA guidelines.
 - The GINA guidelines determine the appropriate treatment objectively admissible in terms of "*therapeutic*" (or "*therapeutic dose*" under the 2009 Programme) use of salbutamol.
32. In sum, the only question that arises is whether the concentration of salbutamol found in Mr Filippo Volandri's samples is consistent with the inhalation of the substance in accordance with the GINA guidelines.
33. Salbutamol is a rapid-acting inhaled beta2-agonist indicated for relief of bronchospasm during acute exacerbations of asthma and for pre-treatment of exercise-induced bronchoconstriction.
34. It is here interesting to note that according to the GINA guidelines, medications to treat asthma can be classified as controllers or relievers. Controllers are medication taken daily on a long-term basis to keep asthma under clinical control. Relievers are medications used "*on a as-needed basis*" that act quickly to reverse bronchoconstriction and relieve its symptoms.
35. It appears that the terms "*as needed*", "*if necessary*", "*al bisogno*" seen on the ATUE/TUE application forms filled on behalf of Mr Filippo Volandri are not just an easy to understand way of expression, but are actually used in medical terms and are consistent with the GINA guidelines.

36. The ITF has successfully established that the presence of salbutamol in Mr Filippo Volandri's samples was in a higher concentration than 1,000 ng/mL. Under the 2008 and 2009 ITF Programmes, the burden of adducing exculpatory circumstances is on Mr Filippo Volandri, who must prove that the abnormal result was the consequence "*of the therapeutic use of inhaled salbutamol*" (Par. S3, appendix 2 to the 2008 ITF Programme) or "*of the use of a therapeutic dose of inhaled salbutamol*".
37. The ITF Tribunal held that the asthma attack on 13 March 2008 was severe as it was potentially life threatening. It held that Mr Filippo Volandri a) took too much salbutamol and b) should have sought medical help as the Player's condition did not improve one hour after the beginning of the asthma attack. In particular, he relied on Dr Fabrizio Gadducci's statements according to which, if after the first hour, normal breathing was not restored, the patient should go to the hospital. The ITF Tribunal concluded that by not complying with those requirements, the Player did not respect the GINA guidelines and the use of salbutamol was therefore not "*therapeutic*". The ITF Tribunal was "*fortified in that conclusion by the fact that the player did not adduce any scientific evidence to show that the amount of salbutamol which he took, according to his best estimate, could have produced a concentration of 1,167 ng/mL in his urine 8-18 hours later*".
38. In the present case, Mr Filippo Volandri has established, on the balance of probabilities, how the specified substance entered his body. It is not contested that the positive findings are the result of the inhalation of salbutamol between 12 and 13 March 2008. It is also not challenged that the Player established, to the comfortable satisfaction of the hearing body, that his ingestion of the specified substance was not intended to enhance his sporting performance or to mask the use of another prohibited substance. However, those accepted facts only allow the Player to benefit from the possible elimination or reduction of the period of suspension (See article M.4 of the 2009 ITF Programme) but are irrelevant with regard to the occurrence or non occurrence of the adverse analytical finding.
39. It is Mr Filippo Volandri's burden to explain that the presence of salbutamol in a concentration of 1,167 ng/mL is consistent with the "*therapeutic*" use of the concerned specified substance. With this respect, Mr Filippo Volandri simply affirmed that, between 12 and 13 March 2008, he only took the amount of salbutamol recommended by the GINA guidelines. Based on the Pocket Guide for Asthma Management and Prevention revised in 2007 by the GINA, the Player submitted that there was an authorized intake of approximately 32 puffs of salbutamol in the 8-18 hours before the providing of his sample on 13 March 2008. The Player alleged that the concentration of salbutamol greater than the 1,000 ng/mL is the inevitable consequence of those puffs. However, he did not offer any scientific evidence whatsoever to support this position. In order to corroborate his allegations, he exclusively produced an "*expert opinion*" issued on 9 February 2009 by F., professor of forensic toxicology, at the institute of forensic medicine in Milan, Italy. This document contains no reference to any scientific literature, no technical data, no indication with regard to F.'s field of expertise or qualifications. The CAS Panel may take into consideration the declarations of F. as mere personal statements, with no additional evidentiary value. This is particularly true as F. was not present at the hearing. The Player chose, although he had the right to bring any witness before the Panel, not to invite him to the hearing, and, therefore, F. was not exposed

to any cross-examination on his opinion by Counsel for the ITF, which should have been a minimum requirement in order to add some weight to his opinion which, as already mentioned, was not supported by any scientific literature, nor any technical data.

40. The CAS Panel considers that Mr Filippo Volandri did not offer any persuasive evidence of how the concentration of 1,167 ng/mL found in his urine could be the result of the therapeutic use of salbutamol. Based upon the evaluation of the foregoing facts, the Player has not succeeded in discharging the onus on him and, hence, must be considered as having committed a doping offence.

B. *Are the sanctions imposed by the ITF Tribunal upon the Player appropriate?*

a) The undisputed facts

- Under the 2008 ITF Programme, salbutamol in a concentration greater than 1,000 ng/mL was qualified as a prohibited substance. The presence of salbutamol in a player's specimen was sanctioned with a two-year period of ineligibility, unless the player could a) establish that the presence is consistent with a therapeutic use exemption (article C.1) and/or b) show "*No Fault or Negligence*" (article M.5.1) or "*No Significant Fault or Negligence*" (article M.5.2) or c) provide assistance in discovering or establishing a doping offence by another person (article M.5.3). There was no other provision in the 2008 Programme that could have given the ITF Tribunal discretion to depart from a two-year ban.
- Under the 2009 ITF Programme, salbutamol, even in a concentration greater than 1,000 ng/mL, is reclassified as "*Specified Substances*", meaning that the hearing body has discretion (assuming it accepted that the Player did not take the medication with intent to enhance his performance or mask the use of a performance-enhancing substance) to impose a sanction of anything from a reprimand up to a two-year period of ineligibility.
- It is accepted that, on the basis of article A.6 of the 2009 ITF Programme, salbutamol must be treated as a specified substance and that the regime of sanction implemented by the 2009 ITF Programme is applicable in the present case. Therefore, Mr Filippo Volandri is entitled to rely on article M.4 of the 2009 ITF Programme ("*Elimination or Reduction of the Period of Ineligibility for Specified Substances under Specified Circumstances*").
- The player has been able to establish how salbutamol entered his body and it is accepted that he inhaled the substance and did not ingest it in any other way. It is also not challenged that the player took salbutamol to treat his asthma and not to enhance his sporting performance. There is no question of masking the use of a performance-enhancing substance in the present case.
- In the event Mr Filippo Volandri is found guilty of a doping offence, his individual results in respect of the 2008 Indian Wells tournament must be disqualified, and in consequence, the prize money and ranking points obtained by him through his participation in that event must be forfeited.

b) In the case at hand:

41. The ITF Tribunal found that the *“player was unwilling to speculate about how many puffs he took, even when pressed by Mr Taylor at the hearing. Our best estimate on the basis of the evidence we have is that he probably took between 10 and 20 puffs overall. It was common ground that one puff corresponds to 100 mcg of salbutamol. Therefore the amount taken corresponds, in our estimation, to between 1,000 and 2,000 mcg”*.

42. Based on the foregoing, the ITF Tribunal concluded *“In the present case, the player was at fault for inhaling too much salbutamol. He ought to have sought medical advice on what dose was therapeutic, just as he ought to have sought medical assistance if he felt his life was at risk”*.

43. The CAS Panel considers the Appealed Decision of the ITF Tribunal as arbitrary, because it harms a feeling of justice and of fairness and because it lacks a plausible explanation of the connection between the facts found and the decision issued.

44. As a matter of fact, the first instance held that because Mr Filippo Volandri took between 10 to 20 puffs of salbutamol, he is *“at fault for inhaling too much salbutamol”*. This is inconsistent with the ITF Tribunal own findings according to which the GINA guidelines determine the appropriate treatment objectively admissible in terms of “therapeutic” use of salbutamol. Based on the said guidelines, Mr Filippo Volandri was allowed to take, during the relevant period of time, much more puffs than “between 10 to 20 overall” as accepted by the ITF Tribunal:

On 12 March 2008: 2 puffs evening as allowed by the TUE of November 2007

During asthma attack: 16 puffs 4 puffs every 20 minutes for the 1st hour as recommended by the GINA guidelines

10 puffs 2nd hour as recommended by the GINA guidelines

On 13 March 2008: 2 puffs morning as allowed by the TUE of November 2007

Before the match: 2 puffs as recommended by the GINA guidelines

Total 32 puffs

45. The Player could have taken up to 32 puffs during the 8-18 hours before the providing of his samples. There is a considerable difference between the figures in accordance with the GINA guidelines and the figures taken into consideration by the ITF Tribunal. Thus, the lower instance has not ascertained objectively how the Player’s degree of fault has been calculated or on what basis it was founded.

46. The ITF Tribunal held that Mr Filippo Volandri should have sought medical help as the asthma attack was life threatening. It was of the opinion that by not going to the hospital, the Player did not follow the GINA guidelines. Further, it found that *“that the player felt able to regain control of his breathing by using the inhaler, without calling for medical help, and that he used his inhaler to the extent needed to regain control of his breathing”*.

47. Again, if “*the extent needed to regain control of his breathing*” amounts to 10-20 puffs, then the Player was within the limits set in the GINA guidelines.
48. Moreover, the life-threatening emergency justifying clinical assistance seems very difficult to assess as Mr Filippo Vollandri was by himself when the asthma attack occurred. Under those circumstances, the CAS Panel does not see how the ITF Tribunal is in a better position than the Player to decide what is right for him. It is accepted by the Player that he called his coach and asked the latter to come to his room. This validates the fact that the situation was somehow out of ordinary. It is also agreed that it was the worse asthma attack the Player has ever dealt with and that the coach suggested to go to the hospital. In contrast, Mr Filippo Vollandri obviously decided that he was able to take care of the problem. This is also in accordance with the GINA guidelines which seek to encourage self-management, that is, to give people with asthma the ability to control their own condition. It appears that after a couple hours, the situation went back to normal.
49. ITF submitted that after an hour following the beginning of the attack, the breathing of Mr Filippo Vollandri did not improve. In order to corroborate this allegation, it refers to the Player’s own brief according to which the coach found the latter “*gasping for breath*”. Here too, the only witnesses are the Player himself and his coach. At what precise time did the coach arrive? What does “*gasping for breath*” actually mean? Does it mean that the respiratory distress was greater than the one usually observed by asthmatic people under asthma attack? Was the coach impressed by a situation he is not familiar with? How much longer was the Player “*gasping for breath*” after the arrival of his coach? How many puffs did the Player take on the arrival of his coach? How is the life-threatening situation compatible with the fact that the only testimony on the event is the one of the Player who described it during his cross-examination in front of the ITF Tribunal in the words: “***I was a little concerned about the situation?***”, and how is the life-threatening situation compatible with the fact that the Player was able to play his match 8 hours later, and, most of all, with the fact that the coach left just an hour after he joined the Player in his room, *i.e.* less than two hours following the beginning of the asthma attack? Under such circumstances, how can the ITF Tribunal qualify the asthma attack as “*severe*” and not just “*mild*”? With this regard, and according to the GINA guidelines, milder exacerbations are defined by a reduction in peak flow of less than 20% and nocturnal awakening. Why does this definition not fit the events of the 13 March 2008?
50. The fact that the above questions, that could lead to a better understanding of the circumstances and the facts and to a more accurate assessment of the severance of the event, did not find an answer cannot be blamed on Mr Filippo Vollandri as he was informed of the positive findings only on 25 July 2008, that is more than 4 month after the sample collection. Despite of the facts that those questions remain unanswered, the ITF Tribunal felt comfortable to come to the conclusion that Mr Filippo Vollandri violated the Gina guidelines by not going to a hospital. It is obvious to the CAS Panel that the lower instance has assumed that the Player was at high risk of asthma-related death, which is arbitrary and purely speculative.

51. Furthermore, the ITF Tribunal has not explained how or why Mr Filippo Vollandri did not respect the GINA guidelines when *“he probably took between 10 and 20 puffs overall”* nor has it established that the Player had to get medical help. Under such circumstances, the CAS Panel does not see on what basis the ITF Tribunal imposed such harsh sanctions upon the Player.
52. As a result, the CAS Panel considers that it has no duty of deference towards the holdings of the ITF Tribunal.
53. The CAS Panel observes that Mr Filippo Vollandri was indeed at fault, as he has not been able to prove that the presence of salbutamol in his sample in excess of 1,000 ng/mL was the consequence *“of the therapeutic use of inhaled salbutamol”*. However, the degree of his fault is minor as the threshold of 1,000 ng/mL was just exceeded. If, as ascertained by the ITF Tribunal itself, one puff corresponds to 100 mcg of salbutamol, the litigious excess represents less than a couple of puffs. Furthermore, the CAS Panel cannot ignore the fact that the Player traveled all the way to California to take part in a tournament, that he was far from home, a few hours away from a match, in the very early morning. After having put all that effort into coming to play, it is understandable that Mr Filippo Vollandri decided not to go to the hospital as it would probably have kept him from playing.
54. However, in assessing the appropriate sanction, the CAS Panel also took the following factors into account. First, Mr Filippo Vollandri has never previously been found guilty of an anti-doping rule violation. This, of itself, is of comparatively little weight: the same point can be made for any first-time offender. Secondly, however, and more importantly, the CAS Panel has been concerned that the procedures before the ITF were slow and suffered from inconsistencies, with the result that the Player was left in a state of uncertainty of over 8 months, which is very long in sporting matters. As a matter of fact, it is only on 13 November 2008 that the Player was formally charged with a doping offence. Before then, Mr Filippo Vollandri received information from the ITF which is to some extent contradictory and may also be confusing:
 - The litigious samples collection occurred on 13 March 2008; the positive findings were known on 9 April 2008 but communicated to the Player on 25 July 2008. Between the sampling and the communication of its results, the Player was able to take part in 12 tournaments and to undergo 3 anti-doping tests (which were all negative).
 - On 25 July 2005, the Player was requested by the ITF to explain the presence of the important concentration of salbutamol found in his urine in March 2008. The same day, Mr Filippo Vollandri wrote to the ITF to give his version of the facts. It is only on 18 September 2008 that the ITF reacted to the Player’s mail. Between those two dates, the Player took part in at least four more tournaments.
 - On 8 October 2008, the Anti-Doping Programme Administrator of the ITF Programme wrote to the Player a letter with very ambiguous terms, which could easily be misleading: *“For the avoidance of any doubt, (1) you have not yet been formally charged with the commission of a Doping Offence; and (2) unless and until you are charged and you have formally admitted committing a Doping Offence, or you have been found by Anti-Doping Tribunal to have committed a Doping Offence, you will not be deemed to have committed such an offence. Nor will any*

provisional period of ineligibility be imposed upon you and you will remain free to compete. (See Article J.4.1 of the Programme)” (emphasis added).

- Finally a notice of charge was addressed to Mr Filippo Volandri on 13 November 2008. Between 18 September and 13 November 2008, the latter played in three more tournaments.
55. Although the ITF knew of the adverse analytical findings, it chose not to inform Mr Filippo Volandri and to let the latter take part in 19 tournaments before formally charging him with a doping offence. Such a long period is unacceptable and incompatible with the intention of the anti-doping regime that matters should be dealt with speedily. The Panel was taken aback when it saw that on 18 September 2008 (more than 6 months after the sampling collection) the ITF requested Mr Filippo Volandri to provide details on a) the time at which he last urinated prior to providing sample on 13 March 2008, b) the time(s) at which he used his inhaler on 13 March 2008 and c) the number of puffs he took on each of those occasions. It is obvious that the Player was not in the position to answer to such questions precisely, because of ITF’s fault and was therefore deprived of the right to fair evidence proceedings, which emerges from the right to be heard, the right to a fair trial and the principle of equal treatment, which are fundamental and which were disregarded in the present case.
56. Based on the above considerations, the Panel is of the opinion that fairness requires that a) a reprimand is imposed upon Mr Filippo Volandri, b) that no period of ineligibility is imposed on the Player and c) that his individual result in respect of the 2008 Indian Wells tournament only is disqualified, and in consequence, the prize money and ranking points obtained by him through his participation in that event are forfeited.

The Court of Arbitration for Sport rules that:

1. The appeal of Mr Filippo Volandri against the decision of the ITF Independent Anti-Doping Tribunal dated 15 January 2009 is partially upheld.
2. The decision issued by the ITF Independent Anti-Doping Tribunal on 15 January 2009 is set aside.
3. On these grounds:
 - a. Mr Filippo Volandri is found guilty of the anti-doping offence specified in the notice of charge set out in the ITF’s letter to the player dated 13 November 2008.
 - b. A reprimand is imposed upon Mr Volandri.
 - c. No period of ineligibility is imposed on Mr Volandri.

- d. Mr Volandri's individual result in respect of the 2008 Indian Wells tournament only is disqualified, and in consequence, the prize money and ranking points obtained by him through his participation in that event are forfeited.
 - e. All of Mr Volandri's results (including ranking points and prize money) in all competitions subsequent to the 2008 Indian Wells tournament shall remain undisturbed.
4. (...)
 5. All other motions or prayers for relief are dismissed.

3. In the particular circumstances of the case, this finding of illegality does not inevitably involve a declaration that a provision of Regulation (EEC) No 1125/74 is invalid. The illegality of Article 5 of Regulation (EEC) No 1125/74 cannot be removed merely by the fact that the Court, in proceedings under Article 177, rules that the contested provision was in part or in whole invalid. As the situation created, in law, by Article 5 of Regulation (EEC) No 1125/74 is incompatible with the principle of equality, it is for the competent institutions of the Community to adopt the measures necessary to correct this incompatibility.

In Joined Cases 117/76 and 16/77,

Reference to the Court under Article 177 of the EEC Treaty by the Finanzgericht Hamburg for a preliminary ruling in the actions pending before that court, in Case 117/76 between

The consortium of:

1. ALBERT RUCKDESCHEL & Co., Kulmbach (Germany),
2. HANSA-LAGERHAUS STRÖH & Co., Hamburg,

and

HAUPTZOLLAMT HAMBURG-ST. ANNEN

and, in Case 16/77, between

DIAMALT AG, Munich,

and

HAUPTZOLLAMT ITZENHOE,

on the validity of Article 11 of Regulation No 120/67/EEC of the Council of 13 June 1967 on the common organization of the market in cereals (OJ English Special Edition 1967, p. 33) as last amended by Regulation (EEC) No 665/75 of 4 March 1975 (OJ L 72, p. 14) and of Article 1 of Regulation (EEC) No 1955/75 of the Council of 22 July 1975 on production refunds in the cereals and rice sectors (OJ L 200, p. 1) and, if need be, of Article 11 of Regulation (EEC) No 2727/75 of 29 October 1975 on the common organization of the market in cereals (OJ L 281, p. 1) in so far as these measures make no provision for a production refund for maize used in the manufacture of quellmehl of an amount equivalent to that of the refund granted for the processing of this product into starch,

THE COURT

composed of: H. Kutscher (President), M. Sørensen and G. Bosco, Presidents of Chambers, A. M. Donner, P. Pescatore, J. Mertens de Wilmars, Lord Mackenzie Stuart, A. O'Keeffe and A. Touffait, Judges,

Advocate-General: F. Capotorti
 Registrar: A. Van Houtte

gives the following

JUDGMENT

Facts and issues

The facts of the case, the course of the procedure and the written observations submitted under Article 20 of the Protocol on the Statute of the Court of Justice of the EEC may be summarized as follows:

I — Facts and written procedure

1. Quellmehl, a product processed from maize, common wheat or broken rice, and pre-gelatinized starch, which is processed from the same basic products, are to some extent in competition with each other, their common feature being that they are both used as an aid to baking, more specifically as leavening in the making of rye bread.

2. Regulation No 19 of the Council of 4 April 1962 on the progressive establishment of the common organization of the market in cereals (JO of 20. 4. 1962, p. 933), introduced a system of levies for certain cereal products. Article 24 of the regulation provided however that the Council might adopt measures derogating from those provisions.

Such measures had been adopted by Regulation No 55 of the Council of 30 June 1962 relating to the system in respect of processed products based on cereals (JO of 2. 7. 1962, p. 1583). Article 17 of that regulation had established the system of discretionary refunds for certain starches. The thirteenth recital in the preamble to the regulation reads as follows:

'Whereas because of the special situation on the market in starches and in particular the need for that industry to keep prices competitive with those for substitute products, it is necessary by way of derogation from the provisions ... of Regulation No 19 of the Council, to ensure by means of a production refund that the basic products used by the industry are made available to it, at a lower price than that which would result from applying the system of levies...'

Regulation No 141/64/EEC of the Council of 21 October 1964 concerning the rules applying to processed products derived from rice and other cereals (JO of 27. 10. 1964, p. 2666) had continued the system of discretionary production

refunds. It had however established for the first time a production refund for maize and common wheat used in the quellmehl industry.

Regulation No 142/64/EEC of the Council of 21 October 1964 providing for the extension and adjustment to 31 March 1965 of the limitations on the production refunds for cereal and potato starch (JO of 27. 10. 1964, p. 2673) and fixing the refunds provided for under Regulation No 141/64/EEC accordingly provided in Article 1 (1) (e) thereof that:

'In the case of quellmehl the refund for maize, common wheat and broken rice used in the manufacture of that product shall be the same as that granted for the same cereals used for starch manufacture.'

The system established by the definitive basic Regulation No 120/67/EEC of the Council of 13 June 1967 on the common organization of the market in cereals (OJ English Special Edition 1967, p. 33) made the grant of the production refund compulsory. In the tenth recital in the preamble to that regulation it is *inter alia* stated

'Whereas ... because of the interchangeability of starches with quellmehl and maize groats and meal, production refunds should also be granted in respect of the latter products;'

Article 11 (1) of the regulation reads:

- '1. A production refund shall be granted:
- (a) for maize and common wheat used by the starch industry for the manufacture of starch and quellmehl;
 - (b) for potato starch;
 - (c) for maize used in the maize industry for the manufacture of maize groats and meal (gritz) used by the brewing industry.

Regulations Nos 178/67/EEC of 27 June 1967, 371/67/EEC of 25 July 1967 of the

Council, fixing the production refunds for starch, potato starch and quellmehl (JO of 28. 6. 1967, p. 2617 and of 31. 7. 1967, p. 40) maintained this parity between starch and quellmehl.

The production refund for quellmehl was maintained until 1 August 1974 with effect from which date it was abolished by Regulation (EEC) No 1125/74 of the Council of 29 April 1974 amending Regulation No 120/67/EEC (OJ L 128 of 10. 5. 1974, p. 12). However the refunds for maize, common wheat and broken rice used for the manufacture of starch and consequently pre-gelatinized starch continued to be granted.

The third and fourth recitals in the preamble to the latter regulation stated that:

'the production refund for quellmehl was initially granted with a view to promoting certain specific uses of quellmehl as a food for human consumption, account being taken of the possibility of its competing with a number of other products;'

and that

'experience has shown that the opportunity for such substitution is economically slight, if not non-existent; ... the production refund for quellmehl should therefore be abolished;'

Regulation (EEC) No 1132/74 of the Council of 29 April 1974 on production refunds in the cereal and rice sectors (OJ L 128 of 10. 5. 1974, p. 24), which fixed the refunds provided for by Regulation (EEC) No 1125/74, resulted in the reduction of the production refund for maize and common wheat used for the manufacture of starch to 24.60 units of account per metric ton [hereinafter called 'tonne']. In order to give a reason for the maintenance of the refund for starch manufacture, the second recital in the preamble to the regulation states *inter alia* that

'a precise assessment of the situation resulting from the level of common prices and from the competition between, on the one hand, maize starch, rice starch, potato starch and, on the other, the substitute chemical products, indicates that the refund should be fixed at such a figure that the price of maize used in starch manufacture is brought down to 8.20 u. a. per 100 kg...'

Regulation (EEC) No 3113/74 of the Council of 9 December 1974 amending Regulation (EEC) No 1132/74 on production refunds in the cereals and rice sectors (OJ L 332, p. 1) resulted in a subsequent reduction (to 15.55 u. a. per tonne) of the refund granted for maize for the manufacture of starch.

Regulation (EEC) No 665/75 of the Council of 4 March 1975 amending Regulation (EEC) No 120/67/EEC (OJ L 72 of 20. 3. 1975, p. 14) which entered into force on 1 August 1975 made, *inter alia*, the production refund for cereals used in the manufacture of starch no longer compulsory. Moreover the regulation abolished the production refund for maize groats and meal (gritz) used by the brewing industry.

In Regulation (EEC) No 1955/75 of the Council of 22 July 1975 on production refunds in the cereals and rice sectors (OJ L 200 of 31. 8. 1975, p. 1) which also entered into force on 1 August 1975, the production refund on, *inter alia*, maize for the manufacture of starch was once more reduced and fixed at 10 u. a. per tonne.

3. The respective plaintiffs in the main actions, who are producers of quellmehl, applied to the respective defendants in the main actions on 22 July (Case 117/76) and 15 August (Case 16/77) 1975 for a permit relating to the grant of a production refund for maize used for the manufacture of quellmehl. These applications were rejected on the ground that Community regulations no longer

provided for the grant of production refunds for quellmehl.

The plaintiffs in the main actions brought the present proceedings before the Finanzgericht Hamburg against these decisions rejecting the applications.

Before that court, the plaintiffs in the main actions urged in particular that the prohibition of discrimination laid down in the second subparagraph of Article 40 (3) of the Treaty has been infringed in so far as a production refund was granted only for pre-gelatinized starch and not for quellmehl, a product which is in competition with starch.

The defendants in the main actions contended that the applications should be dismissed.

4. Holding that the cases raised questions of interpretation of Community law the Finanzgericht Hamburg, by orders of 8 November 1976 and 18 January 1977, stayed the proceedings and requested the Court of Justice under Article 177 of the EEC Treaty to give a preliminary ruling on the following questions:

- '1. Do Article 11 of Regulation No 120/67/EEC as last amended by Regulation (EEC) No 665/75 of 4 March 1975 (OJ L 72 of 20. 3. 1975, p. 14) and Article 1 of Regulation (EEC) No 1955/75 of 22 July 1975 (OJ L 200 of 31. 8. 1975, p. 1) or does Article 11 of Regulation (EEC) No 2727/75 of 29 October 1975 (OJ L 281 of 1. 11. 1975, p. 1) infringe the prohibition of discrimination contained in Article 40 (3) of the EEC Treaty and are they invalid in so far as they do not grant a production refund of the same amount on maize for the manufacture of quellmehl as they do for the processing of this product into starch?
2. If the answer to Question 1 is in the affirmative, have manufacturers of quellmehl a direct claim to the same

production refund as the manufacturers of pre-gelatinized starch or is a legal measure adopted by the Council required for this?

5. In the grounds for the orders making the reference the Finanzgericht Hamburg made, *inter alia*, the following comments:

‘The determination of this dispute turns on the question whether the abolition of the production refund on maize for the manufacture of quellmehl is invalid because it infringes the prohibition of discrimination in Article 40 (3) of the EEC Treaty.

‘There might under Community law be prohibited discrimination if — as the plaintiff maintains — quellmehl and pre-gelatinized starch are interchangeable as aids to baking in the baking industry and if as a result of the abolition of the production refund for quellmehl on the one hand and the retention of the production refund for pre-gelatinized starch on the other hand quellmehl is no longer competitive and has been ousted from its former market. The recitals in the preamble to Regulation No 120/67/EEC state that a production refund should be granted because of the inter-changeability of starches with quellmehl. Accordingly if the purpose of the production refund is the interchangeability of the products, there might be discrimination against the plaintiff in connexion with the manufacture of quellmehl if and in so far as a production refund is granted on the raw materials used in the manufacture of pre-gelatinized starch, because from the point of view of technology, economics and price quellmehl and pre-gelatinized starch are interchangeable. The plaintiff submits that the recital in the preamble to Regulation (EEC) No 1125/74, which states that the production refund for the manufacture of quellmehl should be abolished, because experience has shown that the opportunity for such substitution is economically slight, if not

non-existent, does not correspond to the facts.

‘The adjudicating Senate finds that it is unable to ascertain and review the actual prerequisites for the abolition of the production refund in connexion with the manufacture of quellmehl, in order to be able to decide accordingly whether there is any prohibited discrimination against the plaintiff and other similar undertakings. The recitals in the preamble to Regulation (EEC) No 1125/74 disclose that those responsible for the regulation were in possession of information, which is not available to the court, to the effect that quellmehl as a substitute product in fact was not or was only to an economically insignificant extent in competition in the territory of the EEC with products containing starch. Since the plaintiff contests this, with supporting evidence, the question arises whether Regulation (EEC) No 1125/74 is valid in so far as it relates to the abolition of the production refund on quellmehl, since it may infringe Article 40 (3) of the EEC Treaty. The adjudicating Senate therefore considers that a ruling by the European Court of Justice is necessary in the interest of a uniform application of Community law.

If the Court of Justice should come to the conclusion that the abolition of the production refund on quellmehl is invalid, then there remain doubts as to the legal basis upon which the plaintiff can satisfy its claim and as to the formal conditions which have to be fulfilled. For this reason it has been necessary to refer Question 2.’

6. The orders making the references were registered at the Court Registry on 10 December 1976 and 31 January 1977 respectively.

In accordance with Article 20 of the Protocol on the Statute of the Court of Justice of the EEC, written observations were submitted by the plaintiffs in the main actions, the plaintiff in Case 117/76

being represented by the Chambers of Fritz Modest, Hamburg, the plaintiff in Case 16/77 being represented by E. Eckelt, A. Kallenbach and K.-D. Rathke, Advocates, of Augsburg, and by the Council, represented by Daniel Bignes, Director of its Legal Service, assisted, in Case 16/77, by Felix Van Craeynest, Principal Administrator of the said service and by the Commission, represented by its Legal Advisers Peter Kalbe and Götz zur Hausen, acting as Agents.

By order of 25 May 1977 the Court decided to join the cases for the purposes of the procedure.

After hearing the report of the Judge-Rapporteur and the views of the Advocate-General the Court decided to open the oral procedure without any preparatory inquiry.

Nevertheless the Court requested the parties, the Council and the Commission to give certain explanations in writing either before or during the hearing.

II — Written observations submitted to the Court

The first question

1. (a) The *plaintiffs in the main actions* point out first of all that quellmehl does not have the same importance in the other Member States as in Germany. On the other hand it is not correct to claim, as the defendants in the main actions have done, that quellmehl is of importance only in Germany.

(b) From the technical point of view quellmehl and pre-gelatinized starch are interchangeable and equal from the point of view of their use as aids to the baking of products made from rye flour.

(c) Where there is free competition as regards prices, quellmehl has a slight

advantage over pre-gelatinized starch. This advantage amounts to less than the production refund paid in respect of maize starch. On the other hand the advantage is so marked that in the first place, the baking industry and bakers prefer quellmehl-based aids to baking and, secondly, the starch industry no longer disputes that advantage because it has other ways of selling its starch. The grant of a production refund of the same amount as for maize and rice processed into quellmehl or starch has enabled quellmehl to retain intact its competitive advantage over pre-gelatinized starch.

(d) The reasons advanced to justify the abolition of the production refund granted for the manufacture of quellmehl and the retention of the refund for starch are untrue.

(e) It is only because the allocation of a production refund of an equivalent amount enables the natural competitive situation between pre-gelatinized starch and quellmehl to be maintained that pre-gelatinized starch has not ousted quellmehl from the market in baking aids for rye-flour-based products.

(f) The abolition of the production refund for quellmehl created a fundamental change in the competitive situation which naturally exists between quellmehl and pre-gelatinized starch; after it was abolished pre-gelatinized starch could be offered on the market at a lower price than quellmehl.

According to the plaintiff in the main action in Case 117/76 it is because the manufacturers of quellmehl and of ingredients of quellmehl-based baking products paid the production refund out of their own pockets that they have been able, in the main, to maintain their position on the market.

The plaintiff in the main action in Case 16/77 considers that the level of prices subsequent to the abolition of the

production refund led to a reduction of more than 70 % in the turnover in quellmehl-based products. It adds that the selling price of quellmehl cannot, on the most conservative estimate, be less than DM 100 per 100 kg. On the other hand pre-gelatinized starch made from maize or wheat is at present already being offered at from DM 85 per 100 kg free at destination. The two biggest manufacturers of quellmehl-based ingredients of baking products have suffered a reduction in their turnover in one case of 7.5 % in 1975, compared with 1974, in the other case of 40 % in 1976, compared with 1974. In the case of the two undertakings referred to this reduction in sales has, apart from the abolition of the production refund, resulted in a substantial reduction in the cover for overheads (Deckungsbeiträgen). The plaintiff in the main action in Case 16/77 points out that, until the spring of 1975, the two manufacturers still held their stocks of maize for which production refunds had been granted before entry into force of the contested regulation. The result is that the reduction in the cover for overheads (Deckungsbeiträgen) has become more marked. The manufacturers of quellmehl are suffering losses or, according to circumstances, a considerable reduction in their income and the sole reason for this is to be found in the fact that a production refund is paid for the manufacture of pre-gelatinized starch, whereas, in contrast to this, none is paid for the manufacture of quellmehl.

(g) According to the official statement of the grounds, a production refund for maize, rye and potato starch appears to be required only to enable the starch industry to compete with chemical substitute products. This is an admission that it is not necessary in so far as starch is sold for use in connexion with food for human consumption. Despite this, the production refund is granted for products used in the manufacture of starch without regard to the sector in which the starch is sold.

According to the plaintiffs in the main actions it is possible to restrict the allocation of a production refund for the processing of maize, rice and potatoes used in the manufacture of starch inasmuch as this starch is intended for the industrial sector and is in competition with chemical substitute products.

(h) There is also an unofficial reason for the abolition of the production refund for quellmehl: that a great deal of quellmehl based on maize and rice is sold for animal feed and its use for this purpose is an abuse which must be redressed by abolishing the production refund.

The plaintiffs in the main actions dispute this statement. The association of manufacturers of ingredients for baking products has declared that its members have never sold quellmehl for animal feed. There still exist in the Federal Republic of Germany one or two small undertakings which do not belong to the association of manufacturers of ingredients for baking products but their output is not very great. Outside Germany, there is an undertaking manufacturing quellmehl in Denmark and there are one or two in the Netherlands, but their output is insignificant. But even if these undertakings were to have sold quellmehl for use as animal feed such sales would still have been of comparatively little importance.

They go on to say that the Community regulations on production refunds for the two products in question did not prohibit sale of those products for animal feed. Nor is the production refund restricted to quellmehl or starch used for human consumption or for chemical products.

Unlike quellmehl, large quantities of maize starch are in fact sold for animal feed. But a production refund continues to be granted even for starch used in the animal feed industry.

(i) In the same way as the production refund can be restricted to starch used in industry for chemical purposes, it can, in the case of quellmehl or starch, be restricted exclusively to cases where these products are used for human consumption.

It is not difficult for control to be effectively exercised. The unofficial reason for the abolition of the production refund does not therefore stand up to scrutiny on any count.

(j) The plaintiff in the main action in Case 16/77 refers furthermore to the fact that the need to reduce the budget of the Community was also used as an excuse to justify the abolition of the production refund for quellmehl. It finds this argument unconvincing: in the first place the production refund granted hitherto for the manufacture of quellmehl is of little importance compared with the total volume of production refunds and also with the production refund for the manufacture of starch. Secondly, there is no doubt that it is perfectly possible to abolish the production refunds. Nevertheless, when account is taken of the principle of non-discrimination, this could only lead to the abolition of the production refund both for the manufacture of quellmehl and for the manufacture of pre-gelatinized starch. Finally, it would not be possible to effect any saving in the budget of the Community for the simple reason that, as is shown by the state of the market, after the abolition of the refund for quellmehl, pre-gelatinized starch, for the manufacture of which a production refund is granted, would be used in its place.

(k) Finally the plaintiffs in the main actions contend that there is no substantial ground for abolishing the natural disparity between the competitiveness of the two products in question. Contrary to the contention of the defendant in the main action, it is not true that there is discrimination only

if quellmehl is of economic importance in the food industry throughout the Common Market. There are in the Community production refunds which benefit only the undertakings in certain Member States such as the aid to durum wheat, colza and olive oil.

(l) Moreover, in the case of the quellmehl manufacturers concerned, discrimination is appreciable and substantial and even if discrimination were minimal the *de facto* situation would not justify it.

The plaintiffs in the main actions accordingly request the Court to answer the first question of the Finanzgericht to the effect that the provisions mentioned therein are contrary to the prohibition of discrimination laid down in Article 40 (3) of the Treaty and are null and void in so far as they make no provision for a production refund for maize used in the manufacture of quellmehl up to the same amount as that of the refund granted for the processing of this product into starch.

2. (a) The *Council and the Commission* point out in the first place that, in Case 117/76, the plaintiff in the main action lodged its application on 22 July 1975, that is to say, during the 1974/75 marketing year, while in Case 16/77 the application was lodged on 15 August 1975 and therefore during the 1975/76 marketing year.

In consequence, any entitlement to the refunds and the amounts of the refunds depend, in Case 117/76, on Regulations (EEC) Nos 1125/74, 1132/74 and 3113/74 of the Council and on Regulation (EEC) No 2518/74 of the Commission of 4 October 1974 (OJ L 270, p. 1) and, in Case 16/77, on Regulations (EEC) Nos 1125/74, 665/75 and 1955/75 of the Council.

(b) According to the *Council*, quellmehl and pre-gelatinized starch are to some extent interchangeable in particular when used as baking materials in the manufacture of rye bread. However

because of its different properties quellmehl is more useful than pre-gelatinized starch. It has a greater capacity to absorb water; apart from starch it contains other raw material constituents which are of nutritional value; the process enabling it to be extracted from the raw material is a relatively simple physical operation whereas the manufacture of starch employs a technique which involves relatively more work; and the raw material extraction level is higher. The effect of these advantages is to make quellmehl from 15 to 20 % cheaper than pre-gelatinized starch, which is far more than the amount of the refund which pre-gelatinized starch continued to receive until the 1975/76 marketing year.

Thus the abolition of the subsidy would not have abolished the advantages as regards price and quality which quellmehl enjoys in terms of the manufacture of cooking agents.

(c) As the result of the oil crisis, prices of products competing with starch went up and in consequence did not compete so strongly against starch which, in turn, became a weaker competitor against quellmehl. The competitive pressure of imported processed products was also weaker. Moreover the maize market itself felt the repercussions of the world increase in the prices of cereals and there was less need to protect the processing industries of the Community. Again, the fact that the manufacture of starch is much more costly and complex than that of quellmehl also resulted in making the production costs of starch markedly more sensitive to the increase in investment costs and in labour costs. Finally, the Community realized that quellmehl was no longer put solely to its traditional use, baking, but that, owing to the refund, it was used as a constituent of animal feed. But these developments, which arose from the refund, do not fall within the objectives of the common agricultural policy for the purposes of which the refund was introduced.

It was because it was aware of this state of affairs that the Council reduced the refund for starch (in Regulations (EEC) Nos 1132/74, 3113/74 and 1955/75), made it discretionary (in Regulation (EEC) No 665/75) and abolished it for quellmehl (in Regulations (EEC) Nos 1125/74 and 1132/74).

(d) To grant a refund for starch is consistent with the provisions of Article 39 (1) (c) and (d) of the Treaty. Conversely, because of the use of quellmehl as animal feed, the abolition of the refund for this product furthers the objective designed to limiting the common agricultural policy 'to pursuit of the objectives set out in Article 39' (second subparagraph of Article 40 (3) of the Treaty).

(e) With regard to the alleged infringement of the rule against discrimination, the Council contends that to treat dissimilar situations differently does not amount to discrimination. The grant of a production refund for starch is justified by the state of the market in this product and by its key position between the common agricultural market and the common industrial market. Quellmehl, however, is in a different position. The grant of a refund for quellmehl is in the first place unnecessary as protection for its traditional outlets since the refund granted for pre-gelatinized starch has on several occasions been considerably reduced and, secondly, unjustified inasmuch as it helps to create an unintended outlet by way of animal feed. This different position justifies different treatment despite the fact that the two products concerned are to some extent in competition.

(f) The Council also states that even if, in the past, quellmehl and starch have in general received the same treatment this does not constitute a right to the same treatment, as claimed by the plaintiffs in the main actions. In this connexion the Council refers to the various grounds

which it has already given and which, it declares, have now ceased to exist, however much they may have justified this identity of treatment in the past.

This is clear from the fourth recital in the preamble to Regulation (EEC) No 1125/74 which gives grounds for the abolition of the payment of a refund for quellmehl and begins to reduce it for starch. The reduction to 10 u.a. per tonne of the refund for starch restored the natural superiority of quellmehl as a cooking agent.

(g) In terms of law, the Council refers to the decisions of the Court since its judgment of 17 July 1963 in Case 13/63 *Italy v Commission* [1963] ECR 165 which laid down that it is not discriminatory to treat dissimilar situations differently. The Council also refers to paragraph 22 of the judgment of the Court of 11 July 1974 in Case 11/74, *Union des Minotiers de la Champagne v France* [1974] ECR 877, according to which difference in treatment cannot be regarded as constituting discrimination which is prohibited unless it appears arbitrary.

In the Council's view it appears to be clear from the facts which it has set out, especially from those relating to the natural superiority of quellmehl from the competitive point of view and its use in the manufacture of animal feed, which is contrary to the original object of the subsidy, that it was not guilty of arbitrary discrimination in Regulation (EEC) No 1125/74 (1974/75 marketing year, Case 117/76) or in Regulations (EEC) Nos 665/75 and 1955/75 (1975/76 marketing year, Case 16/77). The same applies to Regulation (EEC) No 2727/75, which was effective only from 1 November 1975.

3. (a) The *Commission* states that the abolition of the production refund for quellmehl is only one aspect of the comprehensive change in the Community's subsidies policy in the case of products processed from cereals, one

of the consequences of which is the reduction of refunds for starch. A charge of discrimination cannot therefore be based on the abolition *per se* of refunds in the case of quellmehl but at most on the fact that the refund granted for pre-gelatinized starch was not abolished in its entirety.

(b) From the legal standpoint the Commission contends that an economic decision of the same kind as the contested measure cannot be discriminatory unless it was based on considerations which are manifestly erroneous; judgment of the Court of 24 October 1973 in Case 43/72, *Merkur v Commission* [1973] ECR 1055.

(c) The Commission accordingly sets forth the considerations on which the contested measures were based: the financial burdens of the common agricultural policy had to be reduced; price arrangements under the system of production refunds had to be adjusted to economic realities: the supply price (the basis of calculation of the production refund, which represents the difference between this price and the Community threshold price) had not followed the trend of market and threshold prices, which was steadily rising and the refunds were, in consequence, practically doubled; and, because of the increase in the price of synthetic products which are in competition with cereal-based starch as the result of the rise in price of oil products, consideration was being given to the need for a fundamental reappraisal of the policy of granting refunds.

(d) Because starch was in competition with synthetic substitute products, the Council did not abolish production refunds for starch but merely reduced the relevant amounts.

(e) In consequence the question arose whether the timing of the reduction in the production refund for quellmehl should be the same as in the case of starch.

An analysis of the competitive position of these two products disclosed vital differences which made it unnecessary to keep the regulations governing the refund so completely in parallel as they had been hitherto. The explanation why quellmehl and starch are treated alike in Article 11 of Regulation No 120/67/EEC lies in the political argument of the 'preservation of the acquired rights' of quellmehl manufacturers rather than in economic necessity and the similarity of economic conditions. In this connexion it must be borne in mind that the manufacture of quellmehl has benefited from a German internal subsidy since 1930.

(f) The amount of the refunds is based on the overall assumption that 161 kg of maize are required for the manufacture of 100 kg of starch. On the other hand the extraction rate for quellmehl is, at most, between 102 and 110 kg and the manufacture of quellmehl involves much less work and requires much less technical knowhow than the manufacture of starch.

Furthermore, cereals themselves need not necessarily serve as raw material for quellmehl. All the other cheaper starch-producing products of the milling industry can be used.

(g) The interchangeability of the two products in question has, in practice, been hitherto of little importance.

On this point the Commission quotes the plaintiff in the main action in Case 16/77 as follows:

'... quellmehl has better technical qualities. The capacity to absorb water in particular ... is higher in the case of quellmehl; ... quellmehl has better qualities from the nutritional point of view ... ;'

'... In the end, however, the choice between the two products is only a matter of price since the use of a greater

quantity of pre-gelatinized starch makes it possible to obtain absolutely the same capacity to absorb water ...'

Given that the cost price of the raw material is the same, the refund, adapted to the needs of starch manufacture, has over-subsidized the already cheaper production of quellmehl. This difference in price, together with the ability to use cheaper low grade flour, makes it possible for the quellmehl industry to invade the market in animal feed.

It is for this reason that the Community institutions reached the conclusion that there was no compelling reason to adhere to the principle of strict equality of treatment between the manufacturers of quellmehl and manufacturers of starch.

In view of the substantial reductions which took place in the production refunds for starch simultaneously with the abolition of the refund for quellmehl, there is no reason to suppose that great and irreparable harm would be done to the competition with pre-gelatinized starch.

In the animal feed industry, the higher prices of maize as a raw material could have been easily offset by the use of lower-grade flours which are cheaper.

Similarly, there is little reason to suppose that pre-gelatinized starch is forcing rye-flour cooking agents out of the traditional market. Pre-gelatinized starch is certainly coming to supersede quellmehl but not specific cooking agents because it does not possess their qualities.

(h) Nor is there any reason to fear that the natural advantage possessed by quellmehl-based products in terms of competition will be reversed as a result of the undue advantage granted to pre-gelatinized starch in terms of price.

The increase in the price of raw material caused by the abolition of the refund is

not reflected fully but only in part in the price of quellmehl, which is also considerably influenced by other factors. The effect of this increase on the price of cooking agents ready to be marketed, like those manufactured by the plaintiffs in the main actions, is even less significant.

Similarly the reduction, owing to the maintenance of refunds, in the price of maize as a raw material compared with the cost price of quellmehl has only a partly favourable effect on the price of pre-gelatinized starch as the finished product.

Price fluctuations due to changes in the amount of the refunds amount to discrimination only if they cause the price of quellmehl to rise appreciably above that of starch.

Like quellmehl producers, the starch manufacturing industry had to bear substantial price increases for maize as its raw material. The advantage which that industry enjoyed in terms of price compared with quellmehl manufacturers lay only in the maintenance of a lower production refund. The amount of the refund which, in the beginning, was as much as 20.40 units of account per tonne fell to 18.45 units of account per tonne in July 1975 and, after August 1975, to 10 units of account per tonne. This was not enough even to come within reach of the advantage of at least DM 100 which quellmehl previously enjoyed as a finished product.

Nor has experience gained in the meantime supplied any evidence of competition which makes it possible for pre-gelatinized starch to replace quellmehl because of the refunds it receives.

Second question

1. The *plaintiff in the main action* in Case 117/76 states that, in the present case, discrimination can be eliminated retroactively by granting, with retroactive

effect, the production refund for the manufacture of quellmehl from maize and rice up to an amount equal to that granted for the manufacture of starch from maize and rice during the same period.

The plaintiff in the main action in Case 16/77 adds that if Regulation (EEC) No 1125/74 is annulled it will mean that Article 11 of Regulation No 120/67/EEC, as it was worded before the entry into force of Regulation (EEC) No 1125/74, is again valid in so far as it governs the production refund for maize used in the manufacture of quellmehl.

The second paragraph of Article 215 of the Treaty has the same legal effect. The principle that the person responsible for the damage should, in the first place, restore the situation to what it would have been if the event causing the damage had not taken place is one of the general principles relating to the liability of the Community for damage caused by its institutions. The same principle is illustrated by the right to have the consequences made good, which is recognized in administrative law and is also common to the legal systems of the Member States.

The plaintiffs in the main actions accordingly request the Court to give an affirmative answer to the second question.

2. The *Council* contends that, even if the Court finds that a set of regulations is legally invalid, it may not put itself in the place of the Community legislature in the exercise of the powers of discretion conferred upon the latter and promulgate a positive rule since a whole range of alternative courses is open to the legislature.

Moreover, the aim of the second question is to have an issue concerning the application of the law settled by the Court, and this is not possible.

3. The *Commission* points out that, even if quellmehl were reentered on the list in Article 11 of Regulation No 120/67/EEC of the products entitled to a refund, the Council is not bound to grant a refund for quellmehl. Regulation (EEC) No 665/75 abolished the compulsory refund which existed previously and left the decision whether a refund should be granted for one of the listed products to the discretion of the Council.

A finding that there had been a misuse of powers would mean that the measures taken were invalid and would oblige the Council to replace them with a non-discriminatory measure coming within the scope of its discretionary power.

There could be an exception only if the Council's margin of discretion was confined to one decision only: that of restoring unchanged and with retroactive effect the right to the refund. In this case, there is, in any event, a choice of several possible solutions.

III — The written reply to a question put by the Court

In response to the Court's request for evidence to prove that quellmehl has been used for animal feed, the Commission produced a telex from the Federal Ministry of Food.

According to this telex the trade association for the animal feed production industry ('Fachverband der Futtermittelindustrie') is one of the groups which has got into touch with the Ministry concerning the abolition of the production refund for quellmehl because its abolition placed quellmehl at a disadvantage compared with pre-gelatinized starch in the production of milk substitute foods for calves and pigs. It also appears from the telex that the Ministry of Food is in possession of a report which shows that, at that time, quellmehl was being offered on the

market in animal feed components at a price of from DM 65 to DM 70 per 100 kg compared with starch products fetching from DM 80 to DM 85 per 100 kg and was thus selling at from about 80 % to 82 % of the price of starch-based and glucose-based products.

The Commission has not been able to see the original documents or to place them at the disposal of the Court because they contained certain confidential matter.

IV — Oral procedure

At the hearing on 21 June 1977, oral observations were made by the plaintiff in the main action in Case 117/76, represented by Fritz Modest, the plaintiff in the main action in Case 16/77, represented by K.-D. Rathke, the Council, represented by the Director of its Legal Service, Daniel Vignes, acting as Agent, and the Commission, represented by its Legal Adviser, Götz zur Hausen, acting as Agent.

The *plaintiff in the main action in Case 117/76* states that, according to information which it is unable to prove beyond doubt, only one undertaking in the Federal Republic of Germany, Interquell, has processed some 5 000 tonnes of maize into quellmehl, half of its output, or 2 500 tonnes, being sent to the animal feed industry, while the quellmehl industry as a whole processes from about 40 000 to 50 000 tonnes of maize into quellmehl.

It does not understand how pre-gelatinized starch can replace quellmehl but not the particular baking aids which have different properties; like quellmehl, pre-gelatinized starch can be used as the basic ingredient of an aid for bakery products.

The cost price of quellmehl is DM 98.79 per 100 kg while starch was, owing to the refund, on offer at DM 98 per 100 kg.

The *plaintiff in the main action in Case 16/77* states that, while quellmehl, like starch, is largely used as a component of food products other than cooking agents, the ways in which the two products can be used are much the same. The production costs of pre-gelatinized starch and of quellmehl are the same.

It is not true that quellmehl is from 15 to 20 % cheaper to produce than starch. In the foodstuffs industry the price relationship is the opposite: prices are from 20 % higher in the case of quellmehl than in the case of pre-gelatinized starch. Prices mentioned in the telex of the German Federal Ministry of Food referred only to animal feed.

Referring to the statement of the plaintiff in the main action that pre-gelatinized starch was on sale at DM 98 per 100 kg, the *Commission* states that this figure relates to the present position whereas the comparison of prices made by the Commission refers to the time when the abolition of the refund was being discussed.

The fact that quellmehl was used in the animal feed industry was not merely an unofficial ground: there was a reference, though rather vague, to this effect in the third recital in the preamble to the regulation.

The Court invited the Commission to develop its arguments at the hearing on the following point:

The difference between Cases 117/76 and 16/77 arising from the fact that the application for grant of a refund in the first case was submitted on the date when Article 11, as amended, of Regulation No 120/67/EEC made the grant of a refund for the products covered by the article compulsory (refund shall be granted), whereas the application in the second case was submitted on a date when the wording in force of Article 11 provided for the refund in respect of the products

covered to be discretionary (refund may be granted).'

The Commission's reply was that, in neither case, was quellmehl any longer mentioned by the aforesaid provision. This is therefore a question which would arise only if the abolition of the refund for quellmehl were to be declared invalid by the Court. If that occurred, quellmehl would, as a finished product, once more come under the regulation concerning the basic product in respect of which a production refund is granted in the first case and may be granted in the second case.

Even if a basic regulation lays down that a refund shall be granted this does not confer any right to it on the party concerned. A right would be conferred on the party concerned only by the fixing of the amount of the refund. Nor, against this, could it be objected that the amount of the refund had already been fixed for pre-gelatinized starch and that a now legislative measure was not therefore necessary to introduce the refund; this would amount to saying that the Council had exercised its discretion irrevocably, once and for all, because it had fixed the refund at a specific sum for starch. In the Commission's view such a contention would be difficult to justify: the act of simply transferring to quellmehl the refund which had originally been fixed for starch is not the only way to achieve this equality of treatment. It is equally possible to confine the refunds to food for human consumption or to restrict the level of the refund for the two products. That, too, can ensure equality of treatment. In the case of the 1975/76 marketing year, equality is a matter for decision by the legislature and could even consist of the total abolition of the refund for pre-gelatinized starch because at the material time the refund was not compulsory.

The Advocate-General delivered his opinion at the hearing on 22 September 1977.

Decision

- 1 By two orders dated respectively 8 November 1976 and 18 January 1977, which reached the Court on 10 December 1976 and 31 January 1977, the Finanzgericht Hamburg has referred to the Court under Article 177 of the EEC Treaty two questions concerning the validity of certain provisions of Community regulations on the subject of refunds for the manufacture of products derived from maize.
- 2 Since the questions referred in both cases are identical and have essentially the same object, it is proper to join the cases for the purposes of judgment.
- 3 The substance of the first question is whether the provisions of Article 11 of Regulation No 120/67/EEC of the Council on the common organization of the market in cereals, as subsequently amended, are invalid in so far as they do not grant a production refund of the same amount on maize for the manufacture of quellmehl as they do for the processing of this product into starch.

The second question is whether, in the event of the reply being in the affirmative, manufacturers of quellmehl can lay direct claim to the same production refund as that granted to manufacturers of pre-gelatinized starch or whether a legal measure adopted by the Council is required for this.

- 4 These questions were referred in connexion with proceedings for the payment of a production refund for quellmehl brought against the competent national authorities by the manufacturers of this product, who claim that the provisions which abolished this refund while maintaining it for starch constitute discrimination contrary to the second subparagraph of Article 40 (3) of the Treaty.
- 5 The production refund for quellmehl extracted from maize, which has been granted in Germany since 1930, was introduced into the common organization of the market in cereals, first as discretionary by Regulation No 142/64/EEC of the Council of 21 October 1964 (JO of 27. 10. 1964, p. 2673) and subsequently as compulsory by Article 11 of Regulation No 120/67/EEC of the Council of 13 June 1967 (JO English Special Edition 1967, p. 33).

These arrangements were identical with those established by the same regulations for the grant of production refunds for starch and the amount of the refunds was also the same for the two products.

Although the reason for the grant of production refunds for starch was the need to keep prices competitive compared with the prices of substitute products derived principally from oil, the reason for the grant of production refunds for quellmehl was, as is made clear in particular by the tenth recital in the preamble to Regulation No 120/67/EEC, the interchangeability of starch and quellmehl.

- 6 The situation remained the same until 1 August 1974, the date of the entry into force of Regulation (EEC) No 1125/74 of the Council of 29 April 1974 (OJ L 128 of 10. 5. 1974, p. 12), whereby Article 11 of Regulation No 120/67/EEC was superseded by a new text providing for the grant of production refunds for starch but not for quellmehl.

The recitals in the preamble to Regulation (EEC) No 1125/74 stated that the reason for abolishing the production refund for quellmehl was that experience had shown that the opportunity for substituting quellmehl for starch for certain specific uses as food for human consumption was 'economically slight, if not non-existent'.

- 7 The second subparagraph of Article 40 (3) of the Treaty provides that the common organization of agricultural markets 'shall exclude any discrimination between producers or consumers within the Community'.

Whilst this wording undoubtedly prohibits any discrimination between producers of the same product it does not refer in such clear terms to the relationship between different industrial or trade sectors in the sphere of processed agricultural products.

This does not alter the fact that the prohibition of discrimination laid down in the aforesaid provision is merely a specific enunciation of the general principle of equality which is one of the fundamental principles of Community law.

This principle requires that similar situations shall not be treated differently unless differentiation is objectively justified.

- 8 It must therefore be ascertained whether quellmehl and starch are in a comparable situation, in particular in the sense that starch can be substituted for quellmehl in the specific use to which the latter product is traditionally put.

In this connexion it must first be noted that the Community regulations were, until 1974, based on the assertion that such substitution was possible.

However, the plaintiffs in the main actions on the one hand, and the Council and the Commission on the other are not in agreement concerning the continued existence of that situation.

The plaintiffs in the main actions contend that the opportunities for substitution are the same as previously, with the result that, since the abolition of the refund for quellmehl, trade in the latter has fallen off in favour of starch.

While the Council and the Commission have given detailed information on the manufacture and sale of the products in question, they have produced no new technical or economic data which appreciably change the previous assessment of the position.

It has not therefore been established that, so far as the Community system of production refunds is concerned, quellmehl and starch are no longer in comparable situations.

Consequently, these products must be treated in the same manner unless differentiation is objectively justified.

- 9 With regard to this latter aspect, the Council and the Commission contend that the abolition of the refund for quellmehl is justified by the fact that quellmehl has been to a great extent diverted from its specific use in food for human consumption in order to be sold as animal feed.

Although this ground, the correctness of which is moreover disputed by the plaintiffs in the main actions, is referred to in the statement which accompanied the proposal submitted by the Commission to the Council and later adopted as Regulation (EEC) No 1125/74, it does not appear in the recitals to that regulation.

During the proceedings, the Commission was requested by the Court to produce evidence to show that quellmehl had been used for animal feed but it was unable to comply with this request.

Even if adequate proof had been forthcoming that it was put to such use and that subsidized starch had not been put to similar use this could have justified the abolition of the refund only in respect of the quantities put to such use and not in respect of the quantities of the products used in food for human consumption.

- 10 In view in particular of the length of time during which the two products were given equality of treatment with regard to production refunds, it has not been established that there are objective circumstances which could have justified altering the previous system as was done by Regulation (EEC) No 1125/74, which put an end to this equality of treatment.

It is clear from the foregoing that the abolition, as a result of Regulation (EEC) No 1125/74, of the refund for quellmehl, while the refund was maintained for maize-based starch, amounts to a disregard of the principle of equality.

- 11 In the particular circumstances of the case, however, this finding of illegality does not inevitably involve a declaration that a provision of Regulation (EEC) No 1125/74 is invalid.
- 12 It must first of all be borne in mind that the amendment of Article 11 of Regulation No 120/67/EEC effected by Article 5 of Regulation (EEC) No 1125/74 took the form not of the deletion of that part of the text which relates to quellmehl but of the replacement of the previous wording by a new wording in which there is no mention of that product.

Thus the provision is unlawful because of something for which it makes no provision rather than on account of any part of its wording.

- 13 However, this unlawfulness cannot be removed merely by the fact that the Court, in proceedings under Article 177, rules that the contested provision is in part or in whole invalid.

On the other hand the conclusion must be drawn that, in law, the situation created by Article 5 of Regulation (EEC) No 1125/74, whereby the previous text was replaced by a new wording of Article 11 of Regulation No 120/67/EEC, is incompatible with the principle of equality and that it is for the competent institutions of the Community to adopt the measures necessary to correct this incompatibility.

The need for a reply to this effect to the questions asked is borne out by the existence of several courses of action which would enable the two products in question once again to be treated equally and to make good any damage sustained by those concerned and by the fact that it is for the institutions responsible for the common agricultural policy to assess the economic and political considerations on which this choice of action depends.

Costs

- 14 The costs incurred by the Council and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable.

As these proceedings are, in so far as the parties to the main action 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 questions referred to it by the Finanzgericht Hamburg by orders of 8 November 1976 and 18 January 1977, hereby rules:

1. The provisions of Article 11 of Regulation No 120/67/EEC of the Council of 13 June 1967, as worded with effect from 1 August 1974 following the amendment made by Article 5 of Regulation (EEC) No 1125/74 of the Council of 29 April 1974, and repeated in subsequent regulations, are incompatible with the principle of equality in so far as they provide for quellmehl and pre-gelatinized starch to receive different treatment in respect of production refunds for maize used in the manufacture of these two products.

2. It is for the institutions competent in matters of common agricultural policy to adopt the measures necessary to correct this incompatibility.

Kutscher Sørensen Bosco Donner Pescatore
Mertens de Wilmars Mackenzie Stuart O'Keefe Touffait

Delivered in open court in Luxembourg on 19 October 1977.

A. Van Houtte

Registrar

H. Kutscher

President

OPINION OF MR ADVOCATE-GENERAL CAPOTORTI
DELIVERED ON 22 SEPTEMBER 1977¹

*Mr President,
Members of the Court,*

1. The opinion which I have to deliver today is concerned with six cases (Joined Cases 64 and 113/76, Joined Cases 117/76 and 16/77 and Joined Cases 124/76 and 20/77) relating to agriculture and they have one important feature in common: they all raise the issue of observance of the principle of non-discrimination by the Community legislature. More specifically, the central issue is whether and under what conditions the principle of non-discrimination must be considered to have been breached when, by means of regulations, the Community authorities decide to abolish aids granted for a time to particular products while maintaining aids already granted to a product in competition with them.

I should state at once that the products which in the present case no longer

benefit from aids (in the form of 'production refunds') are 'quellmehl' and 'gritz'; the product which continues to benefit from them is starch. Quellmehl, which is produced by the processing of maize, wheat or broken rice by means of a heat treatment helps to keep dough damp in the breadmaking process and is traditionally used in Germany and Denmark as an additive in the manufacture of rye bread. Gritz is meal which is made from maize by means of a purely mechanical operation and is mainly used in the brewing of beer. For the main purpose for which they are used, each of the two products can, technically speaking, be replaced by starch.

During the stage at which the common organization of the market in cereals was being progressively established, the similar treatment of starch and quellmehl in the matter of production refunds was the outcome, in particular, of

¹ - Translated from the Italian.

COURT OF JUSTICE

JUDGMENT OF THE COURT

of 8 October 1980

**in Case 810/79 (reference for a preliminary ruling made by the Bundessozialgericht):
Peter Überschär, Hasselt, Belgium, v. Bundesversicherungsanstalt für Angestellte,
Berlin (1)**

(Language of the Case: German)

*(Provisional translation; the definitive translation will be published in the Reports of Cases
Before the Court)*

In Case 810/79: reference to the Court under Article 177 of the EEC Treaty by the Bundessozialgericht (Federal Social Court) for a preliminary ruling in the proceedings pending before that court between Peter Überschär and Bundesversicherungsanstalt für Angestellte — on the interpretation of Annex V to Regulation No 1408/71 of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community (*Official Journal of the European Communities*, English Special Edition 1971 (II), p. 416) as amended by Regulation (EEC) No 1392/74 of the Council of 4 June 1974 (OJ No L 152, p. 1) — the Court, composed of H. Kutscher, President, P. Pescatore and T. Koopmans (Presidents of Chambers), J. Mertens de Wilmars, Lord Mackenzie Stuart, A. O'Keefe, G. Bosco, A. Touffait and O. Due, Judges; H. Mayras, Advocate General; A. Van Houtte, Registrar, gave a judgment on 8 October 1980, the operative part of which is as follows:

Paragraphs 8 and 9 of Part C of Regulation (EEC) No 1408/71 of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community, as amended by Regulation (EEC) No 1392/74 of the Council of 4 June 1974, must be interpreted to mean that a German national who has paid contributions to old age pension insurance in another Member State and who subsequently wishes to pay a posteriori, but with retroactive effect within the meaning of Article 49 a (2) added to the Angestelltenversicherungs-Neuregelungsgesetz by the Rentenreformgesetz of 16 October 1972, German pension contributions in respect of previous periods, may be required to pay German contributions in respect of periods covered by contributions in another Member State. Consideration of the said paragraphs 8 and 9, as thus construed, has disclosed no factor of such a kind as to affect their validity.

(1) OJ No C 9, 11. 1. 1980.

JUDGMENT OF 13. 5. 1986 — CASE 170/84

JUDGMENT OF THE COURT
13 May 1986*

In Case 170/84

REFERENCE to the Court pursuant to Article 177 of the EEC Treaty by the Bundesarbeitsgericht [Federal Labour Court] for a preliminary ruling in the proceedings pending before that court between

Bilka-Kaufhaus GmbH

and

Karin Weber von Hartz

on the interpretation of Article 119 of the EEC Treaty,

THE COURT

composed of: Lord Mackenzie Stuart, President, T. Koopmans, U. Everling, K. Bahlmann and R. Joliet (Presidents of Chambers), G. Bosco, O. Due, Y. Galmot and C. Kakouris, Judges,

Advocate General: M. Darmon

Registrar: D. Louterman, Administrator

after considering the observations submitted on behalf of

Bilka-Kaufhaus GmbH, the appellant in the main proceedings, by K. H. Koch, J. Burkardt and G. Haberer, Rechtsanwälte, Frankfurt am Main,

Mrs Weber von Hartz, the respondent in the main proceedings, by H. Thon, Rechtsanwalt, Frankfurt am Main,

the United Kingdom, by S. H. Hay, of the Treasury Solicitor's Department, acting as Agent,

* Language of the Case: German.

the Commission of the European Communities, by J. Pipkorn and M. Beschel, members of its Legal Department, acting as Agents,

after hearing the Opinion of the Advocate General delivered at the sitting on 15 October 1985,

gives the following

JUDGMENT

(The account of the facts and issues which is contained in the complete text of the judgment is not reproduced)

Decision

1 By an order of 5 June 1984, which was received at the Court on 2 July 1984, the Bundesarbeitsgericht referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty three questions on the interpretation of Article 119 of that Treaty.

2 Those questions arose in the course of proceedings between Bilka-Kaufhaus GmbH and its former employee Karin Weber von Hartz concerning the payment to Mrs Weber von Hartz of a retirement pension from a supplementary pension scheme established by Bilka for its employees.

3 It appears from the documents before the Court that for several years Bilka, which belongs to a group of department stores in the Federal Republic of Germany employing several thousand persons, has had a supplementary (occupational) pension scheme for its employees. This scheme, which has been modified on several occasions, is regarded as an integral part of the contracts of employment between Bilka and its employees.

4 According to the version in force since 26 October 1973, part-time employees may obtain pensions under the scheme only if they have worked full time for at least 15 years over a total period of 20 years.

- 5 Mrs Weber was employed by Bilka as a sales assistant from 1961 to 1976. After initially working full time, she chose to work part time from 1 October 1972 until her employment came to an end. Since she had not worked full time for the minimum period of 15 years, Bilka refused to pay her an occupational pension under its scheme.

- 6 Mrs Weber brought proceedings before the German labour courts challenging the legality of Bilka's refusal to pay her a pension. She argued *inter alia* that the occupational pension scheme was contrary to the principle of equal pay for men and women laid down in Article 119 of the EEC Treaty. She asserted that the requirement of a minimum period of full-time employment for the payment of an occupational pension placed women workers at a disadvantage, since they were more likely than their male colleagues to take part-time work so as to be able to care for their family and children.

- 7 Bilka, on the other hand, argued that it was not guilty of any breach of the principle of equal pay since there were objectively justified economic grounds for its decision to exclude part-time employees from the occupational pension scheme. It emphasized in that regard that in comparison with the employment of part-time workers the employment of full-time workers entails lower ancillary costs and permits the use of staff throughout opening hours. Relying on statistics concerning the group to which it belongs, Bilka stated that up to 1980 81.3% of all occupational pensions were paid to women, although only 72% of employees were women. Those figures, it said, showed that the scheme in question does not entail discrimination on the basis of sex.

- 8 On appeal the proceedings between Mrs Weber and Bilka came before the Bundesarbeitsgericht; that court decided to stay the proceedings and refer the following questions to the Court:
 - (1) May there be an infringement of Article 119 of the EEC Treaty in the form of 'indirect discrimination' where a department store which employs predominantly women excludes part-time employees from benefits under its occupational pension scheme although such exclusion affects disproportionately more women than men?

(2) If so:

- (a) Can the undertaking justify that disadvantage on the ground that its objective is to employ as few part-time workers as possible even though in the department store sector there are no reasons of commercial expediency which necessitate such a staff policy?
- (b) Is the undertaking under a duty to structure its pension scheme in such a way that appropriate account is taken of the special difficulties experienced by employees with family commitments in fulfilling the requirements for an occupational pension?

9 In accordance with Article 20 of the Protocol on the Statute of the Court of Justice of the EEC written observations were submitted by Bilka, Mrs Weber von Hartz, the United Kingdom and the Commission of the European Communities.

The applicability of Article 119

10 The United Kingdom puts forward the preliminary argument that the conditions placed by an employer on the admission of its employees to an occupational pension scheme such as that described by the national court do not fall within the scope of Article 119 of the Treaty.

11 In support of that argument it refers to the judgment of 15 June 1978 (Case 149/77 *Defrenne v Sabena* [1978] ECR 1365), in which the Court held that Article 119 concerns only pay discrimination between men and women workers and its scope cannot be extended to other elements of the employment relationship, even where such elements may have financial consequences for the persons concerned.

12 The United Kingdom cites further the judgment of 16 February 1982 (Case 19/81 *Burton v British Railways Board* [1982] ECR 555) where the Court held that alleged discrimination resulting from a difference in the ages of eligibility set for men and women for payment under a voluntary redundancy scheme was covered not by Article 119 but by Council Directive 76/207 of 9 February 1976 on the

implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions (Official Journal 1976, L 39, p. 40).

- 13 At the hearing the United Kingdom also referred to the proposal for a Council directive on the implementation of the principle of equal treatment for men and women in occupational social security schemes submitted by the Commission on 5 May 1983 (Official Journal 1983, C 134, p. 7). According to the United Kingdom, the fact that the Commission considered it necessary to submit such a proposal shows that occupational pension schemes such as that described by the national court are covered not by Article 119 but by Articles 117 and 118, so that the application of the principle of equal treatment for men and women in that area requires the adoption of special provisions by the Community institutions.

- 14 The Commission, on the other hand, has argued that the occupational pension scheme described by the national court falls within the concept of pay for the purposes of the second paragraph of Article 119. In support of its view it refers to the judgment of 11 March 1981 (Case 69/80 *Worringham and Humphreys v Lloyds Bank* [1981] ECR 767).

- 15 In order to resolve the problem of interpretation raised by the United Kingdom it must be recalled that under the first paragraph of Article 119 the Member States must ensure the application of the principle that men and women should receive equal pay for equal work. The second paragraph of Article 119 defines 'pay' as 'the ordinary basic or minimum wage or salary and any other consideration, whether in cash or in kind, which the worker receives, directly or indirectly, in respect of his employment from his employer'.

- 16 In its judgment of 25 May 1971 (Case 80/70 *Defrenne v Belgium* [1971] ECR 445), the Court examined the question whether a retirement pension paid under a statutory social security scheme constitutes consideration received by the worker indirectly from the employer in respect of his employment, within the meaning of the second paragraph of Article 119.

- 17 The Court replied in the negative, taking the view that, although pay within the meaning of Article 119 could in principle include social security benefits, it did not include social security schemes or benefits, in particular retirement pensions, directly governed by legislation which do not involve any element of agreement within the undertaking or trade concerned and are compulsory for general categories of workers.
- 18 In that regard the Court pointed out that social security schemes guarantee workers the benefit of a statutory scheme to which workers, employers and in some cases the authorities contribute financially to an extent determined less by the employment relationship between the employer and the worker than by considerations of social policy, so that the employer's contribution cannot be regarded as a direct or indirect payment to the worker for the purposes of the second paragraph of Article 119.
- 19 The question therefore arises whether the conclusion reached by the Court in that judgment is also applicable to the case before the national court.
- 20 It should be noted that according to the documents before the Court the occupational pension scheme at issue in the main proceedings, although adopted in accordance with the provisions laid down by German legislation for such schemes, is based on an agreement between Bilka and the staff committee representing its employees and has the effect of supplementing the social benefits paid under national legislation of general application with benefits financed entirely by the employer.
- 21 The contractual rather than statutory nature of the scheme in question is confirmed by the fact that, as has been pointed out above, the scheme and the rules governing it are regarded as an integral part of the contracts of employment between Bilka and its employees.

- 22 It must therefore be concluded that the scheme does not constitute a social security scheme governed directly by statute and thus outside the scope of Article 119. Benefits paid to employees under the scheme therefore constitute consideration received by the worker from the employer in respect of his employment, as referred to in the second paragraph of Article 119.
- 23 The case before the national court therefore falls within the scope of Article 119.

The first question

- 24 In the first of its questions the national court asks whether a staff policy pursued by a department store company excluding part-time employees from an occupational pension scheme constitutes discrimination contrary to Article 119 where that exclusion affects a far greater number of women than men.
- 25 In order to reply to that question reference must be made to the judgment of 31 March 1981 (Case 96/80 *Jenkins v Kingsgate* [1981] ECR 911).
- 26 In that judgment the Court considered the question whether the payment of a lower hourly rate for part-time work than for full-time work was compatible with Article 119.
- 27 Such a practice is comparable to that at issue before the national court in this case: Bilka does not pay different hourly rates to part-time and full-time workers, but it grants only full-time workers an occupational pension. Since, as was stated above, such a pension falls within the concept of pay for the purposes of the second paragraph of Article 119 it follows that, hour for hour, the total remuneration paid by Bilka to full-time workers is higher than that paid to part-time workers.

- 28 The conclusion reached by the Court in its judgment of 31 March 1981 is therefore equally valid in the context of this case.
- 29 If, therefore, it should be found that a much lower proportion of women than of men work full time, the exclusion of part-time workers from the occupational pension scheme would be contrary to Article 119 of the Treaty where, taking into account the difficulties encountered by women workers in working full-time, that measure could not be explained by factors which exclude any discrimination on grounds of sex.
- 30 However, if the undertaking is able to show that its pay practice may be explained by objectively justified factors unrelated to any discrimination on grounds of sex there is no breach of Article 119.
- 31 The answer to the first question referred by the national court must therefore be that Article 119 of the EEC Treaty is infringed by a department store company which excludes part-time employees from its occupational pension scheme, where that exclusion affects a far greater number of women than men, unless the undertaking shows that the exclusion is based on objectively justified factors unrelated to any discrimination on grounds of sex.

Question 2 (a)

- 32 In its second question the national court seeks in essence to know whether the reasons put forward by Bilka to explain its pay policy may be regarded as 'objectively justified economic grounds', as referred to in the judgment of 31 March 1981, where the interests of undertakings in the department store sector do not require such a policy.
- 33 In its observations Bilka argues that the exclusion of part-time workers from the occupational pension scheme is intended solely to discourage part-time work, since in general part-time workers refuse to work in the late afternoon and on Saturdays. In order to ensure the presence of an adequate workforce during those

periods it was therefore necessary to make full-time work more attractive than part-time work, by making the occupational pension scheme open only to full-time workers. Bilka concludes that on the basis of the judgment of 31 March 1981 it cannot be accused of having infringed Article 119.

34 In reply to the reasons put forward to justify the exclusion of part-time workers Mrs Weber von Hartz points out that Bilka is in no way obliged to employ part-time workers and that if it decides to do so it may not subsequently restrict the pension rights of such workers, which are already reduced by reason of the fact that they work fewer hours.

35 According to the Commission, in order to establish that there has been no breach of Article 119 it is not sufficient to show that in adopting a pay practice which in fact discriminates against women workers the employer sought to achieve objectives other than discrimination against women. The Commission considers that in order to justify such a pay practice from the point of view of Article 119 the employer must, as the Court held in its judgment of 31 March 1981, put forward objective economic grounds relating to the management of the undertaking. It is also necessary to ascertain whether the pay practice in question is necessary and in proportion to the objectives pursued by the employer.

36 It is for the national court, which has sole jurisdiction to make findings of fact, to determine whether and to what extent the grounds put forward by an employer to explain the adoption of a pay practice which applies independently of a worker's sex but in fact affects more women than men may be regarded as objectively justified economic grounds. If the national court finds that the measures chosen by Bilka correspond to a real need on the part of the undertaking, are appropriate with a view to achieving the objectives pursued and are necessary to that end, the fact that the measures affect a far greater number of women than men is not sufficient to show that they constitute an infringement of Article 119.

37 The answer to question 2 (a) must therefore be that under Article 119 a department store company may justify the adoption of a pay policy excluding part-time workers, irrespective of their sex, from its occupational pension scheme on the ground that it seeks to employ as few part-time workers as possible, where it is

found that the means chosen for achieving that objective correspond to a real need on the part of the undertaking, are appropriate with a view to achieving the objective in question and are necessary to that end.

Question 2 (b)

- 38 Finally, in Question 2 (b), the national court asks whether an employer is obliged under Article 119 of the Treaty to organize its occupational pension scheme in such a manner as to take into account the fact that family responsibilities prevent women workers from fulfilling the requirements for such a pension.
- 39 In her observations Mrs Weber von Hartz argues that the answer to that question should be in the affirmative. She argues that the disadvantages suffered by women because of the exclusion of part-time workers from the occupational pension scheme must at least be mitigated by requiring the employer to regard periods during which women workers have had to meet family responsibilities as periods of full-time work.
- 40 According to the Commission, on the other hand, the principle laid down in Article 119 does not require employers, in establishing occupational pension schemes, to take into account their employees' family responsibilities. In the Commission's view, that objective must be pursued by means of measures adopted under Article 117. It refers in that regard to its proposal for a Council directive on voluntary part-time work submitted on 4 January 1982 (Official Journal 1982, C 62, p. 7) and amended on 5 January 1983 (Official Journal 1983, C 18, p. 5), which has not yet been adopted.
- 41 It must be pointed out that, as was stated in the judgment of 15 June 1978, the scope of Article 119 is restricted to the question of pay discrimination between men and women workers. Problems related to other conditions of work and employment, on the other hand, are covered generally by other provisions of Community law, in particular Articles 117 and 118 of the Treaty, with a view to the harmonization of the social systems of Member States and the approximation of their legislation in that area.

- 42 The imposition of an obligation such as that envisaged by the national court in its question goes beyond the scope of Article 119 and has no other basis in Community law as it now stands.
- 43 The answer to Question 2 (b) must therefore be that Article 119 does not have the effect of requiring an employer to organize its occupational pension scheme in such a manner as to take into account the particular difficulties faced by persons with family responsibilities in meeting the conditions for entitlement to such a pension.

Costs

- 44 The costs incurred by the United Kingdom and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. As these proceedings are, in so far as the parties to the main proceedings are concerned, in the nature of a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT,

in answer to the questions submitted to it by the Bundesarbeitsgericht by order of 5 June 1984, hereby rules:

- (1) Article 119 of the EEC Treaty is infringed by a department store company which excludes part-time employees from its occupational pension scheme, where that exclusion affects a far greater number of women than men, unless the undertaking shows that the exclusion is based on objectively justified factors unrelated to any discrimination on grounds of sex.

- (2) Under Article 119 a department store company may justify the adoption of a pay policy excluding part-time workers, irrespective of their sex, from its occupational pension scheme on the ground that it seeks to employ as few part-time workers as possible, where it is found that the means chosen for achieving that objective correspond to a real need on the part of the undertaking, are appropriate with a view to achieving the objective in question and are necessary to that end.
- (3) Article 119 does not have the effect of requiring an employer to organize its occupational pension scheme in such a manner as to take into account the particular difficulties faced by persons with family responsibilities in meeting the conditions for entitlement to such a pension.

Mackenzie Stuart	Koopmans	Everling	Bahlmann	
Joliet	Bosco	Due	Galmot	Kakouris

Delivered in open court in Luxembourg on 13 May 1986.

P. Heim
Registrar

A. J. Mackenzie Stuart
President

THE ARBITRATION INSTITUTE OF
THE STOCKHOLM CHAMBER OF COMMERCE

Arbitral Award

Rendered in Stockholm, Sweden
on 16 December 2003

Claimant: Nykomb Synergetics Technology Holding AB, Stockholm

Counsel:
Mr. Jonas Wetterfors and Mr. Per Winnberg
of Hellström & Partners Advokatbyrå KB,
Stockholm

Respondent: The Republic of Latvia, Riga

Counsel:
Mr. Fred Wennerholm and Mr. Petter Törnquist
of Setterwalls Advokatbyrå, Stockholm, and
Mr. Gundars Cers
of Grunte & Cers law firm, Riga.

The Arbitral Tribunal: Bjørn Haug, chairman
Rolf A. Schütze
Johan Gernandt

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1 Introduction

1.1 Overview

Nykomb Synergetics Technology Holding AB (“Nykomb”) is a joint stock company organized in 1995 under the laws of Sweden.

SIA Windau (“Windau”) is a joint stock company organized in 1991 under the laws of Latvia. Windau was originally 100 per cent owned and controlled by Latvian citizens, but Nykomb acquired 51 per cent of the share capital in March 1999 and 49 per cent in September 2000, making Windau a 100 per cent owned subsidiary of Nykomb.

The State Joint-Stock Company Latvenergo (“Latvenergo”) was organized as a state enterprise under Latvian law in 1991, and was in 1993 transformed into a joint stock company under Latvian law. The Republic of Latvia (the “Republic”) owns 100 per cent of the shares in Latvenergo. By an amendment of 3 August 2000 to the Latvian Energy Law the company is defined as “a national economy object of the State economy” that shall not be privatized. The company is actively involved in the production, purchase and distribution of electric power in Latvia.

On 24 March 1997 Latvenergo and Windau entered into an agreement called Contract No. 16/97 (the “Contract” or “Contract No. 16/97”) whereby Windau undertook to build a so called cogeneration plant in the town of Bauska, which was to produce electric power and heat on the basis of natural gas, the electric power to be purchased by Latvenergo and distributed over the national grid, and the heat to be purchased and distributed by the Bauska municipality. The plant was built and was ready to start production on 17 September 1999, but did not start until 28 February 2000 due to a dispute over the purchase price to be paid by Latvenergo. Since 28 February 2000 the Bauska plant has been delivering electric power to Latvenergo according to an interim or settlement agreement of 10 March 2000, at a price which in the Claimant’s view is less than Windau is entitled to under the Contract. The price dispute will be further explored below, but in short the delivery price stipulated in the purchase contracts entered into by Latvenergo is composed of two elements, the general tariff for average sales prices per kWh set by regulatory authorities and a multiplier set by Latvian laws or regulations. The Claimant contends that Windau was ensured for the first eight years of operation a multiplier of two (the “double tariff”), while Latvenergo considers the correct multiplier to be 0.75 of the tariff.

After unsuccessful attempts to reach an amicable settlement Nykomb on 11 December 2001 requested arbitration at the Stockholm Chamber of Commerce in accordance with Article 26.4.c of the Energy Charter Treaty of 17 December 1994 (the “Treaty” or the “ECT”). After exchanges of written briefs a preparatory meeting on 28 February 2003 and a hearing on 15 – 19 September 2003 was held in Stockholm.

1.2 *The Claimant's prayers for relief and legal grounds*

1.2.1 *The Claimant's prayers for relief*

In its Statement of Claim the Claimant made the following prayers for relief:

“Nykomb respectfully requests that the Arbitral Tribunal order the Republic:

- (i) to pay to Nykomb an amount of 667 158 Lats together with interest thereon from 17 September 1999 until actual payment at an annual rate of 6 per cent.
- (ii) to pay to Nykomb an amount of 2 311 020 Lats together with interest thereon from 28 February 2000 until actual payment at an annual rate of 6 per cent.
- (iii) to pay to Nykomb an amount of 4 119 502 Lats together with interest thereon from 16 September 2002 until actual payment at an annual rate of 6 per cent.

Nykomb respectfully requests the Arbitral Tribunal to order the Republic to compensate Nykomb for its cost of arbitration in an amount to be specified later and, as between the parties, alone to bear the responsibility for the compensation to the Arbitral Tribunal and to the Arbitration Institute of the Stockholm Chamber of Commerce.”

In its Brief No. I of 21 March 2003 the Claimant presented as secondary prayers for relief the following:

“Should the Tribunal find that compensation for future losses, i.e. compensation for the period from 30 April 2003 until 16 September 2007 as described above, may not be awarded as claimed by Nykomb in the Statement of Claim – with the exception of the applied discount rate of 6 per cent in Nykomb's present value computation or a finding of an expected yearly production of less than 24 813 MWh - Nykomb respectfully, as a secondary prayer for relief, requests the Tribunal to

- (i) order the Republic, to pay to Nykomb, an amount of 667 158 Lats together with interest thereon from 17 September 1999 until actual payment is made at an annual rate of 6 per cent;
- (ii) order the Republic, to pay to Nykomb, an amount of 2 817 591,7 Lats - or such higher amount that may follow from electricity produced and supplied during March and April 2003 - together with interest thereon from 28 February 2000 until actual payment is made at an annual rate of 6 per cent;
- (iii) confirm that the surplus electric power produced by and purchased from the Bauska Plant is to be purchased at a tariff to be calculated as twice the average electric sales tariff approved by the relevant regulatory body in the Republic of Latvia, currently $30,28 \times 2 = 60,56$ Lats/MWh, and
- (iv) confirm that the surplus electric power so purchased shall be paid on a monthly basis.”

In its Brief No. I of 21 March 2003 the Claimant also stated:

“1.8 As a general point for the primary as well as secondary prayers for relief forwarded by Nykomb, the Tribunal may in the alternative and at its discretion decide whether any award shall be performed by the Republic on its own behalf or as principal for (on behalf of) Latvenergo, and likewise whether such performance shall be made to Nykomb on its own behalf or as principal for (on behalf of) its investment enterprise Windau.

1.9 Despite that Windau is not a party to this arbitration; it would in Nykomb's opinion not be incompatible with international law and the concept of arbitration under the Treaty to extend the res judicata effect of an award also to Windau, being wholly-owned and under direct control of Nykomb.

1.10 The Tribunal may also, as far as Nykomb is concerned, in the alternative and at its discretion, consider to ordering that any damages be paid directly to the investment enterprise Windau rather than to Nykomb as claimant investor. Such a solution is supported by arbitral jurisprudence within international investment law (see the “Mondev Award”, at para 86). “

In its Brief No. III of 9 September 2003 the Claimant amended its prayers for relief as follows:

“A. The Tribunal shall:

- (i) order the Republic, to pay to Nykomb, an amount of 667 158 Lats together with interest thereon from 17 September 1999 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (ii) order the Republic, to pay to Nykomb, an amount of 2 311 020 Lats together with interest thereon from 28 February 2000 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (iii) order the Republic, to pay to Nykomb, an amount of 4 119 502 Lats together with interest thereon from 16 September 2002 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.

B. Nykomb’s secondary prayer for relief, as submitted in Brief I dated 21 March 2003, shall be adjusted accordingly. The Tribunal shall:

- (i) order the Republic, to pay to Nykomb, an amount of 667 158 Lats together with interest thereon from 17 September 1999 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (ii) order the Republic, to pay to Nykomb, an amount of 3 019 030 Lats together with interest thereon from 28 February 2000 until the day of judgement at an annual rate of 6 per cent, and for the period thereafter until actual payment at an annual rate of 18 %.
- (iii) confirm that the surplus electric power produced by and purchased from the Bauska Plant is to be purchased at a tariff to be calculated as twice the average electric sales tariff approved by the relevant regulatory body in the Republic of Latvia, currently 30,28 (double tariff = 60,56) Lats/MWh.
- (iv) confirm that the surplus electric power so purchased shall be paid on a monthly basis.”

1.2.2 Calculation of the amounts in the Claimant's prayers for relief

The specifications given in the Statement of Claim and in subsequent briefs show that the amounts in the Prayers for Relief have been arrived at as follows:

a) Calculations used in the Statement of Claim Prayers for Relief

(i)	<i>Deadlock period 17 September 1999-28 February 2000</i>	
	Expected production (like September 2000-February 2001)	14.661.35 MWh
	At double tariff 60.56 amounts to (for 163 days)	779.593 Lats
	Lost income on heat	82.700 Lats
	Less calculated cost of gas	<u>- 215.135 Lats</u>
	Calculated net loss on electricity and heat	<u>667.158 Lats</u>
(ii)	<i>Loss of income 28 February 2000-16 September 2002</i>	
	Actual production in period (according to invoices)	61.057.33 MWh
	Difference double-0.75 tariff (60.56-22.71) = 37.85 Lats	<u>2.311.020 Lats</u>

(iii) <i>Loss of income in rest of the 8 years' period, 16 September 2002-16 September 2007</i>	
Estimated 5 years' production (like 2001 = 25.249,62 MWh)	126.248.1 MWh
Difference double-0.75 tariff (60.56-22.71) = 37.85 Lats	4.778.491.20 Lats
Discounted at 6 percent per annum	<u>4.119.502.00 Lats</u>

b) Calculations used in the Brief No. III Prayers for Relief

Primary Request for Relief:

Calculations not presented, but the capital sums are identical to the calculations in the Statement of Claims (see details above).
Claims for interest differ from the claims in the Statement of Claim.

(i) <i>Deadlock period 17 September 1999-28 February 2000</i>	
Net calculated loss on electricity and heat	<u>667.158 Lats</u>
(ii) <i>Loss of income 28 February 2000-16 September 2002</i>	<u>2.311.020 Lats</u>
(iii) <i>Loss of income 16 September 2002 – 16 September 2007</i>	<u>4.119.502.00 Lats</u>

Secondary Request for Relief:

(i) <i>Deadlock period 17 September 1999-28 February 2000</i>	
Net calculated loss (presumably calculated as above)	<u>667.158 Lats</u>
(ii) <i>Loss of income 28 February 2000-30 April 2003</i>	
Actual production in period (see Brief No. II page 40)	79.763 MWh
Difference double-0.75 tariff (60.56-22.71) = 37.85 Lats	<u>3.019.030 Lats</u>
(iii) <i>Order for double tariff to be paid in the future.</i>	
(This claim is not specified as to time period, but presumably relates to the period 30 April 2003 – 16 September 2007.)	

The Arbitral Tribunal notes that the primary request for relief in its final version continues to be based on a period of actual deliveries from 28 February 2000 to 16 September 2002, while the secondary request for relief has been updated to cover a period of actual deliveries from 28 February 2000 to 30 April 2003. Consequently, in both cases the third period concerning future deliveries up to 16 September 2007 includes a period up to the time of this award where deliveries have actually taken place and have been paid at 0.75 of the tariff.

The Arbitral Tribunal further notes that, apart from the claim for lost net income on heat production in the “deadlock” period, all the claimed amounts are based on the estimated or actual production of electricity at Bauska in the various periods, with calculation of the price at the double tariff, less the price at 0.75 of the tariff actually paid by Latvenergo to Windau for deliveries after 28 February 2000. In other words, the amounts claimed in the prayers for relief are equal to Windau’s alleged loss of net income for non-delivered heat and electricity in the deadlock period plus Windau’s alleged loss of income for the period

after 28 February 2000 due to the fact that Latvenergo has only paid 0.75 of the tariff for delivered electricity.

1.2.3 Legal grounds asserted by the Claimant

Notwithstanding the way the Claimant calculates its losses, and notwithstanding the remarks in section 1.8-1.10 of the Claimant's brief of 21 March 2003 cited above, the Claimant does not appear to assert that it is entitled to claim payment directly to itself of the damages allegedly due to Windau for loss of net income on undelivered fuel and electricity during the deadlock period or the difference in purchase prices between the double tariff and the price actually paid to Windau for delivered electricity, nor does the Claimant appear to claim that it is entitled to pursue such a claim on behalf of its subsidiary Windau in this arbitration.

The Claimant must be understood to claim for the losses or damages it has incurred *itself* as a result of the undelivered heat and electricity during the deadlock period and as a result of the refusal of Latvenergo to pay the double tariff in the first eight years of production at Bauska. The Republic is asserted to be liable for breaches of its obligations under the Treaty, a) either directly liable on account of its own actions or lack of action, or liable because Latvenergo is a state organ or enterprise, or because Latvenergo's actions are attributable to the Republic, and b) because the non-payment of the double tariff amount to breaches of the Republic's obligations under Part III of the Treaty.

The Claimant asserts that Latvenergo's refusal to pay the double tariff:

- violates the obligation of fair and equitable treatment of investors, Article 10 (1);
- constitutes a treatment less favorable than required by international law, including treaty obligations, Article 10 (1);
- constitutes an impairment by unreasonable or discriminatory measures, Article 10 (1);
- constitutes measures having effect equivalent to expropriation, Article 13 (1).

With regard to Article 22 in Part IV of the Treaty the Claimant remarked in its closing statement:

“There was no negotiation, and there was obviously no economic motivation for Latvenergo to enter into one or several double tariff agreements, but Latvenergo had to deal with Nykomb, and others, and under conditions established by law only. There was no normal “haggling” about price as stated by Professor Wälde. Latvenergo held and still holds that position itself. It is in a monopolistic, public-service market that this transaction took place and which dominates its character from beginning to the end. This attribution – i.e. the operation by which the conduct of Latvenergo is treated as if it were an integral part of the state and by which the veil of its corporate personality is pierced (or lifted) – is based on customary international law (applicable under Art. 26 (6) of the Treaty), the State Responsibility draft of the International Law Commission as interpreted in the most recent and relevant awards, namely Maffezini I and II and in particular Salini v. Morocco. In addition it is also operated by operation of Art. 22 (1, 3 and 4) of the Treaty. We believe Art. 22 to be a special attribution norm for the primary obligations contained in part III of the Treaty, but whatever the legal argument about this, customary international law rules are fully sufficient for attribution and Art. 22 (1, 3 and 4) merely reinforce, by direct effect or by an indirect interpretative support, the attribution. Using a very old and in civil law established concept, Art 22 is clearly “accessory” (“akzessorisch”, “accessorisk”), to the “primary” obligations in Part III of the Treaty.”

The Claimant denies that its claims, or any part thereof, should be dismissed for lack of jurisdiction.

1.3 The Respondent's prayers for relief and asserted legal grounds

In its statement of Defence of 27 November 2002 the Respondent made the following “Prayers for dismissal”:

“3.1 The Republic respectfully requests the Arbitral Tribunal:

(i) to dismiss the claim on its merits;

(ii) to order Nykomb to compensate the Republic for its costs of arbitration in an amount to be specified later; and

(iii) to order Nykomb, as between the parties, alone to be liable for the compensation to the Arbitral Tribunal and to the Arbitration Institute of the Stockholm Chamber of Commerce.

3.2 The Republic does not admit to the amount of Nykomb’s claim.

3.3 Should the Arbitral Tribunal find that Nykomb has a valid claim for damages the Republic respectfully requests the Arbitral Tribunal to limit any adjudged damages to an amount that does not exceed the loss incurred by Nykomb on its investment”.

In its Response of 4 September 2003 to Claimant’s Brief II the Respondent summed up its position as follows:

“8.2 Accordingly, Latvia respectfully requests that the Arbitral Tribunal adjudge and declare:

(i) that it lacks the jurisdiction to entertain the claim in the nature submitted by Nykomb; or

(ii) that Latvenergo’s conducts are not attributable to Latvia; and/or

(iii) that Latvia has not contravened any of its obligations under Part III of the Treaty; or

(iv) that Nykomb has not suffered any loss to warrant compensation; and

(v) that all costs of this arbitral proceedings, including legal costs, are to be borne by Nykomb”.

The Arbitral Tribunal understands these statements to the effect that the Respondent principally claims that all the Claimant’s claims should be dismissed for lack of jurisdiction, and in any event be dismissed on their merits. With respect to the Claimant’s new claims for interest at 18 per cent rather than 6 percent per annum from the time of the award, the Respondent requests that the new interest claim be dismissed for being submitted too late.

2 Jurisdiction

2.1 The general basis for the Arbitral Tribunal’s jurisdiction

The Claimant claims jurisdiction for this arbitration on the basis of Article 26.4.c of the Energy Charter Treaty of 17 December 1994 (the “Treaty” or the “ECT”). The article reads in part:

“ARTICLE 26 SETTLEMENT OF DISPUTES BETWEEN AN INVESTOR AND A CONTRACTING PARTY

(1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.

(2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:

- (a) to the courts or administrative tribunals of the Contracting Party party to the dispute;
- (b) in accordance with any applicable, previously agreed dispute settlement procedure; or
- (c) in accordance with the following paragraphs of this Article.

(3) ---

(4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2) (c), the Investor shall further provide its consent in writing for the dispute to be submitted to:

(c) an arbitral proceeding under the Arbitration Institute of the Stockholm Chamber of Commerce.”

“Investment” and “investor” as used in Article 26 are defined in Article 1 of the Treaty:

ARTICLE 1 DEFINITIONS

As used in this Treaty:

(6) “Investment” means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

- (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
- (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
- (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
- (d) Intellectual Property;
- (e) Returns;
- (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

A change in the form in which assets are invested does not affect their character as investments and the term “Investment” includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the “Effective Date”) provided that the Treaty shall only apply to matters affecting such investments after the Effective Date.

“Investment” refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as “Charter efficiency projects” and so notified to the Secretariat

(7) “Investor” means:

- (a) with respect to a Contracting Party:
 - (i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;
 - (ii) a company or other organization organized in accordance with the law applicable in that Contracting Party;

(b) with respect to a “third state”, a natural person, company or other organization which fulfils, mutatis mutandis, the conditions specified in subparagraph (a) for a Contracting Party.

(8) “Make Investments” or “Making of Investments” means establishing new Investments, acquiring all or part of existing Investments or moving into different fields of Investment activity.

--“

Both Sweden and Latvia are Parties to the Treaty. It is not in dispute that Nykomb, being a company organized under the laws of Sweden and having its seat in Sweden is an investor, and that its acquisition of shares in and its giving of credits to Windau constitute investments within the meaning of the Treaty.

Nor is it contested that Nykomb made attempts at an amicable settlement and made a timely request for arbitration sufficient to meet the requirements set out in Article 26 (1) and (2).

2.2 The claims must be relating to an investment

Article 26 requires that claims raised in an arbitration are relating to an investment under the Treaty. The Claimant’s losses or damages are allegedly caused by the reduced income flow into Windau which affects the Claimant’s investment. The Claimant’s allegations create a clear relationship between the claims and the Claimant’s investments in Windau as required by Article 26. However, it remains to be considered in connection with the merits whether there is a causal link between the refusal of Latvenergo to pay the double tariff and the alleged losses or damages.

2.3 The claims must be based on obligations under Part III of the Treaty

Article 26 further requires that the claims must be based on alleged breaches of the Republic’s obligations under Part III of the Treaty.

As summarized in section 1.2.3 above, the Claimant alleges that all its claims against the Republic are based on breaches of provisions in Articles 10 and 13, which are contained in Part III of the Treaty.

The Claimant has also referred to parts of Article 22. The Respondent has objected to the Tribunal’s jurisdiction on the ground that Article 22 is placed in Part IV of the Treaty. The Arbitral Tribunal notes, however, that the Claimant has stated that the provisions Article 22 referred to do not give rise to any separate claim, but are rather invoked as provisions which clarify the scope and contents of other treaty provisions, among them the provisions in Part III that the Claimant relies on as bases for its claims. The Tribunal finds that the interpretation and application of the relevant Articles of the Treaty, Articles 10 and 13, are best considered under the merits part of this award, and that the references to Article 22 cannot as such be dismissed as inadmissible in the form the references are relied on.

2.4 *Lack of jurisdiction due to jurisdiction of Latvian courts*

a) The *Respondent* requests, for several reasons all denied by the Claimant, that the Claimant's claims shall be dismissed in their entirety for lack of jurisdiction.

The Respondent notes that the Claimant's claims are based on the alleged breach of the agreements between Latvenergo and Windau, viz. Contract No. 16/97 and the agreement of 10 March 2000, and argues on that basis as follows:

- The Claimant is not party to these agreements, Windau's contract rights are not transferred to, nor can they be pursued by Nykomb even if it is a 100 per cent parent company. The claims are not owned by the Claimant;
- Both agreements contain a jurisdiction clause giving exclusive jurisdiction to Latvian courts;
- There is nothing to prevent Windau from suing for the same alleged breaches in a Latvian court, with a risk of double payment of the same claim; and
- When the Republic signed and ratified the Treaty, it did not contemplate that such claims as raised by the Claimant in this arbitration would be capable of being brought under Article 26 of the Treaty, and consequently has not agreed to this arbitration.

As for the first of these arguments, the Tribunal must agree that if the Claimant were to be understood as pursuing a contractual claim directly and exclusively based on the agreements between Latvenergo and Windau, such claims would not be admissible since Article 26 only allows arbitration of claims based on alleged breaches of the Treaty. However, as stated in section 1.2.3 above, the Claimant must be understood to claim for the losses or damages it has incurred *itself* as a result of the undelivered heat and electricity in the deadlock period and the refusal of Latvenergo to pay the double tariff during the eight year period, and such claims are alleged to constitute breaches of the Treaty.

As for the second argument, Nykomb is undeniably a legal entity separate from its subsidiary Windau. Nykomb is not a party to either of the two contracts in question and already therefore not bound by their jurisdiction clauses. Nor would Windau have any authority or power, by means of the contract clauses submitting its contracts disputes to the jurisdiction of Latvian courts, to exclude Nykomb from pursuing its own claims in an arbitration under ECT Article 26, even in a situation where Nykomb's claims are based on alleged breaches of Windau's contracts.

The risk of double payment is admittedly an effect of the establishment of an arbitration facility also for alleged losses or damages suffered indirectly by an investor, for instance through violations against its subsidiary in a country that has adhered to the Treaty. No definite remedies have been developed at this stage, but clearly the Treaty based right to arbitration is not excluded or limited in cases where there is a possible risk of double payment. This risk of double payment is only likely to be resolved through the further development of the law in this area, such as by the means of new judgements, decisions, guidance or other relevant developments.

Finally, the Tribunal notes that the Republic did not file any reservations concerning the scope or interpretation of Article 26 when adhering to the Treaty. Clearly, the Republic must then be obliged to accept Treaty arbitration with such scope as follows from a proper interpretation of that Treaty provision.

b) The *Respondent* further argues that the dispute concerning the alleged breaches of the agreements between Latvenergo and Windau must first be settled by Latvian courts. In its brief of 4 September 2003 the Respondent states:

“Furthermore, Latvia’s argument should not be understood (as do Nykomb and its expert) to advocate the principle of exhaustion of local remedies as a procedural requirement in the traditional sense of international law. Rather, Latvia’s argument regarding Nykomb’s claim for an alleged and contested breach of contract cannot be ascertained until the proper forum has first pronounced on the issue. There is no evidence to suggest that Windau has been prevented from pursuing such a course of action. It is in this sense that Latvia has presented its argument concerning the exhaustion of local remedies, which Nykomb and its legal expert persist in misunderstanding.

For the above reasons, Latvia is of the view that the Arbitral Tribunal lacks the jurisdiction to entertain Nykomb’s claim for the double tariff. Whether such a tariff is due or not is a matter of dispute, and if contested (as seems to be the case here) can only be determined by the proper forum, and in accordance with the proper law of the contracts in question.”

The *Arbitral Tribunal* understands the quoted statement to the effect that the Respondent does not claim the existence of a general obligation under the Treaty or under international law that local remedies must be exhausted before arbitration can be requested under Article 26 of the Treaty. Nonetheless the Tribunal finds it appropriate to state that in the Tribunal’s view, no such general obligation to exhaust local remedies can be derived from the Treaty or international law in general. On the contrary, according to ECT Article 26 (4) the investor has the option of requesting Treaty arbitration even if it has agreed to the jurisdiction of a local forum – which, however, it has not done in the present case. As a preliminary issue, the Tribunal has come to the conclusion that it has jurisdiction to determine, as a preliminary matter, whether there has been a breach of the contract, insofar as it is necessary for its decision in relation to the claims raised on the basis of the Treaty.

2.5 *Lack of jurisdiction due to limited scope of Treaty provisions*

The *Respondent* has asserted several limitations to the scope of the Treaty provisions relied on by the Claimant, which under the circumstances of this case bring the Claimant’s claims outside the jurisdiction of the Tribunal, primarily interpreted as follows:

- a) Contract No. 16/97 was entered into on 24 March 1997, before the Treaty entered into force on 17 March 1998 and at a time when Windau had only Latvian shareholders. The Treaty does not apply retroactively to situations established prior to the entry into force of the Treaty;
- b) The withdrawal of the right to the double tariff occurred before the Claimant’s investments in Windau. The Treaty does not apply retroactively to situations established prior to the Claimant’s investment;
- c) Nykomb was aware of the price dispute, or ought to have been aware of it, before it bought the shares in Windau. Nykomb took a purely business or commercial risk when

investing in Windau. The Treaty only protects against political risks and not against commercial or business risks;

- d) Also, the Contract between Latvenergo and Windau for the purchase of electric power, upon which all the Claimant's claims are based, is a commercial contract and as such not protected by the Treaty. The Treaty protection only applies to investment contracts within the meaning of the Treaty.

The *Arbitral Tribunal* finds that the scope and application of the Treaty provisions relied on by the Claimant is best considered after a general description of the background for the dispute, including the successive laws and regulations and of the purchase contracts entered into by Latvenergo. After such general description the Tribunal will decide whether a claim or a part thereof is found to fall outside the scope of a treaty provision and shall be dismissed for lack of jurisdiction, and, if found to be within the scope of the Tribunal's jurisdiction, whether it shall be dismissed on its merits. See section 4.3.3 below.

3 General background

3.1 Latvian public policy concerning electric power

The Claimant has given the following account of the situation since the early 90'ies¹ which appears largely to be undisputed between the parties.

“When the Soviet Union's occupation of the Republic came to an end in 1991, the Republic needed to reduce its dependency on electricity imported from Russia, Lithuania and Estonia. In the long term, the Republic was faced with a possible shutdown of the nuclear reactors in Russia and Lithuania and a significant uncertainty regarding power generation based on oil shale in Estonia. This dependency on electricity imports was deemed to be a national security risk. If the nuclear reactors in Russia and Lithuania had been closed, or had otherwise become unavailable because of breakdowns or defects, the Republic would have been unable to satisfy its needs for electricity. Electricity from Russia and Belarus is transmitted to the Republic through a connection of the main power system of Russia with the high-voltage networks in the Republic. Russia had, however, and still has, the technical ability to disconnect the high-voltage networks from the main power system of Russia. Such a disconnection would, *inter alia*, raise the electricity costs in the Republic. At the same time, it became apparent that the domestic generating capacity was insufficient to meet the increasing demands on electricity as the Republic was rebuilding its economy. The Republic had also been left with enormous ecological problems, e.g. air pollution from usage of dirty fossil fuels in local heating plants, and needed to encourage the use of cleaner fuels to stimulate a better environment.

To increase domestic generating capacity and the use of cleaner fuels, the Republic needed to attract private investments in the electricity industry, particularly from foreign investors. However, electricity prices were very low in the Republic. This was due mainly to the low import prices charged by the Russian state electricity monopoly and by the Ignalina power plant in Lithuania. Another contributing factor to the low prices in the Republic was the prohibition on several major Latvian hydropower producers to charge the full price for their electricity. Foreign investors could, however, hardly compete on a market so strongly influenced and dependent on import dumping; i.e. the large import of cheap electricity from Russia and Lithuania. Generally, Western investors were quite reluctant at the beginning of the 1990's to risk their capital in Eastern Europe. As a result, Western investors needed a strong incentive, an economic “premium”, to invest in new power generation and co-generation capacity in the Republic.

¹ See the Statement of Claim page 16.

A co-generation plant is able to produce both electricity and heat, hence co-generation. Through the combined production of electricity and heat co-generation plants are able to use more than 80 per cent of the energy contents in the fuels used. The traditional condensing power plants, which were unable to produce both electricity and heat, could only use between 30 to 40 per cent of the energy contents in the fuels used. When introducing co-generation based on natural gas in Latvia, the Republic could, *inter alia*, streamline the use of the energy contents in the fuels used and improve the ecological situation by phasing out highly pollutant fossil fuels.”

In pursuance of its policies concerning electric power production and the attraction of foreign investment in general, the Republic took the following measures: On 5 November 1994 the Republic enacted a Law on International Agreements, on 17 December 1994 signed and subsequently ratified the Energy Charter Treaty, on 13 January 1995 signed the US - Latvia Bilateral Investment Treaty (the “US-Latvia BIT”) and on 6 September 1995 enacted a law “On the Regulation of Entrepreneurial Activity in Energetics” (the “Entrepreneurial Law”). The purpose of enacting the Entrepreneurial Law was to “encourage entrepreneurial activity in this field” (cf. Article 2 of the Law). The law established, in Articles 27(9) and (10), that electricity from, *inter alia*, cogeneration plants with installed capacity from 1 to 12 megawatts was to be purchased into the national power transmission grid at a price twice as high as the average consumer price, i.e. the double tariff. In September 1997 the Parliament adopted the Latvian National Energy Programme. The main purpose of the Energy Programme was to integrate the Latvian electricity market with the European Union and to harmonize Latvian legislation with EU directives and regulations. The Energy Programme aimed to increase competition in the energy sector especially with regard to pricing and tariffs. The Energy Law of 3 September 1998 was enacted as a result of the adoption of the Energy Programme.

3.2 *The organization of the Latvian electricity market*

According to the Claimant², and not contested by the Respondent, in 2000 slightly more than 25 per cent of the electricity consumed in Latvia was imported, mainly from Russia and Lithuania. Of the electricity generated in Latvia, Latvenergo produced approximately 97 per cent while independent producers such as Windau produced the remaining 3 per cent. Latvenergo is also the sole distributor of electric power through the national grid. In its capacity as the main domestic producer and the sole distributor of electricity in Latvia, Latvenergo was, and still is, holding a dominant position in the Latvian electricity market.

There are also a number of smaller domestic producers, with various capacities and various production techniques. Among the domestic producers are about 28 cogeneration plants of different sizes.

Latvenergo is by law the sole distributor of imported and domestically produced electricity through the national grid, and is for this reason in effect the sole purchaser of electricity produced by private entrepreneurs. The purchase price is derived from the electricity tariff consecutively set by public authorities in accordance with methodologies set out in laws and regulations, and from the so called multipliers which are laid down in laws and regulations. Latvenergo states that it has no authority to deviate from the officially determined tariffs and multipliers. But the purchase prices are set out, with reference to relevant tariffs and multipliers, in Latvenergo’s purchase contracts for electricity.

² See the Statement of Claim page 15.

It follows that the part of the Latvian domestic electricity market in which Windau operates is highly regulated. There is no competition between purchasers when an entrepreneur is ready to sell energy produced in Latvia, nor is there any price competition among the domestic producers of electricity.

3.3 *The building and financing of the Bauska cogeneration plant*

No information has been given with respect to the activities of Windau from its incorporation in 1991 up to 1996, nor concerning its activities, if any, beside the Bauska and the other 15 cogeneration projects mentioned below.

On 1 July 1996 Windau entered into a contract with Latvenergo for the building of a cogeneration plant at Bauska. The 1996 contract was replaced by the above-mentioned Contract No. 16/97 of 24 March 1997 concerning the building of the same cogeneration plant. On the same day the parties also entered into a Contract No. 17/97 in which Windau undertook to install three cogeneration plants in the cities of Jelgava, Dobele and Iecava. A third agreement, Contract No. 18/97 entered into on 26 March 1997, is a general agreement pursuant to which Windau undertook to install a further 12 cogeneration plants in various, not specified, cities of Latvia. In all the contracts Windau undertook to sell and Latvenergo undertook to buy any surplus electric power from the plants, that is all the electric power in excess of the power required by the plants for the purposes of their own production.

The three contracts in 1997 were all made effective as of the date of signing. It has been explained by the Claimant that Contract No. 16/97 concerning Bauska, and then presumably also the other two contracts, were signed in anticipation of a limitation of a Latvian law provision which prescribed the double tariff to be paid for a period for eight years for electric power from cogeneration plants. The law amendment was enacted in June 1997 and excluded the double tariff for plants with contracts effective after 31 May 1997. Apparently, the board of Latvenergo reacted negatively to the Windau contracts, and decided on 25 September 1997 that no further contracts were to be entered into with Windau. In a letter of 2 October 1997 to Windau, Latvenergo declared Contracts Nos. 16/97 and 17/97 invalid, *inter alia* asserting that they were signed on behalf of Latvenergo by an unauthorized person. The same claim was made against another cogeneration operator, Latelektro-Gulbene. Latelektro-Gulbene brought a court action against Latvenergo and defeated Latvenergo's contentions. Latvenergo later brought a court action in a Latvian court against Windau, and withdrew the case in January 2003. But it still refuses to pay to Windau the double tariff referred to in Contract No. 16/97.

Noell-KRC Energie- und Umwelttechnik GmbH ("Noell") was a joint stock company established under the laws of the Federal Republic of Germany and was a subsidiary of the German company Preussag AG. Noell had been engaged in supplying cogeneration plants in Germany and other locations, and the group took an interest in participating in the project of building up to 16 cogeneration plants in Latvia as contracted for by Windau. A PriceWaterhouseCoopers report of 30 October 1998 suggested an investment value of DEM 5,6 million per plant, or all in all a contract value of DEM 90 million for the 16 plants. On 19 February 1998 Noell concluded an agreement with Windau providing for mutual co-operation and the supply of turnkey facilities to the cogeneration plants to be built. The first plant was to be built in Bauska, and was to serve as the model project for

the other plants to be built. Noell was to be Windau's turnkey supplier, technical service partner and technical adviser with respect to cogeneration technology.

In mid-1998 major changes took place within the Preussag group. Preussag decided to go out of the engineering business and stop their long term engagement in engineering projects. Noell transferred its power plant business to the German company BBP Power Plants GmbH, a subsidiary of the German company Babcock Borsig AG. Babcock Borsig AG filed for insolvency on 4 July 2002.

According to the oral witness statement by Mr. Bernt Kulbe, the managing director of Noell, Noell in 1998 went looking for another equity holder in the Latvian project. Noell had been working together with Nykomb on different projects since 1996. In the spring of 1998 Noell/Borsig invited Nykomb to take over the developer role for the cogeneration project. Nykomb performed an in-house analysis of the economic and technical parameters of the project and decided in July 1998 to engage and mobilize staff resources to complete the project development process. After further investigations and analyses, including a PriceWaterhouseCoopers report and analysis of 30 October 1999, negotiations concerning financing of the Bauska project were conducted with the Vereinsbank, both with its Riga branch and with its German head office, resulting in a loan agreement dated 12 February 1999 from the Riga branch in the amount of approximately € 1.533.000. It was foreseen at the time that an investment in Bauska would amount to 1.9 million Lats, of which 1.4 million Lats was planned to be covered by loans and 0.4 million Lats by equity.

One part of the financing package was that Nykomb undertook to acquire 51 per cent of the share capital in Windau. In consequence hereof, Nykomb, by a purchase agreement of 11 March 1999 registered on 25 March 1999' bought 51 per cent of the existing shares in Windau and participated with 51 per cent in an increase of the share capital. On 7 September 2000 Nykomb acquired the remaining 49 per cent of the shares to become a 100 per cent shareholder in Windau. It is still the sole shareholder in the company.

Noell and the PreussAG/Borsig group are said to have granted considerable credits to Windau, although further details have not been given. According to a letter of 12 April 2000 from Windau to Latvenergo:

“Currently there is over Lts 2,250,000 invested in this project represented by Lts 750,000 of equity (provided as to Lts 650,000 by Nykomb), Lts 200,000 in supplier credits from Germany and Lts 1,300,000 of local bank loans backed by a strong guarantee from the parent company of Noell KRC in Germany. In addition Nykomb has invested some Lts 200,000 in upgrading the heating grid in the municipality of Ogre.”

By way of illustration, this corresponds to, in Swedish kronor (at 15/-):

	Lats	SEK
Equity	750 000	11 250 000
Supplier credits	200 000	3 000 000
Local bank loans	<u>1 300 000</u>	<u>19 500 000</u>
Investment in Bauska	<u>2 250 000</u>	<u>33 750 000</u>

Plus, as stated in the letter, “Backed by a strong guarantee from the parent company of Noell KRC”.

The Tribunal also notes that according to Windau's annual report for 2001, the managing director of Noell, Mr. Kulbe, was the chairman of the board of Windau. The German group's interest is also indicated by the fact that the German ambassador to Latvia as well as representatives of Noell participated in the meeting with the Prime Minister of Latvia on 26 October 1999, see sections 3.4 and 3.5.7 below. The legal relationship between Nykomb and the German group might have been of interest to the Tribunal when considering the alleged losses or damages incurred by Nykomb because of the reduced income flow into Windau, but this has not been further documented by the Claimant.

The Bauska cogeneration plant was completed and ready for operation on 17 September 1999, but did not start its production until 28 February 2000 due to the dispute over the purchase price for electric power as will be further dealt with below.

3.4 Windau's other cogeneration projects

Preparatory work was also carried out with respect to the other 15 cogeneration plants covered by Contracts Nos. 17/97 and 18/98. Thus, licenses were obtained for two plants in the city of Ogre and for plants in two other cities. An investment was also made in upgrading the grid for distributing heat in Ogre. After the Bauska plant was ready for operation and after the price dispute at Bauska had emerged, a meeting was held on 26 October 1999 with the Prime minister, with the participation of the Swedish and German ambassadors to Latvia as well as representatives of Windau and Noell. The need for a solution of the price dispute was underscored, as was the fact that such a solution was necessary in order for the project work on the other 15 contracted plants to proceed. As will be further explored in section 3.5.7 below, the meeting resulted in a Resolution No. 67 of the Cabinet of Ministers of 30 November 1999 ordering the double tariff to be adhered to. The resolution was however later annulled by the Constitutional Court for constitutional reasons. Thereafter, work on Windau's other cogeneration projects were halted, awaiting a clarification of the purchase prices for electric power at Bauska.

3.5 Latvian laws and regulations concerning purchase prices for electric energy

The Tribunal finds it practical to give a general description of the Latvian laws and regulations pertaining to purchase prices for electric power produced in domestic cogeneration plants, and a description of the parties' differing views on the contents and applicability of some of these legislative instruments.

3.5.1 Regulation No. 54 of 14 March 1995

The system of varying multipliers was first introduced by this regulation, which reads as follows:

“1. In order to promote the production of electric power in the Republic of Latvia, these Regulations provide that the state joint stock company Latvenergo shall purchase electric power from the electric station not under the authority of Latvenergo (hereafter, the “decentralized electric stations”).

2. The purchasing price for electric power produced by decentralized electric stations, except those specified in section 3 hereof, shall correspond to the average calculated tariff for electric power sale of the state joint stock company Latvenergo.

3. The purchasing price for electric power produced by such small-size electric hydroelectric power stations (*not in excess of 2 MW*), which operate or which shall be restored by 2000, shall correspond to the double average tariff for the sale of electric power for a period of eight years from the start of operation of the respective electric station.” (Emphasis added.)

3.5.2 *The Entrepreneurial Law of 6 September 1995*

The Law of 6 September 1995 On the Regulation of Entrepreneurial Activity in Energetics (the “Entrepreneurial Law”) replaced Resolution No. 54 and extended the group of power producers to include, *inter alia*, co-generation plants. Article 27 reads in part as follows:

“Article 27. Procedure for setting tariffs.

(1) The tariffs charged for energy supply shall be calculated by an energy supply enterprise in accordance with the methodology for tariff calculation determined by the Council.

(2) The tariffs shall provide for that enterprises gain economically justified revenues from payments received from the consumers for the coverage of justified costs of energy resources production, salaries, operational and administrative costs, as well as maintenance of existing assets and new approved investments.

- - -

(9) Spare power which corresponds to the state power standard from renewable energy resources (minihydropower plants with installed capacity up to 2 MW and wind power plants), as well as from *little capacity cogeneration plants with installed capacity from 1 MW up to 12 MW* shall be purchased into the state power transmission grid at a higher tariff.

(10) The power purchase price from power plants mentioned in part 9 of this article shall correspond to *the double average sales tariff* of power and shall be valid for eight years from the starting day of operation of the power plant. After that the purchase price shall correspond to the average tariff of power.”(Emphasis added.)

The parties agree that the Entrepreneurial Law unequivocally provided for the double tariff to be paid for electric power from cogeneration plants with installed capacity from 1 MW up to 12 MW. There was no limitation with respect to the time when a purchase contract with Latvenergo must have been entered into or when the production must have started. Windau’s Contract No. 16/97 with Latvenergo expressly states that the price for electric power from Bauska shall be based on the Entrepreneurial Law.

3.5.3 *Regulation No. 23 of 10 January 1997*

On 21 December 1995, the Cabinet of Ministers submitted a draft law to the Latvian Parliament proposing to repeal, *inter alia*, Articles 27 (9) and (10) of the Entrepreneurial Law, in other words a proposal to withdraw the offer to pay the double tariff to cogeneration plants pronounced by the Entrepreneurial Law. However, the draft law was rejected by the Parliament on 25 November 1996. This notwithstanding, the Cabinet of Ministers on 10 January 1997 issued Regulation 23 with a view to amending Article 27 (9) and repealing Article 27 (10), *inter alia* to the effect that the offer to pay the double tariff contained in the Law was removed, and the authority to determine the price setting procedures was passed to the Cabinet. Upon appeal from Parliament members the Constitutional Court, by decision of 7 May 1997, found the Cabinet’s regulation to be in conflict with Article 81 of the Constitution and declared Regulation No. 23 null and void, however only as from the time of the Court’s decision. In a later decision, the Constitutional Court remarked that Regulation No. 23 was in effect when Contract No. 16/97 was signed on 25 March 1997.

3.5.4 Amendments of 11 June 1997 to Art. 27 (9) and (10) of the Entrepreneurial Law

Subsequent to the judgement of the Constitutional Court of 7 May 1997 the Parliament amended Articles 27 (9) and (10) of the Entrepreneurial Law to read as follows:

“(9) Produced spare power which corresponds to the state power standard from renewable energy resources (minihydropower plants with installed capacity up to 2 MW and wind power plants), as well as from *little capacity cogeneration plants with installed capacity up to 12 MW*= shall be purchased into the state power transmission grid at a higher tariff. These provisions on purchase of power from the cogeneration plants shall be applied to all physical persons and legal entities whose/which contract with the State Joint-Stock Company “Latvenergo” to be privatised on purchase of the power into the state power transmission grid from cogeneration plants has taken effect by May 31, 1997;

- - -

(10) The power purchase price from power plants mentioned in part 9 of this article shall correspond to *double average sales tariff* of power and shall be valid for eight years from the transferring for operation of the power plant. After that the spare power, which corresponds to the power standard established by the state, shall be purchased into the state power transmission grid at the tariffs established by the Cabinet of Ministers.”

(emphasis added)

This amendment limited the general application of the double tariff to cogeneration plants where its power purchase contract with Latvenergo “has taken effect by May 31, 1997”. As will be further explored below, Latvenergo and Windau had entered into a contract on 1 July 1996 concerning the installation of a cogeneration plant at Bauska. The contract stipulated that “(t)his Contract shall come into force from the moment when the cogeneration equipment is installed and the Deed of Conveyance signed”. That contract was however replaced by the above-mentioned new Contract No. 16/97 of 24 March 1997, which stipulated that “(t)his Agreement shall take effect as of the date of its signing”. The Claimant has explained that the new contract was negotiated and signed in anticipation of the limitation enacted on 11 June 1997. The Respondent has not denied that the new contract ensured Windau’s continued right to the double tariff also under the Entrepreneurial Law as amended.

3.5.5 The Energy Law of 3 September 1998

The Power Industry Law (the “Energy Law”) was adopted on 3 September 1998 and came into force on 6 October 1998. It repealed the Entrepreneurial Law from the date when the Energy Law was taking effect.

The Energy Law contained no specific provision concerning the use of the double tariff. The right to the double tariff was not repeated for any category of electric power plants in the new law, nor were there any transitory provisions upholding this right for those who were ensured the double tariff under the Entrepreneurial Law as amended in 1997, hereunder the cogeneration plants which had obtained a contract with Latvenergo effective before 31 May 1997 (see section 3.5.4 above).

However, Article 41 provides as follows:

“The Cabinet of Ministers shall determine a common procedure by which licensed electric power supply enterprises must buy up surplus electric power produced which remain after usage for self-needs and in compliance with the electric power parameters determined within the state, from co-

generation stations located within the zone of activity of their license and *the exploitation of which has been started.*” (Emphasis added.)

It is undisputed that this article, authorizing the Cabinet of Ministers to determine common procedures, including price setting for electric power from cogeneration plants, draws a distinction between two categories of plants, depending on the starting point for exploitation. Thus, it is undisputed that the law authorizes the Cabinet to determine procedures for one but not for the other category of cogeneration plants.

However, the parties disagree as to the interpretation and application of Article 41. The *Claimant* contends that the provision applies only to cogeneration plants that had started production at the time of the enactment of the Energy Law, and consequently does not apply to the Bauska plant, which was only ready for production in September 1999. And since the Energy Law does not otherwise open for the determination of tariffs and multipliers this means, in the Claimant’s view, that for cogeneration plants starting after the Energy Law came into force the Entrepreneurial Law (as stipulated in Contract No. 16/97) must still regulate the purchase price-to be paid, even though the Entrepreneurial Law itself was declared to be null and void and no longer in force as from 6 October 1998.

The *Respondent* contends that the correct translation of the expression emphasized above is “the exploitation of which *has not yet started*”. It has submitted a letter dated 17 September 2003 from the legal bureau of the Latvian Parliament, citing and commenting upon the Latvian words used in the law text and in the parliamentary debate, and expressing as its opinion that according to the Latvian wording of Article 41 of the Law means to apply to cogeneration plants the operation of which will be started, *i.e.*, to new cogeneration plants.

The *Arbitral Tribunal* is satisfied, upon the presented evidence of the meaning of Article 41 in its Latvian original, that the authority of the Cabinet to determine the procedures concerning cogeneration plants according to Article 41 was limited to plants which were starting its production after the enactment (or the coming into force) of the Energy Law.

The Tribunal may add that this understanding is also supported by the logic of the choice. It appears less logical to the Tribunal that the new law should only allow for the determination of new procedures for cogeneration plants already in operation, presumably with established prices and conditions, while not authorizing the Cabinet to determine prices and procedures for new cogeneration plants coming into production after the new law. It appears more logical, taking into account that the legislators wished to limit the authority to determine procedures, that the setting of new procedures was authorized for cogeneration plants not yet in operation while the legislative authority was not extended to plants already established and operating. This limitation of the Cabinet’s power might even be seen as the legislator’s will that plants already in operation shall not be subjected to new price setting procedures.

In consequence of the Claimant’s view that Article 41 only applies to cogeneration plants having started production before the Energy Law was enacted (or came into force), the Claimant draws the conclusion that Regulation No. 425 of 31 October 1998 and Resolution No. 9 of 8 January 2002 issued pursuant to Article 41 (see sections 3.5.6 and 3.5.9 below) do not apply to the Bauska production. The Respondent draws the conclusion that Article 41 authorizes the Cabinet to determine new procedures for cogeneration plants not yet in

production, including the Bauska plant, without any limitation with regard to upholding the right to the double tariff ensured under the Entrepreneurial Law.

3.5.6 Regulation No. 425 of 31 October 1998

On 31 October 1998 the Cabinet of Ministers issued Regulation No. 425 pursuant to Article 41 of the Energy Law, effective as from 4 November 1998.

The Regulation reads in part:

“These Regulations stipulate:

1.1. that licenced electric power supply enterprises shall have the obligation to purchase generated surplus electric power ... from the cogeneration stations starting their operation ..., with the installed electric capacity ... *not in excess of four MW*;

1.2 the procedure in which licenced electric power supply enterprises shall purchase electric power surplus from cogeneration stations with electric capacity not in excess of four MW.

2. If electric power surplus is purchased from *cogeneration stations with capacity not in excess of four MW*, the purchase tariffs shall be determined based on the value of the average electric power sale tariff (Tv). The Purchase tariff shall change depending on the value of the average electric power sale tariff (Tv), approved by the Energy Supply Regulation Council and which has been published in the newspaper of Latvijas Vestnesis.

4. If surplus electric power is purchased from co-generation stations with *capacity from 0,5 MW to four MW*, the purchase tariff (Tie) shall be determined depending on the type of fuel used in the technological process of the production:

4.1. Tie = 0,95 TV, if local fuel is used

4.2 Tie= 0,75 Tv, if imported fuel is used”

(Emphasis added.)

The Regulation makes no exception for cogeneration plants which had obtained agreements with Latvenergo before 31 May 1997 and therefore had been ensured the double tariff under the Entrepreneurial Law as amended. The parties agree that this Regulation by its wording expressly prescribes the use of a 0.75 multiplier for this category of cogeneration plants, and thereby expressly abolishes the mandatory use of the double tariff prescribed by the Entrepreneurial Law as amended. But the Claimant contends, as already mentioned, that this new multiplier does not apply to the Bauska plant since Article 41 of the Energy Law did not apply to cogeneration plants not yet in operation, while the Respondent contends – and for that matter procedurally admits – that the applicable multiplier in the case of Bauska was reduced from 2 to 0.75 by this legislative act by the Cabinet.

3.5.7 Resolution No. 67 of 30 November 1999

After a meeting on 29 October 1999 between the Prime Minister of Latvia and the ambassadors of Germany and Sweden, and representatives of Noell and Windau, the Cabinet of Ministers on 30 November 1999 issued the following Resolution:

“1. According to Clause 8, part four, of the Law “On Foreign Investment in the Republic of Latvia”, the Privatization Agency shall ensure conclusion of an agreement between the State Joint-Stock Company under Privatization “Latvenergo” and the Limited Liability Company “Windau” on purchase of surplus electric power, produced by Bauska cogeneration station and meeting electric

power parameters established in the State, transmitted to the electric power distribution grid, for *a price equal to the double average tariff* of electric power sale for eight years after the corresponding power station is commissioned.

2. The Minister of Economy V. Makarovs shall inform the Ambassador of the Kingdom of Sweden about the decision passed.

3 The Ministers, whose Ministries organize tenders for issue of licenses, shall pay special attention to the provisions of the Law “On Foreign Investments in the Republic of Latvia.”

(Emphasis added.)

The Latvian Law on Foreign Investments is dated 5 November 1991. Clause 8.4 reads as follows:

“8.4. In the event, that future laws of the Republic worsen the investment conditions, a foreign investment shall be subject to the laws which were in effect on the date the investment was made.”

Again, the decision of the Cabinet was appealed to the Constitutional Court, which on 24 March 2000 ruled that Section 1 of the decision was null and void from the moment of its adoption. One reason given was that the first foreign investments in Windau were registered only on 24 October 1997 and that Clause 8.4 therefore could not be applied to the case. It also found that “the validity of [the agreement of 26 March 1997] is a dispute of civil legal character, which must be settled in a court of general jurisdiction”. The Tribunal notes that this attempt by the Cabinet to safeguard Windau’s rights was unsuccessful, a main reason being that the Latvian Law on Foreign Investment was inapplicable. No position appears to have been taken by the Constitutional Court as to Windau’s right to the double tariff, which obviously was the basis for the Cabinet’s action.

3.5.8 Amendment of 1 June 2001 to Article 41 of the Energy Law

On 1 June 2001 Article 41 of the Energy Law was amended to read as follows:

“1. The Cabinet of Ministers stipulates common requirements to co-generation plants with respect to their operation mode, reliability and efficiency, as well as the common procedure in which, depending on the type of fuel and efficiency, *the price for the surplus electricity* that is left after consumption for own needs and is purchased from co-generation plants that correspond to the requirements stipulated in this Article shall be determined.

2. The procedure stipulated in Paragraph One of the current Article shall not apply to producers who, *by 1 June 2001, have received a license for electricity generation and have commenced the operation* of these plants and equipment within the term stipulated in the license.”

(Emphasis added)

By this amendment the Cabinet’s authority under Article 41 apparently was excluded for cogeneration plants that had received a license and had commenced their operations before 1 June 2001. This wording of the law apparently excluded the Bauska plant, which had received its license on 4 April 1999 and started operation on 28 February 2000. But there is no indication in the amendment law, or other documented material, whether this new limitation of the Cabinet’s authority under Article 41 should have the effect of a corresponding limitation of Regulation No. 425 of 31 October 1998 issued under Article 41 in its original wording (see section 3.5.6 above), nor have the parties commented on this particular question. As will be seen in section 3.5.9 below, resolution No. 425 was

formally repealed on 8 January 2002, and then replaced by a provision again determining 0.75 to be the multiplier applicable to plants like the Bauska plant.

3.5.9 Regulation No. 9 of 8 January 2002

Regulation No. 9 of 8 January 2002 repealed Regulation No. 425 of 31 October 1998, and stated in its section V. Price determination, *inter alia* the following:

“20. If the electrical capacity installed is more than 0.5 megawatts, but does not exceed four megawatts and fossil fuel has been utilized in its production process, the price for the purchase of surplus electricity shall be determined by applying the coefficient 0.75 to the average sales tariff in the operating area of the relevant system operator’s licence.”

This Regulation was also issued pursuant to Article 41 of the Energy Law, evidently then in its amended version. As mentioned above, the Claimant contends that this regulation is not applicable to the Bauska plant since Article 41 is not applicable.

3.5.10 Conclusions as to the legislative acts

The development with regard to regulation of purchase prices for electric power from cogeneration plants bears witness of a development from an initial broad-sweeping offer in the 1995 Entrepreneurial Law of the double tariff as an investment incentive, towards a gradual limitation and eventually the abolishment of the double tariff as a mandatory incentive prescribed by statute.

There is agreement between the parties that the double tariff was unequivocally set down by the Entrepreneurial Law in 1995, with a legal obligation for Latvenergo to apply it in its purchase contracts for power plants covered by the law. With the exception of an interim period from 10 January to 7 May 1997, see section 3.5.3 above, the double tariff for certain power plants was in force at least until the Energy Law came into force on 6 October 1998. The Claimant contends that Windau continues to have the right to the double tariff, since the transitory provisions of the Energy Law and subsequent regulations emanated in pursuance of that law do not apply to cogeneration plants coming into production after the enactment of the Energy Law. The Respondent contends, and the Arbitral Tribunal accepts upon the evidence presented, that the categorical application of the double tariff was repealed by the Energy Law and replaced by the subsequent Regulation No. 425 of 31 October 1998, the latter replaced by Regulation No. 9 of 8 January 2002 again determining the multiplier to be 0.75 for plants like the Bauska plant.

3.6 Agreements concerning purchase prices for electric energy

The Tribunal also finds it practical to give a description of contracts entered into by Latvenergo with Windau and others. The agreements presented in this arbitration suggest a system of specific contracts between Latvenergo and prospective producers and sellers of electric power within Latvia; first, a relatively short master agreement setting out the sellers obligation to build the plant and to sell the electric power not needed for its own production, and Latvenergo’s obligation to buy the produced electricity, always stipulating the purchase price with reference to relevant Latvian laws and regulations, and, secondly, a more detailed off-take contract, stipulating mostly technical details. According to the Respondent such off-take contracts were consistently entered into by Latvenergo only at

the point in time when the producer had completed its installations and was ready to start production.

As a general background for the dispute concerning the price and *force majeure* clauses in the Windau agreements a description is given below of such clauses in the purchase agreements documented in this arbitration.

3.6.1 *The Liepājas Siltums agreement of 4 April 1995*

The first purchase contract documented in this arbitration is an Agreement of 4 April 1995 between Latvenergo (referred to in the agreement as the “Energy System”) and the joint stock company Liepājas Siltums concerning a cogeneration plant with electric power of 4.9 million kWh. The Agreement contains the following clause:

“5. The Energy System shall pay to the Cogeneration Station for the balance of electric power delivered by the Cogeneration Station to the Energy System’s grid according to Regulations No. 54, issued by the Republic of Latvia Cabinet of Ministers on 14.03.95.”

On 1 January 1996, after Regulations No. 54 had been replaced by the Entrepreneurial Law (see sections 3.5.1 and 3.5.2 above), the parties entered into a supplemental agreement replacing *inter alia* the above-mentioned Clause 5:

“1. From the day of signing this Agreement, [the Parties have agreed] to change and express in the following wording the following Clauses:

Clause 5:

As from 10 January 1996 and until the end of the term of this agreement, the Energy System shall pay to the Cogeneration Station for the balance of electric power delivered by the Cogeneration Station to the Energy System’s grid according to the double calculated average sales tariff for electric power of VAS “Latvenergo” (or its legal successors).

As for 1996, the double average sales tariff for electric power of VAS “Latvenergo” has been mutually agreed in Supplement No. 1 to this Agreement of 01.01.1996, it is 0.048 Ls per 1 kWh.

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3.6.2 *The Windau contract of 1 July 1996 Bauska*

In the contract of 1 July 1996 between Latvenergo and Windau, the first contract concerning the Bauska plant, the price clauses read as follows:

“II. Price

Price for the electric power is defined in lats according to double average electric power sales tariffs on the basis of the Republic of Latvia Law “On Regulation of Entrepreneurial Activities in Energy Industry”.

Prices are fixed in Supplement No. 1, which is an integral part of this Contract.

V. Liability

The Parties shall be released from liability for violation against their contractual obligations, if it has been caused by force majeure conditions – changes in the legislation and decisions of the Government, earthquake, war, floods, etc.

VI. Additional provisions

If the average electric power sales price changes, changes shall also be made in prices defined in this Contract.

--"

The Supplement No. 1 referred to reads:

"The Seller shall sell the excess electric power to the Buyer for the price 0.052 Ls/kWh."

3.6.3 The Windau contract No. 16/97 of 24 March 1997 Bauska

In Contract No. 16/97 of 24 March 1997 that replaced the contract of 1 July 1996 the price clause reads as follows:

"II. PRICE

Price for electric power shall be stated in lats, based on of the Republic of Latvia law "On Regulation of Entrepreneurial Activity in Power Industry".

V. RESPONSIBILITY

The parties shall be released from responsibility for breach of obligations under this Agreement, if the reason for such breach is the so-called FORCE MAJEURE circumstances – changes in laws and resolutions of the Government, earthquakes, war, floods, etc.

VI. ADDITIONAL PROVISIONS

Upon change of average sale price of electric power, also the prices under this agreement shall be changed."

3.6.4 The Windau contract No. 17/97 of 24 March 1997 Jelgava, Dobele and Iecava

In the Contract No. 17/97 of the same date as Contract No. 16/97, concerning cogeneration plants in Jelgava, Dobele and Iecava, the price clauses reads as follows:

"2. Contract price

The price for electric power shall be established in lats on the basis of the law "On the Regulation of Entrepreneurial Activities in the Energy Sector" of the Republic of Latvia.

5. Liability of the Parties

The Parties shall not be liable for the infringement of any provision of this Contract if such infringement is caused by force majeure, i.e. amendments to legislative regulations, government resolutions, earthquake, war, flood, etc.

6. Additional conditions

If the average sales price of electric power changes, the Contract price shall be modified accordingly.

--"

3.6.5 The Windau contract No. 18/97 of 26 March 1997 12 cogeneration plants

In the Contract No. 18/97 signed two days later, on 26 March 1997, concerning the set up of 12 cogeneration plants in (unspecified) towns in Latvia, the purchase price was determined as follows:

"2. Purchase Price

Surplus electric power shall be purchased for the price, which is effective in Latvia on the specific date of purchase."

5. Force majeure

The parties shall be fully or partially released from responsibility, if Force Majeure circumstances have occurred, moreover, if such circumstances have occurred after the execution of relevant agreements and the parties could neither foresee nor influence them.

The parties acknowledge that Force Majeure circumstances include resolutions of the Parliament and the Cabinet of Ministers which eliminate or materially affect the performance of the agreements, natural catastrophes – floods, fire and rebellions. - - -“

3.6.6 *The Latelektro-Gulbene letter of intent of 19 May 1997*

Concerning another cogeneration plant, “Latelektro-Gulbene”, an agreement called a “letter of intent” was entered into on 19 May 1997, in which the parties *inter alia* agreed as follows:

2. ... “Latvenergo” agrees:

2.1 - - -

2.2 To pay the invoices for the electric power produced once every month according to the tariff defined in the law. ...”

The Arbitral Tribunal notes that this plant was granted its production license on 3 April 1997, the same date as the Bauska plant was granted its production license, and the letter of intent, similar to the new Contract No. 16/97 for Bauska, was entered into shortly before the adoption on 11 June 1997 of the amendment to the Entrepreneurial Law providing that only agreements being effective before 31 May 1997 would continue to benefit from the double tariff.

See also section 3.6.8 below.

3.6.7 *The Latvenergo – Windau agreement of 10 March 2000*

As already mentioned, the Bauska plant was ready for production on 17 September 1999, but Latvenergo refused to enter into an off-take agreement, and production was not commenced, apparently due to the dispute over the multiplier to be used in determining the purchase price. On 30 November 1999 the Cabinet had issued Resolution No. 67 in support of the double tariff. The Resolution was however appealed to the Constitutional Court, see section 3.5.7 above.

With this as a background, operation was started 28 February 2000 and on 10 March 2000, the parties entered into a detailed off-take agreement. With respect to the purchase price for electric energy this agreement provided as follows:

“2. Purchase Price and Sale Price of Electric Energy.

2.1 Latvenergo shall buy from Windau the surplus electric energy generated in cogeneration regime pursuant to requirement of the issued license, after satisfaction of Windau’s own needs (power surplus transmitted to the power system network) and which energy corresponds to parameters specified in the country, at the following price:

(a) until the judgment of the Constitutional Court in respect of the case relating to the acknowledgement as being invalid of Section of the November 30, 1999 protocol decision the Cabinet of Ministers, Latvenergo shall buy from Windau and pay for the electric energy generated at the power plant pursuant to the formula $Tie = 0.75 Tv$...the difference ... shall be paid by

Latvenergo ... to the escrow account at A/S Vereinsbank Riga, which shall be used pursuant to the following conditions:

i in the event that the Constitutional Court acknowledges Section 1 of the November 30, 1999 protocol decision of the Cabinet of Ministers to be valid, this money shall be immediately transferred into the bank account of Windau at the S/S Vereinsbank Riga;

ii ...

(b) after the judgment of the Constitutional Court, Latvenergo shall buy from Windau and pay for the surplus electric energy generated at the power plant for the period of eight years after the commissioning of the Windau cogeneration plant in Bauska, in the following amount

i if by virtue of the judgment of the Constitutional Court, the November 30, 1999 decision of the Cabinet of Ministers or Section 1 thereof will remain effective, the purchase price from the cogeneration plant in Bauska shall be calculated pursuant to the formula $Tie = 2.0 Tv$;

ii if by virtue of the judgement of the Constitutional Court, the November 30, 1999 protocol decision of the Cabinet of Ministers or Section 1 thereof will lose effect, the purchase price from the cogeneration plant in Bauska shall be calculated pursuant to the formula $Tie = 0.75 Tv$.

2.2 The parties mutually agree that irrespective of adoption of any judgment of the Constitutional Court, either party shall be entitled to submit its objections or claims in respect of the purchase price of electric energy stated in Section 2.1 (b) of this Agreement in the manner prescribed by law, and the parties agree that in the event that following the review of such objection or claim, the decision adopted by court differs from the provisions of Section 2.1.(b), the purchase price, determined pursuant to this court decision shall further be applied.

...”

7. Force Majeure

7.1 The Party referring to Force Majeure circumstances as a hindrance for the performance of its obligations ... shall give notice thereof ... within three calendar days

7.2 If either Party fails to perform its obligations in accordance with this Agreement due to Force Majeure, it shall be released from responsibility”

The Arbitral Tribunal notes that the *force majeure* clause in this contract does not define or exemplify what is to be considered as force majeure.

3.6.8 *The Latelektro-Gulbene agreement of 30 October 2001*

The Latelektro-Gulbene plant went into operation on 6 March 1998 but was disconnected from the grid in July 1998 because Latvenergo refused to pay the double tariff prescribed in the Entrepreneurial Law. In October 1998 Latelektro-Gulbene Ltd. filed a claim for the double tariff against Latvenergo in the Riga Regional Court, and won by the court's judgement of 16 December 1998. The decision was appealed, but was confirmed by an appellate court on 30 March 1999 and by the Latvian Supreme Court by a decision of 30 June 1999. All the courts found that the letter of intent of 19 May 1997 constituted a legally binding contract and that it unequivocally stipulated that the double tariff was to be paid in the eight years' period from the commissioning of the plant, by referring to the law in force at the moment of signing the contract. The Tribunal notes that all three court decisions were rendered after the Energy Law had been enacted and had come into force on 6 October 1998.

Following the Supreme Court decision Latvenergo accepted the double tariff and entered into a new agreement with Latelektro-Gulbene dated 30 October 2001. The purchase price is not specifically defined, but the double tariff in the first eight years is clearly assumed in clause 10.3:

“7. Force Majeure

7.1 None of the Parties shall be held liable if the performance of any provision hereof is delayed or made impossible by any natural or man-made calamities, by mass disorders, war, riots, as well as action of state authorities or any other condition beyond the control of the Party whose obligations are affected by it, which the Parties could not anticipate, while making this Agreement, and which the Parties are unable to prevent by using reasonable methods available to them.

7.2 The Party, which refers to force majeure conditions ... shall report about it ... not later than within three calendar days ...

- - -

10. Term of Agreement

10.1 The Parties agree that this Agreement shall be in force for an undetermined period of time, subject to Clause 10.3 hereof.

10.3 If the Parties do not agree on a new purchase price for electric power by 6 March 2006, when the duty of Latvenergo to buy electric power for the double tariff expires, then this agreement shall lose its legal force at the moment when the said term expires.”

3.7 The legal significance of the price and force majeure clauses

Although the wording of the agreements varies, the purchase agreements documented in this arbitration all have the same general structure: The seller undertakes to install the power plant(s) and to sell to Latvenergo its surplus power (that is, produced power beyond what is needed by the seller for its own production), and Latvenergo undertakes to purchase the surplus power on the basis of tariffs stipulated by law.

Apart from specifying in a couple of the contracts the precise tariff to be paid in the current year, all contracts consistently refer to actual laws and regulations as determining the price to be paid and do not stipulate prices other than those deriving from legislation and administrative decrees. None of the contracts suggests that Latvenergo has had the authority or even the intention to deviate from what follows from laws and regulations, and Latvenergo has expressly denied having any such authority. Thus, in a letter to Windau of 20 March 1998 Latvenergo stated that

“...the law regulates purchase of power from cogeneration stations and it is a state regulated business. At the moment determining a different purchase price would be a violation of the given law”.

However, as may be derived from the court decisions in the Latelektro-Gulbene case, the price clauses in the purchase contracts are not merely references to Latvian laws and regulations at any time, but these clauses are deemed by the highest legal authority, the Latvian Supreme Court, to be legally binding contractual obligations under Latvian law. And specifically, the contracts are to be interpreted as fixing the multiplier in effect at the moment of signing the contract. The situation thus documented are facts interpreted by the Latvian courts concerning the Latvian legal situation that can be taken into regard by this Tribunal, without any need for the Tribunal to embark on any interpretation or application of Latvian national law on its own.

The Tribunal will add that there are several other circumstances that support the understanding of the purchase agreements set down by the Latvian Supreme Court. One is that several of the agreements make express reservations for changes of the tariff for average sale prices but not for changes of the multiplier. Such reservations would be

superfluous if the contract was to be understood merely to refer to laws and regulations at any time, and do support the impression that the multiplier was unreservedly granted for the eight years as stipulated in the Entrepreneurial Law. Another is that the offering of an investment incentive to prospective investors for a period of eight years would naturally be perceived by investors as a firm commitment for the full eight year period unless clear reservations were made to the contrary.

3.8 *The purchase price agreed between Latvenergo and Windau*

a) Following the legal findings of the Latvian Supreme Court in the quite similar Latelektro-Gulbene case there can be no doubt that Contract No. 16/97 of 24 March 1997 stipulated the purchase price for electric power from the Bauska plant to be the double tariff for a period of eight years from the time when Windau was ready to start production and had been commissioned.

b) However, the *Respondent* has contended that the *force majeure* clause in Contract No. 16/97 expressly makes reservations for new laws or regulations, which may alter the parties' rights or obligations under the contract. The *Claimant* denies that the clause can be read to this effect.

The *Arbitral Tribunal* considers that it would not be an evident conclusion of the unspecific reference to new legislation in the *force majeure* clause in Contract No. 16/97 that the legislator should be free to revoke the double tariff commitment, leaving the investor with no protection against a reduction or abolishment of this investment incentive. In particular, the structure of Contract No. 16/97, setting out in Article V a general reservation for changes in the legislation, immediately followed by a specific reservation in Article VI for changes of the "average sale price of electric power" (but thus not in the multiplier), strongly supports that changes affecting the price setting were not meant to be included in the *force majeure* clause. The Latvian Supreme Court decision in the Latelektro-Gulbene case, pronouncing that the purchase price (except for changes in the average tariff) is to be the one following from laws and regulations in force at the time of signing the contract, also gives strong support to the conclusion that the contractually stipulated multiplier may not be changed by means of the general reservation in the *force majeure* clause in Contract No. 16/97, even if the Gulbene letter of intent did not contain a similar general reservation against changes in the legislation. – As will be seen from the quotations above, the Latvenergo – Windau contract of 10 March 2000 does not contain any definition of *force majeure* which includes later changes in the legislation.

c) Further, the *Respondent* contends that Contract No. 16/97, including its agreement on the purchase price, was replaced by the agreement of 10 March 2000 (see section 3.6.7 above), fixing the multiplier at 0.75 after the Constitutional Court's decision. The *Claimant* contends that the 10 March 2000 agreement was a purely interim agreement, entered into under a certain degree of duress and in order to get out of the loss-producing standstill situation while waiting for the Constitutional Court's decision.

The *Arbitral Tribunal* notes that, after Windau was ready to start production on 17 September 1999 and the price dispute had emerged in full, Latvenergo sent Windau the following letter dated 27 September 1999:

"Subject: On signing the interim agreement

During the negotiations in the Privatization Agency Latvenergo orally expressed you an offer to sign an interim agreement until our disagreement in the matters related to the purchase of the produced surplus power is solved.

Taking into account the tense course of the negotiations, the oral offer as if did not receive the necessary attention.

Therefore we repeatedly offer you to sign an **interim agreement** on purchasing surplus power from the station and on supplying power to the station from Latvenergo, determining the precise term for such an agreement. ...

We understand that a station, which has been launched, has to start operating as soon as possible and this is exactly the reason for our proposal. Understanding your concern, we can include in the agreement the provision that the agreement shall not be in any way related to the previous or future relationship between Latvenergo and 'Windau Ltd'."

The Tribunal further notes that the agreement of 10 March 2000 itself does not state whether it is an interim agreement, or whether it constitutes a replacement of or a supplement to Contract No. 16/97. But the agreement states in clause 10.1 that its term of validity shall not be limited, and in clause 10.2 that the validity of the agreement shall depend on the validity of the licenses issued to the parties.

With regard to the clauses regarding the purchase price to be paid, the agreement stands out as an interim agreement concerning what payments shall be made in the period until the price dispute has been settled. The parties agree (see section 2.1 of the agreement) that up to the time of the Constitutional Court's decision payment shall be made at 0.75 of the tariff, with an immediate correction of the payment up to the double tariff if the Constitutional Court decides the issue before it in favour of the Claimant. And for the time after the Constitutional Court's decision, payments shall be at the double tariff if confirmed by the Constitutional Court but otherwise be based on the 0.75 multiplier, in both cases until such time as the price dispute is settled "in the manner prescribed by law". See section 2.2.

Section 2.2 of the agreement expressly stipulates that either party shall be entitled to submit its objections or claims in respect of the prices payable under the payment arrangement in section 2.1, irrespective of the adoption of any judgement of the Constitutional Court. This must reasonably be interpreted to mean that the price and payment clauses in the agreement constitute no change in the parties' claims and material basis with regard to the long-term price to be paid. In the Tribunal's opinion this confirms that Contract No. 16/97 was not revoked or replaced by the new agreement.

As mentioned above, for the period up to the decision of the Constitutional Court, the agreement makes it clear that the payment at 0.75 is an interim payment arrangement, with the payments to be corrected up to the double tariff if that would follow from the Court's decision. For the period from the Constitutional Court's decision up to the time when the dispute is settled "in the manner prescribed by the law", the interim payment is also to be at 0.75 of the tariff (unless otherwise determined by the Constitutional Court), but the agreement does not state expressly whether the interim payments are to be corrected, provided that the subsequent legal decision concludes that the correct payment according to Contract No. 16/97 is the double tariff. The Tribunal has considered whether the agreement must be interpreted as establishing that the interim payments shall be final. In other words, whether a legal decision establishing that Contract No. 16/97 determines the price to be the double tariff is only to take effect from the time of the legal decision, in the present case only from the time of this arbitration award. However, the agreement's clear

stipulation that the parties maintain their rights to pursue their claims under Contract No. 16/97 and obtain a legal decision without any limitation created by the agreement of 10 March 2000, leads the Arbitral Tribunal to the conclusion that also the agreement for the period after the Constitutional Court's decision is only an interim payment arrangement, with the payments to be corrected in accordance with the subsequent legal decision.

The Arbitral Tribunal therefore concludes that the agreement of 10 March 2000 is an interim agreement for the payments to be made during an unspecified period until the price dispute can be finally settled, making no changes with regard to the purchase price ultimately payable under Contract No. 16/97.

d) The *conclusion* must consequently be that the contractually agreed purchase price between Latvenergo and Windau for electric power from the Bauska plant shall be the double tariff for a period of eight years from the time when Windau was ready to start production and the plant had been commissioned.

4 The legal basis for the claims against the Republic

4.1 Introduction

The Claimant's claims are based on the undisputed fact that the start-up of production at the Bauska plant was delayed from 17 September 1999 until 28 February 2000, apparently due to Latvenergo's refusal to pay the double tariff for electric power from the Bauska plant, and due to the undisputed fact that all electric power delivered after the start-up on 28 February 2000 has only been paid at 0.75 of the average tariff.

The Arbitral Tribunal holds, and the parties seem to agree, that for the Republic to be held responsible in this arbitration the following conditions must be satisfied:

- a) The non-payment must be caused directly by the Republic or a state organ, or Latvenergo's actions in the contractual relationship with Windau must be attributable to the Republic;
- b) The non-payment and the circumstances around such non-payment must constitute a violation of an obligation under Part III of the Treaty; and
- c) The non-payment of the double tariff must have caused loss or damage to the Claimant's investment.

The condition under lit. c) will be dealt with under section 5 below.

4.2 The Republic's responsibility for the non-payment

As concluded in sections 3.5.10 and 3.8.d above, the Arbitral Tribunal considers that Windau originally had both a statutory and a contractually established right to the double tariff for an eight year period.

It is conceded by the Respondent that the Entrepreneurial Law in force at the time of Latvenergo and Windau entering into Contract No. 16/97 on 24 March 1997 gave Windau a *statutory right* to the double tariff during the first eight years of production. The Respondent has also conceded that Windau's acquired statutory right to the double tariff was taken away by successive legislative acts, first, possibly, with the amendment to the Entrepreneurial Law of 11 June 1997 (see section 3.5.4), then definitely by the repeal of the Entrepreneurial Law by the Energy Law with effect from 6 October 1998 and the Cabinet of Ministers' Regulation No. 425 of 31 October 1998 (see sections 3.5.5 and 3.5.6 above). These are acts for which the Republic is directly responsible.

With regard to a *contractually established* right to the double tariff the Arbitral Tribunal concludes that by entering into Contract No. 16/97 Latvenergo also gave Windau a contractual right to the double tariff for eight years, see section 3.8.d above. It is not contested that Latvenergo has never paid the double tariff for electricity delivered by Windau.

No explicit explanation or documentation has been given as to the reasons for Latvenergo's refusal to pay the double tariff, but apparently the immediate reason for Latvenergo's refusal to pay was the repeal of the statutory right to the double tariff. It is in evidence that Latvenergo had no authority of its own to decide or negotiate purchase prices for electric power produced in Latvia. The average price tariff at any time was determined by regulatory authorities, and the so called multipliers were determined by law, or according to law, with an obligation for Latvenergo to apply the relevant tariff and the multipliers determined by the public authorities. Failing any indication to the contrary, it may be assumed that Latvenergo felt it to be its duty to deny Windau the double tariff after the legislators' decision to repeal Windau's established statutory right to the double tariff.

However, Latvenergo must have been aware that Windau in all likelihood had a contractual right to the double tariff. As mentioned above, the Latvian Supreme Court in a judgement of 30 June 1999 decided, in the quite parallel case of Latelektro-Gulbene, that Latvenergo had a contractual obligation to pay according to the multiplier in force at the time of entering into the agreement, regardless of later changes in the legislation. Latvenergo also signed a new contract with Latelektro-Gulbene confirming payment of the double tariff during the eight year period.

The central government of Latvia was also fully aware of Latvenergo's refusal to pay the double tariff. After a meeting with the Prime Minister on 29 October 1999 the Cabinet of Ministers on 30 November 1999 issued a Resolution ordering the double tariff to be paid to Windau (see section 3.5.7 above). As explained, the Resolution was later invalidated by the Constitutional Court for constitutional reasons, but the incident is evidence of the central government's full knowledge of Latvenergo's failure to pay the double tariff. There is no evidence of the government taking any further steps to protect Windau's rights under the contract, or to reinstate Windau's statutory right to the double tariff, for instance in accordance with the Republic's obligations to protect foreign investments under the Energy Charter Treaty, see section 4.3.2 below.

It must therefore be concluded that the breach of Windau's contractual rights was allowed to continue, and in that sense was caused, by the government's failure to act in order to correct the situation.

The Arbitral Tribunal is also of the view that in the circumstances of this case, the Republic must be considered responsible for Latvenergo's actions under the rules of attribution in international law.

Latvenergo was established in 1991 as a state enterprise, and was in 1993 transformed into a joint stock company with the Republic as a 100 per cent owner. For a while the plans were to privatize the company, and the company was administered by the Latvian Agency for Privatization. But by a change in the Energy Law on 3 August 2000 it was decreed that:

“As a national economy object of the State importance, the Joint Stock Company “Latvenergo” shall not be privatized. All shares in the Joint Stock Company “Latvenergo” are owned by the State.”

By order of the Cabinet of Ministers of 9 August 2000 the supervision of the company was transferred to the Ministry of Economy.

Both before and after these organizational changes Latvenergo held a dominant position as a major domestic producer of electric power and as sole distributor of electricity over the national grid. It was clearly an instrument of the State in a highly regulated electricity market. In the market segment where Windau operated, Latvenergo had no commercial freedom. It had no freedom to negotiate electricity prices but was bound, and considered itself to be bound, by the legislation and the regulatory bodies' determination of the purchase prices to be paid for electric power produced by cogeneration plants. Latvenergo cannot be considered to be, or to have been, an independent commercial enterprise, but clearly a constituent part of the Republic's organization of the electricity market and a vehicle to implement the Republic's decisions concerning the price setting for electric power.

For this reason, whether Latvenergo's refusal to pay the double tariff was based on a misunderstanding of the legal situation, or whether it for other reasons ignored the legal framework under which it was operating, its actions concerning the purchase price are attributable to the Republic. Consequently, the Republic must be found responsible for Latvenergo's failure to pay the double tariff. – The Tribunal will add that for this finding it is not necessary to rely on the supplemental rule in Article 22 (1) of the Treaty contended by the Claimant (see section 4.3.1 below).

4.3 Violations of Treaty obligations

The *Claimant* alleges that the non-payment of the double tariff constitutes violation of several of the provisions of Article 10 of the Treaty, and also amounts to expropriation, or having an effect equivalent to an expropriation, as defined in Article 13 of the Treaty. It also relies on Article 22 (1) of the Treaty.

These Articles read in part:

“ARTICLE 10 PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS

(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favorable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such

Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favorable than that required by international law, including treaty obligations. Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.

- - -

(3) For the purposes of this Article, "Treatment" means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.

- - -

(7) Each Contracting Party shall accord to Investments in its Area of Investors of other Contracting Parties, and their related activities including management, maintenance, use, enjoyment or disposal, treatment no less favourable than that which it accords to Investments of its own Investors or of the Investors of any other Contracting Party or any third state and their related activities including management, maintenance, use, enjoyment or disposal, whichever is the most favourable.

- - -“

“ARTICLE 13 EXPROPRIATION

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:

- (a) for a purpose which is in the public interest;
- (b) not discriminatory;
- (c) carried out under due process of law; and
- (d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date"). - - -“

“ARTICLE 22 STATE AND PRIVILEGED ENTERPRISES

(1) Each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of this Treaty..

- - -”

With reference to these Treaty provisions the Claimant mainly contends that:

- Windau is subject to a treatment having an effect equivalent to expropriation;
- The Republic fails to accord fair and equitable treatment of investments and constant protection and security of such investments;
- The failure to pay the double tariff represents discrimination, and a violation of the obligation to most-favoured nation's treatment; and
- Latvenergo is under both statutory and contractual obligation to purchase electric power from the Bauska plant at the double tariff, and the Republic is, pursuant to

Article 10 (1), under a duty to observe obligations that it has entered into, including obligations entered into by Latvenergo.

The *Respondent* denies for a number of reasons that the Respondent is in breach of any obligations under the Treaty, mainly contending that Latvenergo is a separate legal entity for which the Republic is not responsible, and that the scope of the asserted Treaty provisions are limited as set out in section 2.5 above.

4.3.1 Expropriation

The *Claimant* does not contend that the non-payment of the double tariff amounts to a direct and formal expropriation meeting the requirements of Article 13 (1) (a)-(c), but rather that it constitutes an “indirect” or “creeping” expropriation. By taking away a substantial part of Windau's income from sales it makes the enterprise not economically viable and the Claimant's investment worthless.

The *Respondent* denies that Latvenergo’s non-payment amounts to the equivalent of an expropriation even in the wider sense developed under recent international treaty law and practice. First, no public authority is involved in Latvenergo’s action under the contract, second, there is no taking of possession or control over the enterprise, and third, the payment of 0.75 rather than 2.00 of the tariff does not result in the investment becoming worthless. The Claimant itself admits that the pay-back time is only lengthened, but that does not amount to expropriation.

The *Arbitral Tribunal* has considered the expert legal opinions and arbitral awards rendered under similar treaties presented in this case by the parties. The Tribunal finds that “regulatory takings” may under the circumstances amount to expropriation or the equivalent of an expropriation. The decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail. In the present case, there is no possession taking of Windau or its assets, no interference with the shareholder’s rights or with the management’s control over and running of the enterprise – apart from ordinary regulatory provisions laid down in the production licence, the off-take agreement, etc.

The Tribunal therefore *concludes* that the withholding of payment at the double tariff does not qualify as an expropriation or the equivalent of an expropriation under the Treaty.

4.3.2 Fair and equitable treatment, discrimination etc.

The *Claimant* contends that Latvenergo’s actions, and the Republic's responsibility for such actions, constitutes violations of several of the Republic's obligations contained in or made operative by Article 10 of the Treaty, and has submitted evidence of circumstances upon which it bases its contentions.

The *Respondent* denies any violation of any international obligations contained in or referred to in Article 10, and has submitted evidence and explanations to counter the Claimant's contentions.

The *Arbitral Tribunal* notes in general that the actions for which the Republic is asserted to be responsible may qualify as a violation of various Treaty provisions. The Tribunal

further notes that the damage or loss caused by the non-payment of the double tariff is the same. Thus, in order to establish liability for the Republic it is strictly speaking sufficient to find that one of the relevant provisions has been violated.

a) *Unreasonable or discriminatory measures*

Article 10 (1) provides *inter alia* that

“...no Contracting Party shall in any way impair by ...unreasonable or discriminatory measures their [the Investor’s Investments] ...use, enjoyment or disposal”.

The *Claimant* contends that Windau has been subject to discriminatory measures by Latvenergo’s refusal to pay the double tariff. Latvenergo has been, and still is, paying SIA “Latelektro-Gulbene” and Joint Stock Company “Liepājas Siltums” the double tariff for its surplus electric power. There is no legitimate reason to treat Windau differently from the two aforementioned enterprises.

The *Respondent* does not deny the fact of the double tariff being paid to the two companies mentioned, but contends that the situations are not comparable. The Respondent has provided lists and some details concerning the 28 cogeneration power plants existing in Latvia, and asserted that they are in many respects different and therefore have been awarded different multipliers. An evaluation must take place in each case. No discrimination is demonstrated by the fact that the two above-mentioned plants have been granted the double tariff, whereas Bauska has not.

The *Arbitral Tribunal* accepts that in evaluating whether there is discrimination in the sense of the Treaty one should only “compare like with like”. However, little if anything has been documented by the Respondent to show the criteria or methodology used in fixing the multiplier, or to what extent Latvenergo is authorized to apply multipliers other than those documented in this arbitration. On the other hand, all of the information available to the Tribunal suggests that the three companies are comparable, and subject to the same laws and regulations. In particular, this appears to be the situation with respect to Latelektro-Gulbene and Windau. In such a situation, and in accordance with established international law, the burden of proof lies with the Respondent to prove that no discrimination has taken or is taking place. The Arbitral Tribunal finds that such burden of proof has not been satisfied, and therefore *concludes* that Windau has been subject to a discriminatory measure in violation of Article 10 (1).

b) *Other asserted Treaty violations*

For the reason stated above, the Arbitral Tribunal does not find it necessary to adjudge the other Treaty violations asserted in this arbitration.

4.3.3 *Limited scope of the Treaty provisions allegedly breached*

As mentioned in section 2.5 above, the Respondent has asserted several limitations to the scope of the Treaty provisions relied on by the Claimant:

a) *The Treaty does not apply retroactively to contracts entered into before the Treaty entered into force:*

It is undisputed that Contract No. 16/97 was entered into on 24 March 1997 and that the Energy Charter Treaty only came into force on 17 March 1998. However, none of the Claimant's claims are based on the date of the signing of the Contract. The claims are built on the repeal of Windau's statutory right to the double tariff, which took place in September/October 1998, and on the breach of the contractual obligation to pay the double tariff, which materialized in September 1999 when the Bauska plant was ready to go into operation, and which has been maintained since then, albeit in accordance with the interim agreement of 10 March 2000. Both the changes in the law and the breach of contract occurred after the entry into force of the Treaty. There is therefore no question of retroactive effects of the Treaty in this situation.

b) The Treaty does not apply retroactively to a withdrawal of the right to the double tariff which was effected before Nykomb's investment took place:

It is undisputed that the Claimant's first investment in Windau occurred by the contract of 11 March 1999, registered on 25 March 1999, for the purchase of 51 per cent of the shares in Windau. The withdrawal of Windau's statutory right to the double tariff took place in September/October 1998, which was before Nykomb's investment. But as pointed out in lit. a) above, the claims for losses or damages are also based on the breach of the Contract which occurred from September 1999, which is after Nykomb's first investment was made. At least in the latter situation there is no question of the retroactive effects of the Treaty.

c) Nykomb was aware of the price dispute, or ought to have been aware of it, and took a commercial risk not protected by the Treaty:

The Respondent also contends that Nykomb was aware of the price dispute, or ought to have been aware of it, before it bought the shares in Windau. Nykomb took a purely business or commercial risk when investing in Windau. The Treaty only protects against political risks and not against commercial or business risks.

This contention raises the question of what Nykomb knew, or ought to have known, about Latvenergo's refusal to pay the double tariff at the time of its investment. It also invites the question of whether a Contracting State to the Treaty can free itself from its Treaty obligations simply by informing a prospective foreign investor that it has established and intends to continue a discrimination of the foreign investment which would otherwise be a violation of the Treaty.

The Tribunal will first deal with the dispute between Latvenergo and Windau concerning the validity of Contract No. 16/97. The relevant sequence of events in connection with this can be summarized as follows:

24 Mar 1997	Contract Nos. 16/97 and 17/97 entered into
26 Mar 1997	Contract No. 18/97 entered into
11 June 1997	The Entrepreneurial Law was amended, excluding contracts after 31 May 1999
25 Sep 1997	Latvenergo board decision: No further contracts with Windau
2 Oct. 1997	Latvenergo declared Contract Nos. 16/97 and 17/97 invalid
24 Oct. 1997	Dupont Aldrich Inc. and Jonathan Moseley became shareholders

19 Feb 1998	Noell turnkey and supply contract with Windau
6 Mar 1998	Windau compromise proposal to Latvenergo on invalidity dispute
20 Mar 1998	Latvenergo rejected any compromise, referring to being "bound by law"
Spring 1998	Noell invited Nykomb to take over as equity investor
8 May 1998	Windau asks for an off-take contract for Bauska
21 May 1998	Latvenergo refused, referring to board decision of 25 September 1997
29 Jun 1997	Windau letter to Council concerning the double tariff
30 Jun 1998	Council's letter to Windau confirming the double tariff
July 1998	Nykomb involved itself in project investigations
30 Oct. 1998	PriceWaterhouseCooper's financial proposal
16 Dec 1998	First instance Court decision in the Latelektro-Gulbene case
12 Feb 1999	Loan agreement between Vereinsbank and Windau
11 Mar 1999	Nykomb's purchase agreement for 51 per cent of the shares in Windau
30 Jun 1999	The Latvian Supreme Court ruling in the Latelektro-Gulbene case
11 Sep 1999	Bauska ready to start operation. Latvenergo refuses to pay double tariff
28 Feb 2000	Bauska started operation
10 Mar 2000	Windau –Latvenergo interim agreement
About Jan 2002	Latvenergo's court action against Windau on validity of Contract 16/97
11 Feb 2002	Nykomb Request for Arbitration
January 2003	Latvenergo's court action withdrawn, according to Claimant.

As will be seen, there was an ongoing dispute between Latvenergo and Windau almost from the beginning concerning the validity of Contract No. 16/97. As early as 2 October 1997 Latvenergo proclaimed that it considered the Contract invalid. As late as at the turn of the year 2001/2002, according to the Claimant, Latvenergo brought an action in the Latvian courts against Windau, claiming the invalidity of the Contract.

A similar court action had earlier been brought by the company Latelektro-Gulbene against Latvenergo. In both cases Latvenergo appears to have argued that the purchase agreements were invalid, because they were signed on behalf of Latvenergo by a person unauthorized to do so, because the price clauses (see section 3.6.3 and 3.6.6 above) were unclear and therefore not legally binding, and because the purchase price agreement had been superseded by subsequent legislation.

Latelektro-Gulbene won its case in three Latvian court instances, which culminated in the decision of the Latvian Supreme Court in June 1999 (see section 3.6.8 above). Latvenergo's court action against Windau was initiated after the Latelektro-Gulbene case had been decided and Latvenergo had entered into a new contract with Latelektro-Gulbene accepting the double tariff, see section 3.6.8 above. The case against Windau was only withdrawn in January 2003. It has not been explained why Latvenergo gave up the court case.

In the present arbitration the Respondent does not challenge the general validity of Contract No. 16/97, but contends that it does not establish a right to the double tariff for

eight years. As further developed above, the Arbitral Tribunal finds and concludes to the contrary.

But it remains to be considered whether it is of any legal significance whether Nykomb was aware of, or ought to have been aware of, Latvenergo's contentions that Contract No. 16/97 was invalid and that therefore the right to the double tariff was contended to be ineffective.

The representatives of Nykomb must clearly have been aware of the dispute between Latvenergo and Windau over the validity of Contract No. 16/97, and therefore aware of an uncertainty as to whether the whole contract would fall away, and with it Windau's right to the double tariff. This uncertainty is reflected in the PriceWaterhouseCoopers financial analysis of 30 October 1998, where calculations were made alternatively on the basis of a 1.00 multiplier (that is, ordinary tariff price for electric power) and the 2.00 multiplier according to the Contract.

The double tariff was also treated as a condition for the repurchase of shares in the agreement of 11 March 1999 whereby Nykomb bought 51 per cent of the shares in Windau. According to Clause 5.1 of the agreement the sellers were secured the right to repurchase 21 per cent of the shares, subject to several conditions, mainly,

- that Windau shall have sold all generated electricity to Latvenergo at the double tariff provided for by the Latvenergo agreements (defined in clause 2.2.9 as Contract Nos. 16/97, 17/97 and 18/97);
- that three years had expired after the commissioning of the Bauska plant; and
- that Windau had fulfilled all its liabilities and repaid all loans and covered all expenses connected with the purchase, construction and commissioning of (the 16) co-generation plants.

By clause 2.2.9 of the agreement the sellers represented and warranted that “[T]he Latvenergo Agreements are in full force and effect and enforceable in accordance with its terms”, compare in relation to this the Council's letter of 30 June 1998 confirming the double tariff.

It must therefore be concluded that Nykomb was fully aware of the uncertainty and risk deriving from Latvenergo's position, but took its precautions in the share purchase agreement and took the risk that the Contract was valid and invested in the Windau shares.

Whether or not one would characterize the risk Nykomb was taking as a commercial risk, is in the Tribunal's view immaterial. It is the Tribunal's conclusion that Windau had entered into a purchase contract for the delivery of electric power that was, and is, legally valid and binding and gave Windau the right to the double tariff for eight years. Nykomb made its share investment relying on this contract. Latvenergo's contentions that Contract No. 16/97 was invalid and did not establish the right to the double tariff were legally unfounded. Nykomb's awareness of Latvenergo's contentions does not relieve the Republic of its obligations under the Treaty resulting from Latvenergo's refusal to pay the double tariff. Generally, a Contracting Party to the Treaty cannot be relieved of its obligations

under the Treaty simply by letting it be announced that legally binding commitments, upon which the foreign investor is relying, will not be honored.

d) *The Claimant's claims are based on a commercial contract not protected by the Treaty*

Finally, the Respondent contends that the Contract between Latvenergo and Windau for the purchase of electric power, upon which all the Claimant's claims are based, is a commercial contract and as such not protected by the Treaty. The Treaty protection only applies to investment contracts within the meaning of the Treaty.

It follows from the remarks above that the Arbitral Tribunal cannot regard the purchase contract as purely commercial, nor can the action to refuse payment of the double tariff under the contract be considered as purely commercial.

As for the objection that the purchase contract is not an investment contract within the meaning of the Treaty, it suffices to note that such a contract clearly falls within the definition of investments in Article 1 of the Treaty.

4.3.4 Conclusion

In consequence of the above findings the *Arbitral Tribunal concludes* that the Respondent is found to be liable under the Treaty for the losses or damages incurred by the Claimant.

5 Assessment of losses or damages

5.1 Legal principles of assessment

Article 13 (1) of the Treaty spells out the principles of compensation in the special case of investments being nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation. As concluded in section 4.3.1 above, the Tribunal does not find that the refusal to pay the double tariff amounts to expropriation or the equivalent of an expropriation within the meaning of Article 13 (1). The Tribunal considers that the principles of compensation provided for in Article 13 (1) are not applicable to the assessment of damages or losses found to be caused by violations of Article 10, as in the present case.

Another assessment rule is contained in Article 26 (8), which provides that the awards of arbitration according to Article 26 may include an award of interest. The question of interest will be dealt with below.

The Arbitral Tribunal holds, and it seems to be agreed between the parties, that the question of remedies to compensate for losses or damages caused by the Respondent's violation of its obligations under Article 10 of the Treaty must primarily find its solution in accordance with established principles of customary international law. Such principles have authoritatively been restated in The International Law Commission's Draft Articles on State Responsibility adopted in November 2001 (hereinafter referred to as the "Articles ILC").

According to Articles 34 and 35 ILC restitution is considered to be the primary remedy for reparation. Article 35 states:

“A State responsible for an internationally wrongful act is under an obligation to make restitution, that is, to re-establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:

- (a) is not materially impossible;
- (b) does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.”

Restitution in the present case is conceivable, either through a juridical restitution of provisions of Latvian law ensuring Windau’s right to the double tariff as it was ensured under the Entrepreneurial Law, or through a monetary restitution to Windau of the missing payments of the difference between the contractually established double tariff and 0.75 of the tariff actually paid. But even if damage or losses to an investment may be inflicted indirectly through loss-creating actions towards a subsidiary in the country of a Contracting State, restitution must primarily be seen as an appropriate remedy in a situation where the Contracting State has instituted actions directly against the investor. An award obliging the Republic to make payments to Windau in accordance with the Contract would also in effect be equivalent to ordering payment under Contract No. 16/07 in the present Treaty arbitration. The Arbitral Tribunal therefore finds the appropriate approach, for the time up to the time of this award, to be an assessment of compensation for the losses or damages inflicted on the Claimant's investments. For the time after this award see section 5.2, last paragraph, below.

5.2 *Assessment of losses or damages suffered by the Claimant*

a) As already pointed out (see section 1.2.2 above) the Claimant requests a relief equal to Windau's alleged loss of net income on heat and electric power in the “dead-lock” period 16 September 1999 – 28 February 2000 and Windau’s alleged loss of sales income on electric power for the rest of the eight years’ period to 16 September 2007, namely the difference between the double tariff and the 0.75 of the tariff actually paid, or expected to be paid.

The *Respondent* has argued, and the *Arbitral Tribunal* must agree, that the reduced flow of income into Windau obviously does not cause an identical loss for Nykomb as an investor. If one compares this with a situation where Latvenergo would have paid the double tariff to Windau, it is clear that the higher payments for electric power would not have flowed fully and directly through to Nykomb. The money would have been subject to Latvian taxes etc., would have been used to cover Windau's costs and down payments on Windau's loans etc., and disbursements to the shareholder would be subject to restrictions in Latvian company law on payment of dividends. An assessment of the Claimant's loss on or damage to its investment based directly on the reduced income flow into Windau is unfounded and must be rejected.

b) However, there can be no doubt that the non-payment of the double tariff to Windau has caused a substantial reduction of the economic value and security of the Claimant's investments in the Windau enterprise.

A primary measurement of an investment is the capitalized earnings value. A substantial reduction of Windau's earnings as demonstrated in this case must be considered as

convincing evidence that a substantial damage to or loss on the Claimant's investment has been suffered. A reduction of the tariff multiplier from 2.00 to 0.75 represents a 62.5 per cent reduction of the sales income from electric power. Furthermore, if one takes as illustrative the relationship between Windau's gross income on electricity and heat sales suggested by the Claimant's calculation for the "dead-lock" period, the reduction of the tariff multiplier results in a reduction of the total income from sales by about 57 per cent, more than half of Windau's total income as compared with a situation where the double tariff would be paid.

It is also clear that the higher income flow would have served to consolidate Windau's financial position, provided means for paying back bank loans and other credits, and ensured a quicker pay-back on the investments in the cogeneration plant. For Nykomb as an investor the effect would be increased security for its investments in credits, shares and subordinated loans. From another perspective, the Claimant has pointed out that the reduced liquidity caused by the refusal to pay the double tariff may lead to the consequence that Windau shall not be able to pay back the loan to Vereinsbank that is due for payment in January 2004.

But the loss or damage suffered by Nykomb as an investor is difficult to quantify. The difficulty is also increased by the fact that the Claimant has submitted rather limited documentation concerning the financial and economic situation of Windau and the circumstances concerning its own investment, for instance the relationship between Nykomb and Noell and the Noell group.

At the hearing the Claimant submitted a list of "capital requirements" for the Bauska plant 1999-2003, including the situation at the end of 2000 (for illustration, SEK at 15/- is added here):

		End 2000	
		Lats	SEK
NYKOMB			
	Shares	250 000	3 750 000
	Loans	380 000	5 700 000
	Owner costs	439 000	6 585 000
		<u>1 069 000</u>	<u>16 035 000</u>
NOELL/BBP	1 495 000	22 425 000	
VEREINSBANK	622 000	9 330 000	
SUM TOTAL		<u>3 186 000</u>	<u>47 790 000</u>

This statement concerning the Claimant's total investment would appear to suggest a maximum of what the Claimant stands to lose on account of Latvenergo's non-payment of the double tariff. But the loss of Windau's future earning potential, and the conceivable consequential loss for Nykomb as a 100 per cent owner of the enterprise, must also be considered. As for this last element the Tribunal has little material upon which to base an assessment, apart from various submitted financial analyses and Windau's accounts for the last few years.

Faced with the lack of further specifics, together with the undeniable finding that Nykomb as an investor has suffered economic loss or damage on its investment, the Arbitral Tribunal is compelled to make an assessment, taking into regard the requirements under applicable customary international law of causation, foreseeability and the reasonableness of the result.

The Tribunal finds that the best available basis for such an assessment is the calculated loss of electricity production in the “dead-lock” period and the actual production of electric energy up to the time of this award. The Tribunal does not consider the asserted loss of heat production in the “dead-lock” period to be helpful in connection with this, nor is it substantiated in any sufficient degree what net loss has been suffered on the non-production of heat. The only cost deducted in the Claimant's calculation of the net loss is the cost of natural gas required for the production.

The Tribunal considers that in the circumstances a discretionary award of one third of the estimated loss in purchase prices of electricity up to the time of this award may serve as a reasonable basis for quantification of the Claimant's assumed losses up to the time of this award, due to the Respondent's violations of its Treaty obligations.

To develop the chosen basis for the Arbitral Tribunal's assessment the Tribunal has added, to the Claimant's figures for electricity production up to 30 April 2003, an estimated figure for power production from 1 May 2003 up to the time of the award, based on the figures for power production up to 30 April 2003. It has also been found reasonable to include in the estimate a 6 per cent simple interest, reckoned for practical reasons for each of the periods in question from the mid point of the respective periods up to the time of the award.

On this basis the Arbitral Tribunal assesses a reasonable compensation in the sum of Lats 1.600.000. In view of the Claimant's use of the Latvian currency in its requests for relief the same currency is used in this assessment.

As specifically regards the asserted losses on delivery of electric power to Latvenergo for the remainder of the eight year period, the Tribunal considers this potential loss to be too uncertain and speculative to form the basis for an award of monetary compensation. But the Tribunal considers it to be a continuing obligation upon the Republic to ensure the payment at the double tariff for electric power delivered under the Contract for the rest of the eight year period, and therefore gives an order for the Republic to fulfill its obligation under the Treaty to protect the Claimant's investment.

5.3 Payment of interest

The *Claimant* has claimed interest on the claimed amounts in the various periods, from the beginning of each of the designated periods until payment. In its first requests for relief, and in its calculations of net present values of future losses on the sale of electric power, the Claimant claimed for an annual interest rate of six per cent, stating that this is the prevailing interest rate in Latvia. In its Brief No. III of 9 September 2003 (see section 1.2.1 above) the Claimant claimed for an annual interest rate of six per cent up to the date of the award, and 18 per cent from that date until payment. The Claimant contends that it has the

right to claim 18 per cent which is the stipulated interest rate in the Contract between Windau and Latvenergo in the event of late payment.

The *Respondent* has not objected to the statement regarding the prevailing interest rate in Latvia of six per cent per annum, but has objected to the Claimant's asserting a right to the interest rate in the Windau – Latvenergo contract.

According to Article 26 (8) of the Treaty an arbitration award may include the award of interest. The *Arbitral Tribunal* finds it appropriate in the present case to award interest.

As mentioned above, the Tribunal has, for the periods up to the time of the award, included an interest element at six per cent per annum as a basis for the assessment of the Claimant's accumulated losses by the time of the award.

As for the time after the award the Tribunal finds it appropriate to award six per cent per annum on the awarded amounts, from the time of the award until payment is effected. This interest rate must be seen as accepted by the parties to be the prevailing rate in Latvia.

The Claimant has no right to claim in this arbitration the interest rate agreed between Windau and Latvenergo. The interest to be considered under the Treaty is a compensation related to the compensation to the Claimant for its own damages or losses. The interest clause in the Windau – Latvenergo contract is related to late payments under the contract and clearly includes a penalty element not applicable in the present case.

6 Allocation and allowability of costs

6.1 The Parties' arguments

The *Claimant* claims compensation for its own costs, which amount to SEK 8.354.000. The Claimant also requests the Arbitral Tribunal to order the Respondent to pay all the costs and expenses of this arbitration.

The *Respondent* claims compensation for its own costs, which amounts to SEK 6.435.270 and LAT 229.174. The Respondent also requests the Arbitral Tribunal to order the Claimant to pay all the costs and expenses of this arbitration.

The only comment from the parties in relation to costs is from the Respondent saying that it is not reasonable that the Republic should bear the increase in the Claimant's costs which must have been the result of a new counsel for the Claimant coming in at a late stage in the proceedings.

6.2 In general

According to Article 41 of the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, the Arbitral Tribunal may, unless the parties have agreed otherwise, at the request of a party in the Award, order the losing party to compensate the other party for legal representation and other expenses for presenting its case. An 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 Claimant has to a certain extent been successful in its claim and is therefore, in principle, entitled to an award ordering the Respondent to bear part of the costs for this arbitration.

6.3 The fees and costs of the Arbitral Tribunal and the Arbitration Institute

The fees and costs of the arbitrators amount to the following.

The fee of the chairman of the Arbitral Tribunal, Mr. Bjørn Haug, amounts to € 90.000. His costs amount to € 7.677.

The fee of Mr. Rolf A. Schütze amounts to € 49.500. His costs amount to € 10.475.

The fee of Mr. Johan Gernandt amounts to € 49.500. His costs amount to € 2.763.

Value Added Tax (“VAT”) at a rate of 25 per cent for Mr. Johan Gernandt (Swedish VAT) and 16 per cent for Mr. Rolf A. Schütze (German VAT) is to be imposed on charges for legal services.

The fee of The Stockholm Chamber of Commerce Arbitration Institute amounts to € 20.946. Value Added Tax (“VAT”) at a rate of 25 per cent is to be imposed on the part of the administrative fee payable by the Swedish party.

As follows from section 6.1 and 6.2 above, and considering the other circumstances of the case, the Arbitral Tribunal concludes that it is reasonable to apportion the costs of the arbitration (except for the parties’ own costs) equally between the parties.

Consequently, the costs of the arbitration, notably the fees, charges and disbursements of the Arbitral Tribunal and the Arbitration Institute shall be paid by the Claimant with 50 per cent and by the Respondent with 50 per cent. The Arbitral Tribunal will so award.

6.4 The costs for legal representations and expenses

The Claimant has, as also stated above, to a certain extent been successful in its claim and is therefore, in principle, entitled to an award ordering the Respondent to bear some part of the Claimant’s costs for this arbitration.

The Arbitral Tribunal notes that the major part of the work involved in presenting the Claimant’s claim has, in the opinion of the Arbitral Tribunal, been devoted to the difficult legal issue of whether or not the Respondent is liable for the claim, in which the Claimant has been successful. However, the Arbitral Tribunal finds reason to make some adjustment of the Claimant’s monetary claim. The Arbitral Tribunal concludes that the amount requested by the Claimant, i.e. SEK 8.354.000, is high, that the Claimant has changed its counsel, which normally leads to additional costs, and that a reasonable sum to be awarded in favour of the Claimant to be paid by the Respondent, considering the circumstances and the outcome of the case, is SEK 2,000,000. The Arbitral Tribunal will so award.

7 Arbitral Award

For the reasons stated above, the Arbitral Tribunal unanimously renders the following

Arbitral Award

1. a) The Republic of Latvia is ordered to pay to Nykomb Synergetics Technology Holding AB, Stockholm, Lats 1,600,000 –onemillionsixhundredthousand Lats – plus interest at the rate of 6 (six) per cent per annum from the date of the award until full payment is effective.
b) The Republic of Latvia is ordered to ensure the payment of the double tariff to Windau SIA, Riga, for electric power delivered from Windau's cogeneration plant at Bauska in accordance with Contract No. 16/97 for the period from the date of this award until 16 September 2007.
2. The Republic of Latvia is ordered to pay to Nykomb Synergetics Technology Holding AB, Stockholm, as compensation for its costs incurred in connection with this arbitration SEK 2,000,000 –twomillion SEK.
3. In accordance with the decision of the Arbitration Institute of the Stockholm Chamber of Commerce, the arbitrators and the said Arbitration Institute shall be entitled to fees and compensation for expenses in the following amounts:

a) Bjørn Haug, chairman,	
fees	€ 90.000
costs	€ 7.677
	€ 97.677
b) Rolf A. Schütze, arbitrator,	
fees	€ 49.500
costs	€ 10.475
16 per cent VAT on fees and costs	€ 9.596
	€ 69.571
c) Johan Gernandt, arbitrator,	
fees	€ 49.500
costs	€ 2.763
25 per cent VAT on fees and costs	€ 13.066
	€ 65.329
d) The Arbitration Institute,	
administrative fee	€ 20.946
Sum total	€ 253.523

As between the parties, Nykomb Synergetics Technology Holding AB shall be responsible for 50 per cent and the Republic of Latvia for 50 per cent of the amounts due in this arbitration to the arbitrators and the Arbitration Institute.

In relation to the arbitrators and the Arbitration Institute the parties shall be jointly and severally liable for the payment of the amounts due to the arbitrators and the Arbitration Institute.

- Nykomb Synergetics Technology Holding AB shall also pay 25 per cent VAT on its part of the administrative fee to the Arbitration Institute, i.e. (25 per cent of €20.946/2) = € 2.618.

Stockholm, 16 December 2003.

Rolf A. Schütze (s)

Bjørn Haug (s)

Johan Gernandt (s)

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

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Registry

Permanent Court of Arbitration

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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 Inkasní, 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.

F. Subsequent Procedural Timetable

22. Having already received the Claimant's Memorial and the Respondent's Counter-Memorial, the Tribunal on 9 June 2004 endorsed the parties' agreement to the following timetable for the submission of further written pleadings:

Claimant's Reply – 24 September 2004; and
Respondent's Rejoinder – 4 February 2005.

Those further written pleadings were submitted by the parties within the time allowed for them.

G. Oral Hearings

23. In subsequent discussion with the parties, it was agreed that oral hearings would be held in London, at the International Dispute Resolution Centre, from Friday, 8 April 2005 to Wednesday, 20 April 2005. The hearings duly took place between those dates.

24. At those hearings, the Tribunal was addressed by:

On behalf of the Claimant: Mr Jan Paulsson
Mr Peter Turner
Professor James Crawford SC

On behalf of the Respondent: Mr George von Mehren

In addition, the Tribunal heard the following witnesses:

Called by the Claimant: Mr Randall Dillard
Professor Hyun Song Shin

Called by the Respondent: Mr Michael Descheneaux
Mr Pavel Racoča
Mr Luděk Niedermayer
Mr Jan Mládek
Mr Pavel Mertlík
Mr Kamil Rudolecký
Mr Ivan Pilip
Mr Pavel Kavánek
Professor Joseph J. Norton
Mr Brent Kaczmarek

25. After the conclusion of the oral hearings, the Tribunal allowed the parties, if they so wished, to file post-hearing briefs by 30 June 2005. Both parties filed post-hearing briefs within that deadline.

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."¹ 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 Inkasna, 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 Racoča, 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”).² 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”)³ 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,⁴

...

- (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 Racoča (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.*,⁵ 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”⁶ – a requirement which the International Court of Justice (“ICJ”) has held includes relevant rules of general customary international law.⁷

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”),⁸ 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,⁹ 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 1987¹⁰ 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.¹¹

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”.¹²

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.¹³

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.¹⁴

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 nam. 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. GR 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.¹⁵

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.¹⁶ 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".¹⁷ 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.¹⁸

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".¹⁹ 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".²⁰

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")²¹ 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.²²

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.²³

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.²⁴

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.²⁵ 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.²⁶ 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”.²⁷ 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” standard²⁸ does not incorporate the traditional *Neer* formula²⁹ 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”).³⁰ These rules are binding upon the Contracting Parties to the Treaty,³¹ 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”.³²

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.³³

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 expectations³⁴ 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.³⁵

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.³⁶

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.³⁷

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.³⁸ 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.³⁹

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.⁴⁰

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 process⁴¹ 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.⁴²

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.⁴³

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.⁴⁴

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"⁴⁵ (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.⁴⁶ 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 1993.⁴⁷ 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....⁴⁸

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].⁴⁹

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 who's 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.⁵⁰ 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.⁵¹

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.⁵²

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.⁵³

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.⁵⁴ 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”.⁵⁵

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”.⁵⁶ The host State is, however, obliged to exercise due diligence.⁵⁷ As the tribunal in *Wena*, quoting from *American Manufacturing and Trading*,⁵⁸ 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.⁵⁹

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.⁶⁰ 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:

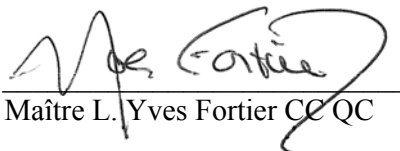
- a. The Tribunal has jurisdiction to hear and decide the dispute which the Claimant, Saluka Investments BV, has submitted to it;
- b. the Respondent, the Czech Republic, has not acted in breach of Article 5 of the Treaty;
- c. the Respondent has acted in breach of Article 3 of the Treaty;
- d. the question 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

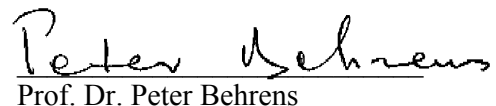
Dated: 17 March 2006



Sir Arthur Watts KCMG QC
Chairman



Maître L. Yves Fortier CCQC



Prof. Dr. Peter Behrens

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- ¹ CNB Report, *The Banking Sector During the Economic Transformation* 7 (1997).
- ² 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].
- ³ Treaty Establishing the European Community, OJ (C 325), 24 December 2002.
- ⁴ *Sic.* Presumably, “by a foreign person” was intended.
- ⁵ Claimant’s Reply, para. 30.
- ⁶ Article 31(3)(c) of the 1969 Vienna Convention on the Law of Treaties, 1155 UNTS 331.
- ⁷ 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).
- ⁸ L.B. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AJIL 515 (1961).
- ⁹ OECD Draft Convention on the Protection of Foreign Property (12 October 1967), 71 ILM 117.
- ¹⁰ Restatement (Third) of Foreign Relations Law § 712 cmt. g (1987).
- ¹¹ 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.
- ¹² *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); *Technicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, 29 May 2003, para. 119.
- ¹³ 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.
- ¹⁴ The Presidium of the Cabinet of the Czech Republic had consented to the imposition of forced administration by Resolution on 15 June 2000.
- ¹⁵ In any event, the Respondent will have the opportunity to raise this argument, if it wishes, in the quantum phase of this arbitration.
- ¹⁶ 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).
- ¹⁷ *S.D. Myers, Inc.*, 40 ILM 1408, para. 261.
- ¹⁸ 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).
- ¹⁹ *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) and *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, 25 May 2004.
- ²⁰ *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), both of which were also based on Article 3 of the Treaty.

²¹ North American Free Trade Agreement, 8-17 December 1992, 32 ILM 605 (entered into force 1 January 1994).

²² *Waste Management*, 30 April 2004, para. 98.

²³ 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.

²⁴ USA (L.F. Neer) v. United Mexican States, 21 AJIL 555, at 556 (1927).

²⁵ 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.

²⁶ 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).

²⁷ *Genin*, ICSID Case No. ARB/99/2.

²⁸ *Genin*, ICSID Case No. ARB/99/2, para. 289.

²⁹ *Genin*, ICSID Case No. ARB/99/2, para. 290; see also *Mondev*, ICSID Case No. ARB(AF)/99/2, para. 116.

³⁰ Vienna Convention on the Law of Treaties, May 23, 1969, 1155 UNTS 331.

³¹ The Treaty entered into force on 1 October 1992 for both The Netherlands and the Czech and Slovak Federal Republic.

³² See *MTD Equity*, ICSID Case No. ARB/01/7, para. 113, where the Tribunal referred to The Concise Oxford Dictionary of Current English (5th ed.).

³³ *S.D. Myers, Inc.*, 40 ILM 1408, para. 263.

³⁴ 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.

³⁵ *Tecmed*, ICSID Case No. ARB(AF)/00/2, para. 154 (emphasis added).

³⁶ *CME v. Czech Republic*, 13 September 2001, para. 155 (emphasis added).

³⁷ *Waste Management*, 30 April 2004, para. 98 (emphasis added).

³⁸ 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.

³⁹ Occidental Exploration and Production Company (OEPC) v. Ecuador, 1 July 2004, para. 183 (emphasis added).

⁴⁰ *S.D. Myers, Inc.*, 40 ILM 1408, para. 263.

⁴¹ For a comprehensive account of arbitral practice see Schreuer, *supra* note 18, at 380-383.

⁴² IMF, *Lessons from Systemic Bank Restructuring: A Survey of 24 Countries* (Washington 1997).

⁴³ Resolution of the Czech Government No. 369, 27 May 1998.

⁴⁴ See Czech National Bank, *Report on Banking Supervision in the Czech Republic* 24-28 (December 1999).

⁴⁵ In the documents, the following code names were used for CSOB and IPB: “Carthago” for CSOB; “India” for IPB.

⁴⁶ 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”.

⁴⁷ Europe Agreement, *supra* note 2.

⁴⁸ *ADF Group*, ICSID Case No. ARB(AF)/00/1, para. 42.

⁴⁹ 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.

⁵⁰ 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).

⁵¹ *Benjamin Isaiah v. Bank Mellat*, 2 Iran U.S. Cl. Trib. Rep., 30 March 1983, 232, at 236-237.

⁵² Fisheries Jurisdiction Case (Spain v. Canada), Judgment on Jurisdiction of the Court, 4 December 1998, ICJ Reports (1998), at para. 66.

⁵³ Black's Law Dictionary (6th ed. 1990).

⁵⁴ 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).

⁵⁵ *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).

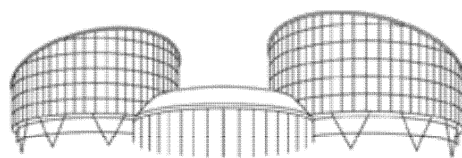
⁵⁶ *Tecmed*, ICSID Case No. ARB(AF)/00/2, para. 177.

⁵⁷ Dolzer & Stevens, *supra* note 26, at 61.

⁵⁸ *AMT*, ICSID Case No. ARB/93/1, para. 28.

⁵⁹ *Wena*, ICSID Case No. ARB/98/4, para. 84.

⁶⁰ See OECD Working Papers, *supra* note 18, at 26-28 ("obligation of vigilance and protection").



EUROPEAN COURT OF HUMAN RIGHTS
COUR EUROPÉENNE DES DROITS DE L'HOMME

THIRD SECTION

CASE OF KELLY AND OTHERS v. THE UNITED KINGDOM

(Application no. 30054/96)

JUDGMENT

STRASBOURG

4 May 2001

FINAL

04/08/2001

This judgment will become final in the circumstances set out in Article 44 § 2 of the Convention. It may be subject to editorial revision.

In the case of Kelly and Others v. the United Kingdom,

The European Court of Human Rights (Third Section), sitting as a Chamber composed of:

Mr J.-P. COSTA, *President*,
Mr W. FUHRMANN,
Mr L. LOUCAIDES,

Mrs F. TULKENS,
Mr K. JUNGWIERT,
Sir Nicolas BRATZA,
Mr K. TRAJA, *judges*,

and Mrs S. DOLLÉ, *Section Registrar*,

Having deliberated in private on 4 April 2000 and on 11 April 2001,

Delivers the following judgment, which was adopted on the last-mentioned date:

PROCEDURE

1. The case originated in an application (no. 30054/96) against the United Kingdom lodged with the European Commission of Human Rights (“the Commission”) under former Article 25 of the Convention for the Protection of Human Rights and Fundamental Freedoms (“the Convention”) by Irish nationals, Vincent Kelly, Kevin McKearney, Amelia Arthurs, Letitia Donnelly, Mary Kelly, Annie Gormley, Patrick O’Callaghan, Carmel Lynagh and Brigid Hughes (“the applicants”), on 5 October 1995.

2. The applicants, who had been granted legal aid, were represented by Mr P. Mageean and Mr D. Korff, lawyers practising in Belfast and London, respectively. The United Kingdom Government (“the Government”) were represented by their Agent, Mr C. Whomersley of the Foreign and Commonwealth Office, London.

3. The applicants, next-of-kin of nine men killed during a security force operation at Loughgall on 8 May 1987 – Patrick Kelly, Patrick McKearney, Declan Arthurs, Seamus Donnelly, Eugene Kelly, Michael Gormley, Gerard O’Callaghan, James Lynagh and Antony Hughes – alleged that their relatives had been killed unjustifiably, without any attempt being made to bring them before a court, that this disclosed discrimination and that there was no effective remedy available to them in respect of their complaints. They invoked Articles 2, 6, 14 and 13 of the Convention.

4. The application was transmitted to the Court on 1 November 1998, when Protocol No. 11 to the Convention came into force (Article 5 § 2 of Protocol No. 11).

5. The application was allocated to the Third Section of the Court (Rule 52 § 1 of the Rules of Court). Within that Section, the Chamber that would consider the case (Article 27 § 1 of the Convention) was constituted as provided in Rule 26 § 1 of the Rules of Court.

6. Having consulted the parties, the President of the Chamber decided that in the interests of the proper administration of justice, the proceedings in the present case should be conducted simultaneously with those in the cases of *Jordan v. the United Kingdom* (no. 24746/94), *McKerr v. the United Kingdom* (no. 28883/95) and *Shanaghan v. the United Kingdom* (no. 37715/97).

7. Third-party comments were received from the Northern Ireland Human Rights Commission on 23 March 2000, which had been given leave by the President to intervene in the written procedure (Article 36 § 2 of the Convention and Rule 61 § 3).

8. A hearing took place in public in the Human Rights Building on 4 April 2000.

There appeared before the Court:

(a) *for the Government*

Mr C. WHOMERSLEY,
Mr R. WEATHERUP, QC,

Agent,

Mr P. SALES,
Mr J. EADIE,
Mr N. LAVENDER, *Counsel*,
Mr O. PAULIN,
Ms S. McCLELLAND,
Ms K. PEARSON,
Mr D. McILROY,
Ms S. BRODERICK,
Ms L. McALPINE,
Ms J. DONNELLY,
Mr T. TAYLOR, *Advisers*;

(b) *for the applicants*

Mr D. KORFF,
Ms F. DOHERTY, *Counsel*,
Mr P. MAGEEAN, *Solicitor*.

The Court heard addresses by Mr Weatherup and Mr Korff.

9. By a decision of 4 April 2000, the Chamber declared the application admissible.

10. The applicant and the Government each filed observations on the merits (Rule 59 § 1).

THE FACTS

I. THE CIRCUMSTANCES OF THE CASE

11. The facts of the case, as submitted by the parties and which may be deduced from the documents, may be summarised as follows. The applicants accepted that the summaries below are an accurate reflection of the written statements made by the official personnel involved, without making any admission as to the credibility, consistency and veracity of these statements.

A. Background to the operation at Loughgall

12. Following a briefing that there was likely to be a terrorist attack on Loughgall station of the Royal Ulster Constabulary (the RUC) in County Armagh on 8 May 1987, twenty four soldiers and three RUC officers arrived at the station in the early hours of that day. Under the command of Soldier A, the soldiers positioned themselves in six locations surrounding the RUC station. Soldiers A, B, C, D, E and F were dressed in plain clothes and remained inside the RUC station (Position 1). All the other soldiers wore military uniform. Soldiers G, H, I and J were positioned in a wooded area to the south of the Loughgall Road, near the junction with a road which is the first on the right from the police station going towards Armagh (Position 2). Soldiers K, L, M and N were positioned in a wooded area to the south of the Loughgall road, generally opposite No. 202 Loughgall Road (Position 3). Soldiers O, P, Q and R were instructed to position themselves in a wooded area to the south of the Loughgall Road, near what is known as Ballygasey Cottage (Position 4). Soldiers S, T and

U were positioned in a wooded area to the rear of St Luke's Church, on the south side of the Loughgall Road and to the east of the RUC station (Position 5). Soldiers V, W and X occupied a position in a wooded area to the north of the Loughgall Road, about 300 to 400 yards to the rear of the RUC station (Position 6).

13. Three members of the RUC, Constables A, B and C, were positioned inside the RUC station. The RUC station, which operated on a part-time basis only, was opened as normal at 9 a.m. on 8 May 1987. Police Constable A was in charge of the station, with B and C assisting him in the running of the station. The station was closed at 11 a.m., re-opened at 5 p.m. and closed again at 7 p.m.

14. At about 2.30 p.m. two hooded men hijacked a blue Toyota Hiace van from a Mr Corr, who was carrying out some work at the Snooker Club, Mountjoy Road, Dungannon, Co Tyrone. He was warned not to report the incident to the police for four hours. When the men left, Mr Corr phoned his employer, the van's owner, and told him about the incident. The owner, Mr McGrath, waited four hours and reported the incident to Coalisland RUC at approximately 6.50 p.m.

15. At about 6 p.m., three armed men who said they were from the IRA entered the house of the Mackle family in Aghinlig Upper, Dungannon. The men said they wanted to borrow the digger and one of the sons was brought outside to fill it with diesel. At about 6.30 p.m., a vehicle pulled up outside and a fourth man arrived. It appears that a bomb containing 300 to 400 pounds of explosives was prepared in the yard of the house and placed in the bucket of the digger. At about 6.50 p.m. the digger was driven out of the yard and the other vehicle left shortly afterwards. At about 7.10 p.m. the remaining two gunmen left the house. Attempts by the family to phone the police failed as their phone and that of their neighbour were out of order. However, two of the sons eventually alerted a police patrol.

B. The incident at Loughgall

16. The soldiers reported a number of sightings of the blue Hiace van passing in front of the RUC station in both directions. Reports that the van had been hijacked, and that a digger was acting suspiciously in the area, were also received. Given this information and the knowledge that diggers had been used in previous terrorist attacks, the soldiers were on full alert when, between 7.15 and 7.30 p.m., the blue van came from the Loughgall direction and parked outside the station on the far side of the road facing Armagh.

17. A man, dressed in blue overalls and wearing a balaclava, emerged from the rear of the van and began to walk into the roadway. He raised his rifle and began to shoot at the RUC station. Soldiers A to E, who had positioned themselves at windows on the first floor of the station began to return fire without warning. Soldier F had set up the radio equipment in the rear ground floor room, and he remained there during the shooting. The driver then got out of the van and began to fire at the station. At least four more men emerged from the rear of the van and commenced firing at the station. Following continuous fire from the direction of the RUC station and from other soldiers, some of the IRA men began to take cover behind the van and others went to get into the back of the van. Soldiers A to E fired into the side of the van. Soldier B received a facial injury from flying glass after a window by which he was standing was broken by gunfire.

18. During this time, one of the IRA men drove the digger through the front gate of the station and Soldier B, having spotted this, fired a short burst at the driver. The digger stopped and shortly afterwards there was an explosion which caused masonry and dust to

fly everywhere. Soldiers A to F and Constable A were unhurt by the blast, which damaged a large part of the station. Constable C was later treated for a fractured skull, damage to his left sinus, broken facial bone, a broken finger, a broken toe and bruising. Constable B also received some injuries. Constables B and C were led outside by Constable A and Soldier C, who administered first aid to them. Soldier F also left the station by the rear and did not take any part in the shooting.

19. Soldiers A, B, D and E moved towards the front of the RUC station and continued to fire at the men near the van, firing through the sides of the van when the men took cover inside, until there was no further movement from the gunmen. In his statement to the police, Soldier B stated that he approached the van to clear it of further danger to his life and those of his colleagues. As he looked into the back of the van, he saw two men and a number of weapons. One of the men made a sudden movement and Soldier B fired one round into him as it was his belief that it was the man's intention to get one of the weapons. Soldier V stated that he approached the van with Soldier B, carrying out a visual check of the bodies. As he moved alongside the van, there was a movement in the area of a body that caught his eye. He took this as an immediate threat and fired one burst into the body.

20. Soldiers positioned in other areas also fired at the various gunmen once they had begun to shoot at the RUC station. Some of the soldiers stated that they came under fire. Shortly after the bomb exploded, Soldiers K and R observed what they thought was a gunman lying in the grass behind the police station. He failed to stand up when challenged to do so, and both soldiers fired several rounds at what turned out to be a large lump of wood. Moving down along the back of the houses towards the police station, Soldier K saw a man whom he apprehended, tied his hands and feet and handed him over to the RUC who arrested him. This man was a Mr Tennyson who was not involved in the attack. He happened on the shooting, and had left his car to seek cover when he was detained.

21. Soldier V fired at a man in a blue boiler suit crossing the road in a crouched manner. The man fell. He saw another man behind a wall and shouted to him to stand up. The man moved away quickly, then turned fully towards Soldier V who saw something in his hand which he regarded as an immediate threat and fired two bursts from his rifle until the man fell. Soldier S passing the body saw no weapon near it.

22. When the blue van and the digger arrived at the RUC station, there had been a white Citroen car right behind them. After shooting started but before the bomb went off, this car began to reverse towards the soldiers in position 5. Soldiers S, T and U opened automatic fire on the car and when they stopped firing the vehicle was about 20 metres away. The front seat passenger got out of the car despite a warning from Soldier U not to move. He was wearing blue coveralls. Almost immediately, he was hit by gunfire from Soldier U and he fell to the ground. Later realising that he was still alive, Soldiers S and U moved him onto the pavement and put two field dressings on his wounds. The driver of the car was dead at the wheel of the car.

23. Soldier W approaching the police station noticed ten feet away in the driveway a person lying on his back still moving. He saw that the man's right hand was clenched and that something metallic was protruding. Believing the man to be a threat to himself and Soldier V, he fired two shots at him. Soldier X checking the body found that the man was holding a cigarette lighter.

24. Other vehicles near the scene of the attack included a red Sierra 15 metres from position 6, occupied by a woman and her daughter, a blue Escort about 70 metres from the scene which was empty and a white Sierra, with three female occupants. These cars, or their occupants, were directed to positions of safety by soldiers as soon as the opportunity arose.

25. When the shooting ceased the soldiers and members of the RUC were airlifted back to their barracks.

C. Police investigation of the incident

26. From 7.35 p.m., officers from the RUC Criminal Investigation Department, the Scenes of Crime Department and the Northern Ireland Forensic Laboratory began arriving to survey the crime scene and identify items of forensic interest. Photographs were taken of the scene and of the bodies. The scene can be described as follows:

27. There were two significantly bullet damaged vehicles, a blue Toyota Hiace van (with approximately 125 bullet holes in the bodywork) and a white Citroen car (with approximately 34 bullet holes in the front, rear and side of the car). In the vicinity of the junction of Clovenden Road/Ballygasey Road there were bullet damaged Vauxhall Cavalier and Ford estate cars.

28. The bodies were wearing blue boiler suits except where specified otherwise.

The first body (Patrick Kelly) was found lying at the front of the van with a radio lying on the ground beside the body and a rifle lying on the body. There was debris on the rifle suggesting that this person was lying on the ground before the explosion. The pathologist noted that his right upper canine tooth had recently been torn out.

The second body (Michael Gormley) was lying on the pavement at the north side of the van near the open side door with a rifle nearby. The body was lying on top of the right leg of body 3, strongly suggesting that body 3 was lying on the ground before body 2 fell.

The third body (Seamus Donnelly) was lying on the pavement towards the north side of the Toyota van. There was ammunition and a cigarette lighter near the body. The pathologist observed at least twenty separate missile wounds (i.e. bullet and fragment) and found that discharge abrasion on an entry wound on the front of the neck indicated that when the gun was discharged the muzzle was within several feet of the body, probably while it was lying on the ground.

The fourth body (Patrick McKearney) was lying face down along the outside panel inside the rear of the van with the head towards the rear door. There was ammunition in the pocket of the boiler suit (he was also wearing a flak jacket) and in the jeans pocket. The *post mortem* examination revealed at least a dozen wounds to the torso and head.

The fifth body (James Lynagh) was lying diagonally across the interior of the van with the feet towards the rear door. There was ammunition in the pocket of the boiler suit and in the anorak and jeans pockets. Material on the body suggested that it was on the floor before the explosion occurred. He had received multiple bullet and fragment injuries.

There were four loaded rifles and one shotgun found in the van. Three of the stocks were folded.

The sixth body (Eugene Kelly), which had massive head damage and multiple injuries elsewhere, was seated in the driver seat of the van. There was a revolver lying between the driver's seat and his door.

The seventh body (Declan Arthurs) was lying in a lane-way opposite the premises of the Loughgall Football Club. This body was not wearing a boiler suit and there was a cigarette lighter close to the right hand.

The eighth body (Gerald O'Callaghan) was lying on its right side on the pavement at the Loughgall side of the lane-way. Twelve wounds were noted by the pathologist.

The ninth body (Antony Hughes) was seated with the seat belt on in the driver's seat of the white Citroen car. The body was not wearing a boiler suit. The *post mortem* examination showed twenty-nine wounds (bullet and shrapnel).

29. At 10.35 p.m. on 8 May 1987, the police took possession of the firearms used by Soldiers A to X which were delivered the following day to the Northern Ireland Forensic Science Laboratory for examination.

30. On the morning of 9 May 1987, a scene of crimes officer and forensic experts from the Northern Ireland Forensic Science Laboratory conducted an examination of the scene and took possession of a large number of exhibits. The cars were removed for expert examination.

31. Spent cartridge cases were recovered from all over the crime scene which stretched from the junction of Cloveneden Road/Ballygasey Road to the Church/Church Hall in the vicinity of the start of Main Street, Loughgall. In total, 678 spent cartridge cases were recovered, 78 of which were from IRA weapons.

32. On 9 and 10 May 1987, two forensic doctors carried out *post mortem* examinations of the bodies.

33. Between 9 and 12 May 1987, police officers conducted lengthy interviews with soldiers A to X, each of whom made a written statement. On 16 March 1988, soldier L was asked by the police to clarify his statement.

34. On 21 July 1988, the RUC forwarded a report to the Director of Public Prosecutions for Northern Ireland (the DPP) on the outcome of their RUC investigation. On 22 September 1988, he concluded that the evidence did not warrant the prosecution of any person involved in the shootings. The Government stated that this decision was notified to the next-of-kin of the deceased. The applicants stated that only the family of Antony Hughes was informed.

D. The inquests

35. On 9 May 1990, the statements taken during the RUC investigation were forwarded to the Coroner.

36. On 6 September 1990, the Coroner held a preliminary meeting attended by the lawyers representing the relatives of the deceased. At their request, he adjourned the inquest which he had intended to hold on 24 September 1990, pending the determination of the *Devine* case, before the Court of Appeal (and subsequently the House of Lords), which concerned the powers of Coroners and the procedure at inquests. Judgments were given by the Court of Appeal on 6 December 1990 and by the House of Lords on 6 February 1992, pursuant to which it was established that rule 17 of the Coroners' Rules did not prevent coroners admitting written statements in evidence.

37. The inquests were further adjourned pending the outcome of proceedings relating to the inquests into the deaths of Gervaise McKerr, Eugene Toman and Sean Burns (see application no. 28883/95 brought by Jonathan McKerr). These proceedings involved decisions by the High Court on 2 June 1992 and 21 December 1992 and by the Court of Appeal on 28 May 1993, by which it was held that relatives' counsel was entitled to see a

document used by a witness to refresh his memory. There were further proceedings before the High Court on 20 April 1994, when the writs of subpoena, by which the Coroner had attempted to obtain, *inter alia*, copies of the Stalker and Sampson Reports, were set aside. The McKerr, Toman and Burns inquests terminated on 8 September 1994.

38. An inquest into the deaths of the men in the present case was opened on 30 May 1995 in public before a Coroner and a jury of 10 members. It lasted four days. The RUC and Ministry of Defence were represented. On the first day of the inquest, counsel representing the families of six out of the nine deceased (Patrick Kelly, Declan Arthurs, Eugene Kelly, Michael Gormley, Seamus Donnell and Gerard O'Callaghan) sought for the statements of prospective witnesses to be made available to them at the commencement of the proceedings together with the maps and photographs. The Coroner made available the maps and photographs but did not permit counsel (other than those instructed on the Coroner's behalf) to see witness statements until the witness was giving evidence.

39. On the same day of the inquest, counsel for the six families asked for the proceedings to be adjourned to allow them to seek judicial review of the decision to refuse access to the witness statements. This adjournment was refused and, following the rejection of a second application, counsel was instructed by the six families to withdraw from the hearing to seek a remedy by way of judicial review. This step was taken on 31 May 1995 following consultation with the families and because it was felt "utterly impossible for the applicants' interests to be fairly or adequately represented given the rulings of the Coroner".

40. The hearing of the inquest proceeded without representation for any of the nine families. The Coroner heard 45 witnesses, including the brother of Antony Hughes who had been shot and injured, civilian and police eye-witnesses, including Constables A and B and the police officers involved in the investigation. None of the soldiers appeared but their statements were lodged. It was concluded on 2 June 1995 that all nine men had died from serious and multiple gun shot wounds.

41. The family of Declan Arthurs sought judicial review of the Coroner's decisions not to allow the legal representatives to see witness statements before they gave evidence, not to allow additional time to their advisers to consider expert and controversial evidence, and the refusal of the application for an adjournment. Leave was granted on 1 June 1995. In his judgment of 24 May 1996, Mr Justice McCollum in the High Court refused to quash the Coroner's decisions or the jury verdict. In doing so, the judge placed considerable emphasis on the character of an inquest as a fact finding exercise and not a method of apportioning guilt.

E. Civil proceedings

42. Seven of the families (the relatives of Antony Hughes, Kevin Antony McKearney, Michael Gormley, Seamus Donnelly, Declan Arthurs, Gerard O'Callaghan and Eugene Kelly) issued civil proceedings against the Ministry of Defence on 2 December 1988, 20 March 1990 and 4 May 1990 respectively.

43. On 25 April 1991, the Hughes family settled proceedings for 100,000 pounds sterling (GBP) in respect of Antony Hughes, who was a civilian unconnected with the IRA gunmen.

44. No further steps were taken to pursue the proceedings by the family of Kevin Antony McKearney. Regarding the remaining five families, who are represented by the same lawyer, statements of claim were issued in October 1993, alleging that the shooting of the

deceased represented excessive force and was unnecessary and unlawful or, alternatively, that there was negligence, *inter alia*, in failing to give warnings or an opportunity to submit to lawful arrest and using excessive force.

45. On 13 January 1994, the five families issued notice of their intention to proceed with their claims.

46. On 3 March 1994, the Ministry of Defence served their defence, stating *inter alia* that the force used was necessary to prevent the deceased committing unlawful acts and to protect lives and personal safety. They also served a notice requesting further and better particulars of the statement of claim.

II. RELEVANT DOMESTIC LAW AND PRACTICE

A. Use of lethal force

47. Section 3 of the Criminal Law Act (Northern Ireland) 1967 provides *inter alia*:

“1. A person may use such force as is reasonable in the circumstances in the prevention of crime, or in effecting the arrest or assisting in the lawful arrest of offenders or suspected offenders or persons unlawfully at large.”

Self-defence or the defence of others is contained within the concept of the prevention of crime (see e.g. Smith and Hogan on Criminal Law).

B. Inquests

1. Statutory provisions and rules

48. The conduct of inquests in Northern Ireland is governed by the Coroners Act (Northern Ireland) 1959 and the Coroners (Practice and Procedure) Rules (Northern Ireland) 1963. These provide the framework for a procedure within which deaths by violence or in suspicious circumstances are notified to the Coroner, who then has the power to hold an inquest, with or without a jury, for the purpose of ascertaining, with the assistance as appropriate of the evidence of witnesses and reports, *inter alia*, of *post mortem* and forensic examinations, who the deceased was and how, when and where he died.

49. Pursuant to the Coroners Act, every medical practitioner, registrar of deaths or funeral undertaker who has reason to believe a person died directly or indirectly by violence is under an obligation to inform the Coroner (section 7). Every medical practitioner who performs a *post mortem* examination has to notify the Coroner of the result in writing (section 29). Whenever a dead body is found, or an unexplained death or death in suspicious circumstances occurs, the police of that district are required to give notice to the Coroner (section 8).

50. Rules 12 and 13 of the Coroners Rules give power to the Coroner to adjourn an inquest where a person may be or has been charged with murder or other specified criminal offences in relation to the deceased.

51. Where the Coroner decides to hold an inquest with a jury, persons are called from the Jury List, compiled by random computer selection from the electoral register for the district on the same basis as in criminal trials.

52. The matters in issue at an inquest are governed by Rules 15 and 16 of the Coroners Rules:

“15. The proceedings and evidence at an inquest shall be directed solely to ascertaining the following matters, namely: -

(a) who the deceased was;

(b) how, when and where the deceased came by his death;

(c) the particulars for the time being required by the Births and Deaths Registration (Northern Ireland) Order 1976 to be registered concerning his death.

16. Neither the coroner nor the jury shall express any opinion on questions of criminal or civil liability or on any matters other than those referred to in the last foregoing Rule.”

53. The forms of verdict used in Northern Ireland accord with this recommendation, recording the name and other particulars of the deceased, a statement of the cause of death (e.g. bullet wounds) and findings as to when and where the deceased met his death. In England and Wales, the form of verdict appended to the English Coroners Rules contains a section marked “conclusions of the jury/coroner as to the death” in which conclusions such as “lawfully killed” or “killed unlawfully” are inserted. These findings involve expressing an opinion on criminal liability in that they involve a finding as to whether the death resulted from a criminal act, but no finding is made that any identified person was criminally liable. The jury in England and Wales may also append recommendations to their verdict.

54. However, in Northern Ireland, the Coroner is under a duty (section 6(2) of the Prosecution of Offences Order (Northern Ireland) 1972) to furnish a written report to the DPP where the circumstances of any death appear to disclose that a criminal offence may have been committed.

55. Until recently, legal aid was not available for inquests as they did not involve the determination of civil liabilities or criminal charges. Legislation which would have provided for legal aid at the hearing of inquests (the Legal Aid, Advice and Assistance (Northern Ireland) Order 1981, Schedule 1 paragraph 5) has not been brought into force. However, on 25 July 2000, the Lord Chancellor announced the establishment of an Extra-Statutory Ex Gratia Scheme to make public funding available for representation for proceedings before Coroners in exceptional inquests in Northern Ireland. In March 2001, he published for consultation the criteria to be used in deciding whether applications for representation at inquests should receive public funding. This included *inter alia* consideration of financial eligibility, whether an effective investigation by the State was needed and whether the inquest was the only way to conduct it, whether the applicant required representation to be able to participate effectively in the inquest and whether the applicant had a sufficiently close relationship to the deceased.

56. The Coroner enjoys the power to summon witnesses who he thinks it necessary to attend the inquest (section 17 of the Coroners Act) and he may allow any interested person to examine a witness (Rule 7). In both England and Wales and Northern Ireland, a witness is entitled to rely on the privilege against self-incrimination. In Northern Ireland, this privilege is reinforced by Rule 9(2) which provides that a person suspected of causing the death may not be compelled to give evidence at the inquest.

57. In relation to both documentary evidence and the oral evidence of witnesses, inquests, like criminal trials, are subject to the law of public interest immunity, which recognises and gives effect to the public interest, such as national security, in the non-disclosure of certain information or certain documents or classes of document. A claim of public interest immunity must be supported by a certificate.

2. The scope of inquests

58. Rules 15 and 16 (see above) follow from the recommendation of the Brodrick Committee on Death Certification and Coroners:

“... the function of an inquest should be simply to seek out and record as many of the facts concerning the death as the public interest requires, without deducing from those facts any determination of blame... In many cases, perhaps the majority, the facts themselves will demonstrate quite clearly whether anyone bears any responsibility for the death; there is a difference between a form of proceeding which affords to others the opportunity to judge an issue and one which appears to judge the issue itself.”

59. Domestic courts have made, *inter alia*, the following comments:

“... It is noteworthy that the task is not to ascertain how the deceased died, which might raise general and far-reaching issues, but ‘how...the deceased came by his death’, a far more limited question directed to the means by which the deceased came by his death.

... [previous judgments] make it clear that when the Brodrick Committee stated that one of the purposes of an inquest is ‘To allay rumours or suspicions’ this purpose should be confined to allaying rumours and suspicions of how the deceased came by his death and not to allaying rumours or suspicions about the broad circumstances in which the deceased came by his death.” (Sir Thomas Bingham, MR, Court of Appeal, *R. v the Coroner for North Humberside and Scunthorpe ex parte Roy Jamieson*, April 1994, unreported)

“The cases establish that although the word ‘how’ is to be widely interpreted, it means ‘by what means’ rather than in what broad circumstances ... In short, the inquiry must focus on matters directly causative of death and must, indeed, be confined to those matters alone ...” (Simon Brown LJ, Court of Appeal, *R. v. Coroner for Western District of East Sussex, ex parte Homberg and others*, (1994) 158 JP 357)

“... it should not be forgotten that an inquest is a fact finding exercise and not a method of apportioning guilt. The procedure and rules of evidence which are suitable for one are unsuitable for the other. In an inquest it should never be forgotten that there are no parties, no indictment, there is no prosecution, there is no defence, there is no trial, simply an attempt to establish the facts. It is an inquisitorial process, a process of investigation quite unlike a trial...”

It is well recognised that a purpose of an inquest is that rumour may be allayed. But that does not mean it is the duty of the Coroner to investigate at an inquest every rumour or allegation that may be brought to his attention. It is ... his duty to discharge his statutory role - the scope of his enquiry must not be allowed to drift into the uncharted seas of rumour and allegation. He will proceed safely and properly if he investigates the facts which it appears are relevant to the statutory issues before him.” (Lord Lane, Court of Appeal, *R v. South London Coroner ex parte Thompson* (1982) 126 SJ 625)

3. Disclosure of documents

60. There was no requirement prior to 1999 for the families at inquests to receive copies of the written statements or documents submitted to the Coroner during the inquest. Coroners generally adopted the practice of disclosing the statements or documents during the inquest proceedings, as the relevant witness came forward to give evidence.

61. Following the recommendation of the Stephen Lawrence Inquiry, Home Office Circular No. 20/99 (concerning deaths in custody or deaths resulting from the actions of a police officer in purported execution of his duty) advised Chief Constables of police forces in England and Wales to make arrangements in such cases for the pre-inquest disclosure of

documentary evidence to interested parties. This was to “help provide reassurance to the family of the deceased and other interested persons that a full and open police investigation has been conducted, and that they and their legal representatives will not be disadvantaged at the inquest”. Such disclosure was recommended to take place 28 days before the inquest.

62. Paragraph 7 of the Circular stated:

“The courts have established that statements taken by the police and other documentary material produced by the police during the investigation of a death in police custody are the property of the force commissioning the investigation. The Coroner has no power to order the pre-inquest disclosure of such material... Disclosure will therefore be on a voluntary basis..”

Paragraph 9 listed some kinds of material which require particular consideration before being disclosed, for example:

- where disclosure of documents might have a prejudicial effect on possible subsequent proceedings (criminal, civil or disciplinary);
- where the material concerns sensitive or personal information about the deceased or unsubstantiated allegations which might cause distress to the family; and
- personal information about third parties not material to the inquest.

Paragraph 11 envisaged that there would be non-disclosure of the investigating officer’s report although it might be possible to disclose it in those cases which the Chief Constable considered appropriate.

C. Police Complaints Procedures

63. The police complaints procedure was governed at the relevant time by the Police (Northern Ireland) Order 1987 (the 1987 Order). This replaced the Police Complaints Board, which had been set up in 1977, by the Independent Commission for Police Complaints (the ICPC). The ICPC has been replaced from 1 October 2000 with the Police Ombudsman for Northern Ireland appointed under the Police (Northern Ireland) Act 1998.

64. The ICPC was an independent body, consisting of a chairman, two deputy chairmen and at least four other members. Where a complaint against the police was being investigated by a police officer or where the Chief Constable or Secretary of State considered that a criminal offence might have been committed by a police officer, the case was referred to the ICPC.

65. The ICPC was required under Article 9(1)(a) of the 1987 Order to supervise the investigation of any complaint alleging that the conduct of a RUC officer had resulted in death or serious injury. Its approval was required of the appointment of the police officer to conduct the investigation and it could require the investigating officer to be replaced (Article 9(5)(b)). A report by the investigating officer was submitted to the ICPC concerning supervised investigations at the same time as to the Chief Constable. Pursuant to Article 9(8) of the 1987 Order, the ICPC issued a statement whether the investigation had been conducted to its satisfaction and, if not, specifying any respect in which it had not been so conducted.

66. The Chief Constable was required under Article 10 of the 1987 Order to determine whether the report indicated that a criminal offence had been committed by a member of the police force. If he so decided and considered that the officer ought to be charged, he was required to send a copy of the report to the DPP. If the DPP decided not to prefer criminal charges, the Chief Constable was required to send a memorandum to the ICPC indicating

whether he intended to bring disciplinary proceedings against the officer (Article 10(5)) save where disciplinary proceedings had been brought and the police officer had admitted the charges (Article 11(1)). Where the Chief Constable considered that a criminal offence had been committed but that the offence was not such that the police officer should be charged or where he considered that no criminal offence had been committed, he was required to send a memorandum indicating whether he intended to bring disciplinary charges and, if not, his reasons for not proposing to do so (Article 11(6) and (7)).

67. If the ICPC considered that a police officer subject to investigation ought to be charged with a criminal offence, it could direct the Chief Constable to send the DPP a copy of the report on that investigation (Article 12(2)). It could also recommend or direct the Chief Constable to prefer such disciplinary charges as the ICPC specified (Article 13(1) and (3)).

D. The Director of Public Prosecutions

68. The Director of Public Prosecutions (the DPP), appointed pursuant to the Prosecution of Offences (Northern Ireland) 1972 (the 1972 Order) is an independent officer with at least 10 years' experience of the practice of law in Northern Ireland who is appointed by the Attorney General and who holds office until retirement, subject only to dismissal for misconduct. His duties under Article 5 of the 1972 Order are *inter alia*:

“(a) to consider, or cause to be considered, with a view to his initiating or continuing in Northern Ireland any criminal proceedings or the bringing of any appeal or other proceedings in or in connection with any criminal cause or matter in Northern Ireland, any facts or information brought to his notice, whether by the Chief Constable acting in pursuance of Article 6(3) of this Order or by the Attorney General or by any other authority or person;

(b) to examine or cause to be examined all documents that are required under Article 6 of this Order to be transmitted or furnished to him and where it appears to him to be necessary or appropriate to do so to cause any matter arising thereon to be further investigated;

(c) where he thinks proper to initiate, undertake and carry on, on behalf of the Crown, proceedings for indictable offences and for such summary offences or classes of summary offences as he considers should be dealt with by him.”

69. Article 6 of the 1972 Order requires *inter alia* Coroners and the Chief Constable of the RUC to provide information to the DPP as follows:

“(2) Where the circumstances of any death investigated or being investigated by a coroner appear to him to disclose that a criminal offence may have been committed he shall as soon as practicable furnish to the [DPP] a written report of those circumstances.

(3) It shall be the duty of the Chief Constable, from time to time, to furnish to the [DPP] facts and information with respect to –

(a) indictable offences [such as murder] alleged to have been committed against the law of Northern Ireland; ...

and at the request of the [DPP], to ascertain and furnish to the [DPP] information regarding any matter which may appear to the [DPP] to require investigation on the ground that it may involve an offence against the law of Northern Ireland or information which may appear to the [DPP] to be necessary for the discharge of his functions under this Order.”

70. According to the Government's observations submitted on 18 June 1998, it had been the practice of successive DPPs to refrain from giving reasons for decisions not to institute or proceed with criminal prosecutions other than in the most general terms. This practice was based upon the consideration that

- (1) if reason were given in one or more cases, they would be required to be given in all. Otherwise, erroneous conclusions might be drawn in relation to those cases where reasons were refused, involving either unjust implications regarding the guilt of some individuals or suspicions of malpractice;
- (2) the reason not to prosecute might often be the unavailability of a particular item of evidence essential to establish the case (e.g. sudden death or flight of a witness or intimidation). To indicate such a factor as the sole reason for not prosecuting might lead to assumptions of guilt in the public estimation;
- (3) the publication of the reasons might cause pain or damage to persons other than the suspect (e.g. the assessment of the credibility or mental condition of the victim or other witnesses);
- (4) in a substantial category of cases decisions not to prosecute were based on the DPP's assessment of the public interest. Where the sole reason not to prosecute was the age, mental or physical health of the suspect, publication would not be appropriate and could lead to unjust implications;
- (5) there might be considerations of national security which affected the safety of individuals (e.g. where no prosecution could safely or fairly be brought without disclosing information which would be of assistance to terrorist organisations, would impair the effectiveness of the counter-terrorist operations of the security forces or endanger the lives of such personnel and their families or informants).

71. Decisions of the DPP not to prosecute have been subject to applications for judicial review in the High Court.

In *R. v. DPP ex parte C* (1995) 1 CAR, p. 141, Lord Justice Kennedy held, concerning a decision of the DPP not to prosecute in an alleged case of buggery:

"From all of those decisions it seems to me that in the context of the present case this court can be persuaded to act if and only if it is demonstrated to us that the Director of Public Prosecutions acting through the Crown Prosecution Service arrived at the decision not to prosecute:

- (1) because of some unlawful policy (such as the hypothetical decision in Blackburn not to prosecute where the value of goods stolen was below £100);
- (2) because the Director of Public Prosecutions failed to act in accordance with his own settled policy as set out in the code; or
- (3) because the decision was perverse. It was a decision at which no reasonable prosecutor could have arrived."

72. In the case of *R. v. the DPP and Others ex parte Timothy Jones* the Divisional Court on 22 March 2000 quashed a decision not to prosecute for alleged gross negligence causing a death in dock unloading on the basis that the reasons given by the DPP – that the evidence was not sufficient to provide a realistic prospect of satisfying a jury - required further explanation.

73. *R. v. DPP ex parte Patricia Manning and Elizabeth Manning* (decision of the Divisional Court of 17 May 2000) concerned the DPP's decision not to prosecute any prison officer for manslaughter in respect of the death of a prisoner, although the inquest jury had

reached a verdict of unlawful death - there was evidence that prison officers had used a neck lock which was forbidden and dangerous. The DPP reviewing the case still concluded that the Crown would be unable to establish manslaughter from gross negligence. The Lord Chief Justice noted:

“Authority makes clear that a decision by the Director not to prosecute is susceptible to judicial review: see, for example, R. v. Director of Public Prosecutions, ex parte C [1995] 1 Cr. App. R. 136. But, as the decided cases also make clear, the power of review is one to be sparingly exercised. The reasons for this are clear. The primary decision to prosecute or not to prosecute is entrusted by Parliament to the Director as head of an independent, professional prosecuting service, answerable to the Attorney General in his role as guardian of the public interest, and to no-one else. It makes no difference that in practice the decision will ordinarily be taken by a senior member of the CPS, as it was here, and not by the Director personally. In any borderline case the decision may be one of acute difficulty, since while a defendant whom a jury would be likely to convict should properly be brought to justice and tried, a defendant whom a jury would be likely to acquit should not be subjected to the trauma inherent in a criminal trial. If, in a case such as the present, the Director's provisional decision is not to prosecute, that decision will be subject to review by Senior Treasury Counsel who will exercise an independent professional judgment. The Director and his officials (and Senior Treasury Counsel when consulted) will bring to their task of deciding whether to prosecute an experience and expertise which most courts called upon to review their decisions could not match. In most cases the decision will turn not on an analysis of the relevant legal principles but on the exercise of an informed judgment of how a case against a particular defendant, if brought, would be likely to fare in the context of a criminal trial before (in a serious case such as this) a jury. This exercise of judgment involves an assessment of the strength, by the end of the trial, of the evidence against the defendant and of the likely defences. It will often be impossible to stigmatise a judgment on such matters as wrong even if one disagrees with it. So the courts will not easily find that a decision not to prosecute is bad in law, on which basis alone the court is entitled to interfere. At the same time, the standard of review should not be set too high, since judicial review is the only means by which the citizen can seek redress against a decision not to prosecute and if the test were too exacting an effective remedy would be denied.”

As regards whether the DPP had a duty to give reasons, the Lord Chief Justice said:

“It is not contended that the Director is subject to an obligation to give reasons in every case in which he decides not to prosecute. Even in the small and very narrowly defined cases which meet Mr Blake's conditions set out above, we do not understand domestic law or the jurisprudence of the European Court of Human Rights to impose an absolute and unqualified obligation to give reasons for a decision not to prosecute. But the right to life is the most fundamental of all human rights. It is put at the forefront of the Convention. The power to derogate from it is very limited. The death of a person in the custody of the State must always arouse concern, as recognised by section 8(1)(c), (3)(b) and (6) of the Coroner's Act 1988, and if the death resulted from violence inflicted by agents of the State that concern must be profound. The holding of an inquest in public by an independent judicial official, the coroner, in which interested parties are able to participate must in our view be regarded as a full and effective inquiry (see McCann v. United Kingdom [1996] 21 EHRR 97, paragraphs 159 to 164). Where such an inquest following a proper direction to the jury culminates in a lawful verdict of unlawful killing implicating a person who, although not named in the verdict, is clearly identified, who is living and whose whereabouts are known, the ordinary expectation would naturally be that a prosecution would follow. In the absence of compelling grounds for not giving reasons, we would expect the Director to give reasons in such a case: to meet the reasonable expectation of interested parties that either a prosecution would follow or a

reasonable explanation for not prosecuting be given, to vindicate the Director's decision by showing that solid grounds exist for what might otherwise appear to be a surprising or even inexplicable decision and to meet the European Court's expectation that if a prosecution is not to follow a plausible explanation will be given. We would be very surprised if such a general practice were not welcome to Members of Parliament whose constituents have died in such circumstances. We readily accept that such reasons would have to be drawn with care and skill so as to respect third party and public interests and avoid undue prejudice to those who would have no opportunity to defend themselves. We also accept that time and skill would be needed to prepare a summary which was reasonably brief but did not distort the true basis of the decision. But the number of cases which meet Mr Blake's conditions is very small (we were told that since 1981, including deaths in police custody, there have been seven such cases), and the time and expense involved could scarcely be greater than that involved in resisting an application for judicial review. In any event it would seem to be wrong in principle to require the citizen to make a complaint of unlawfulness against the Director in order to obtain a response which good administrative practice would in the ordinary course require."

On this basis, the court reviewed whether the reasons given by the DPP in that case were in accordance with the Code for Crown Prosecutors and capable of supporting a decision not to prosecute. It found that the decision had failed to take relevant matters into account and that this vitiated the decision not to prosecute. The decision was quashed and the DPP was required to reconsider his decision whether or not to prosecute.

74. *In the Matter of an Application by David Adams for Judicial Review*, the High Court in Northern Ireland on 7 June 2000 considered the applicant's claim that the DPP had failed to give adequate and intelligible reasons for his decision not to prosecute any police officer concerned in the arrest during which he had suffered serious injuries and for which in civil proceedings he had obtained an award of damages against the police. It noted that there was no statutory obligation on the DPP under the 1972 Order to give reasons and considered that not duty to give reasons could be implied. The fact that the DPP in England and Wales had in a number of cases furnished detailed reasons, whether from increasing concern for transparency or in the interests of the victim's families, was a matter for his discretion. It concluded on the basis of authorities that only in exceptional cases such as the Manning case (paragraph 73 above) would the DPP be required to furnish reasons to a victim for failing to prosecute and that review should be limited to where the principles identified by Lord Justice Kennedy (paragraph 71 above) were infringed. Notwithstanding the findings in the civil case, they were not persuaded that the DPP had acted in such an aberrant, inexplicable or irrational manner that the case cried out for reasons to be furnished as to why he had so acted.

III. RELEVANT INTERNATIONAL LAW AND PRACTICE

A. The United Nations

75. The United Nations Basic Principles on the Use of Force and Firearms by Law Enforcement Officials (UN Force and Firearms Principles) were adopted on 7 September 1990 by the Eighth United Nations Congress on the Prevention of Crime and the Treatment of Offenders.

76. Paragraph 9 of the UN Force and Firearms Principles provides, *inter alia*, that the “intentional lethal use of firearms may only be made when strictly unavoidable in order to protect life”.

77. Other relevant provisions read as follows:

Paragraph 10

“... law enforcement officials shall identify themselves as such and shall give a clear warning of their intent to use firearms, with sufficient time for the warnings to be observed, unless to do so would unduly place the law enforcement officials at risk or would create a risk of death or serious harm to other persons, or would be clearly inappropriate or pointless in the circumstances of the incident.”

Paragraph 22

“... Governments and law enforcement agencies shall ensure that an effective review process is available and that independent administrative or prosecutorial authorities are in a position to exercise jurisdiction in appropriate circumstances. In cases of death and serious injury or other grave consequences, a detailed report shall be sent promptly to the competent authorities responsible for administrative review and judicial control.”

Paragraph 23

“Persons affected by the use of force and firearms or their legal representatives shall have access to an independent process, including a judicial process. In the event of the death of such persons, this provision shall apply to their dependants accordingly.”

78. Paragraph 9 of the United Nations Principles on the Effective Prevention and Investigation of Extra-Legal, Arbitrary and Summary Executions, adopted on 24 May 1989 by the Economic and Social Council Resolution 1989/65, (UN Principles on Extra-Legal Executions) provides, *inter alia*, that:

“There shall be a thorough, prompt and impartial investigation of all suspected cases of extra legal, arbitrary and summary executions, including cases where complaints by relatives or other reliable reports suggest unnatural death in the above circumstances ...”

79. Paragraphs 10 to 17 of the UN Principles on Extra-Legal Executions contain a series of detailed requirements that should be observed by investigative procedures into such deaths.

Paragraph 10 states, *inter alia*:

“The investigative authority shall have the power to obtain all the information necessary to the inquiry. Those persons conducting the inquiry ... shall also have the authority to oblige officials allegedly involved in any such executions to appear and testify ...”

Paragraph 11 specifies:

“In cases in which the established investigative procedures are inadequate because of a lack of expertise or impartiality, because of the importance of the matter or because of the apparent existence of a pattern of abuse, and in cases where there are complaints from the family of the victim about these inadequacies or other substantial reasons, Governments shall pursue investigations through an independent commission of inquiry or similar procedure. Members of such a commission shall be chosen for their recognised impartiality, competence and independence as individuals. In particular, they shall be

independent of any institution, agency or person that may be the subject of the inquiry. The commission shall have the authority to obtain all information necessary to the inquiry and shall conduct the inquiry as provided in these principles.”

Paragraph 16 provides, *inter alia*:

“Families of the deceased and their legal representatives shall be informed of, and have access to, any hearing as well as all information relevant to the investigation and shall be entitled to present other evidence ...”

Paragraph 17 provides, *inter alia*:

“A written report shall be made within a reasonable time on the methods and findings of such investigations. The report shall be made public immediately and shall include the scope of the inquiry, procedures, methods used to evaluate evidence as well as conclusions and recommendations based on findings of fact and on applicable law ...”

80. The “Minnesota Protocol” (Model Protocol for a legal investigation of extra-legal, arbitrary and summary executions, contained in the UN Manual on the Effective Prevention and Investigation of Extra-legal, Arbitrary and Summary Executions) provides, *inter alia*, in section B on the “Purposes of an inquiry”:

“As set out in paragraph 9 of the Principles, the broad purpose of an inquiry is to discover the truth about the events leading to the suspicious death of a victim. To fulfil that purpose, those conducting the inquiry shall, at a minimum, seek:

- (a) to identify the victim;
- (b) to recover and preserve evidentiary material related to the death to aid in any potential prosecution of those responsible;
- (c) to identify possible witnesses and obtain statements from them concerning the death;
- (d) to determine the cause, manner, location and time of death, as well as any pattern or practice that may have brought about the death;
- (e) to distinguish between natural death, accidental death, suicide and homicide;
- (f) to identify and apprehend the person(s) involved in the death;
- (g) to bring the suspected perpetrator(s) before a competent court established by law.”

In section D, it is stated that “In cases where government involvement is suspected, an objective and impartial investigation may not be possible unless a special commission of inquiry is established ...”

B. The European Committee for the Prevention of Torture

81. In the report on its visit to the United Kingdom and the Isle of Man from 8 to 17 September 1999, published on 13 January 2000, the European Committee for the Prevention of Torture (the CPT) reviewed the system of preferring criminal and disciplinary charges against police officers accused of ill-treating persons. It commented, *inter alia*, on the statistically few criminal prosecutions and disciplinary proceedings which were brought, and identified certain aspects of the procedures which cast doubt on their effectiveness:

The chief officers appointed officers from the same force to conduct the investigations, save in exceptional cases where they appointed an officer from another force, and the majority of investigations were unsupervised by the Police Complaints Authority.

It stated at paragraph 55:

“As already indicated, the CPT itself entertains reservations about whether the PCA [the Police Complaints Authority], even equipped with the enhanced powers which have been proposed, will be capable of persuading public opinion that complaints against the police are vigorously investigated. **In the view of the CPT, the creation of a fully-fledged independent investigating agency would be a most welcome development. Such a body should certainly, like the PCA, have the power to direct that disciplinary proceedings be instigated against police officers. Further, in the interests of bolstering public confidence, it might also be thought appropriate that such a body be invested with the power to remit a case directly to the CPS for consideration of whether or not criminal proceedings should be brought.**

In any event, **the CPT recommends that the role of the ‘chief officer’ within the existing system be reviewed.** To take the example of one Metropolitan Police officer to whom certain of the chief officer’s functions have been delegated (the Director of the CIB [Criminal Investigations Bureau]), he is currently expected to: seek dispensations from the PCA; appoint investigating police officers and assume managerial responsibility for their work; determine whether an investigating officer’s report indicates that a criminal offence may have been committed; decide whether to bring disciplinary proceedings against a police officer on the basis of an investigating officer’s report, and liaise with the PCA on this question; determine which disciplinary charges should be brought against an officer who is to face charges; in civil cases, negotiate settlement strategies and authorise payments into court. It is doubtful whether it is realistic to expect any single official to be able to perform all of these functions in an entirely independent and impartial way.

57. ...Reference should also be made to the high degree of public interest in CPS [Crown Prosecution Service] decisions regarding the prosecution of police officers (especially in cases involving allegations of serious misconduct). Confidence about the manner in which such decisions are reached would certainly be strengthened were the CPS to be obliged to give detailed reasons in cases where it was decided that no criminal proceedings should be brought. The CPT recommends that such a requirement be introduced.”

THE LAW

I. ALLEGED VIOLATIONS OF ARTICLE 2 OF THE CONVENTION

82. The applicants submitted that their relatives had been unjustifiably killed and that there had been no effective investigation into the circumstances of their death. They invoked Article 2 of the Convention which provides:

“1. Everyone’s right to life shall be protected by law. No one shall be deprived of his life intentionally save in the execution of a sentence of a court following his conviction of a crime for which this penalty is provided by law.

2. Deprivation of life shall not be regarded as inflicted in contravention of this Article when it results from the use of force which is no more than absolutely necessary:

- (a) in defence of any person from unlawful violence;
- (b) in order to effect a lawful arrest or to prevent the escape of a person lawfully detained;
- (c) in action lawfully taken for the purpose of quelling a riot or insurrection.”

A. The submissions made to the Court

1. The applicant

83. The applicants submitted that the death of their relatives was the result of the unnecessary and disproportionate use of force by SAS soldiers and that their relatives were the victims of a shoot-to-kill policy operated by the United Kingdom Government in Northern Ireland. They argued that in this case the planning and conduct of the operation were such as to suggest that its object was to kill all those involved or that it was negligent as to whether deaths would occur. They referred to the context in which the authorities were applying a more aggressive security response, to the prior knowledge which the security forces had of the operation, including the members of the IRA involved, the fact that no steps were taken to arrest or intercept the IRA members before the incident and that the operation was run as an ambush intended to kill those walking into it. There was no attempt to warn or arrest the IRA members when they arrived on the scene. Instead, there was a heavy concentration of fire which also placed civilians at risk of death and injury. No attempt was made to stop civilian cars from entering the location of the ambush. Having regard to the number and type of bullets fired (600 bullets were recovered out of a possible 2585 used and a mixture of ball tracer and armour piercing ammunition employed), the fact that at least three of the dead men were unarmed, the way in which the soldiers acted to neutralise any perceived threat and the evidence that at least one man (Seamus Donnelly) had been shot at close range while on the ground, the operation could not be regarded as employing minimum or proportionate force.

84. The inadequate investigations into this and other cases were also evidence of official tolerance on the part of the State of the use of unlawful lethal force. Here, none of the soldiers were arrested although there were grounds for doing so. They were allowed to leave the scene and not questioned for up to three days later. They had not been isolated from each other and their statements bore remarkable similarity in language, structure and content.

85. The applicants submitted that, while they had been denied any effective resolution to their claims, there was sufficient evidence to justify the Court in ruling that there had been a substantive violation of Article 2. They pointed out that the Government had not presented any arguments that the authorities had done their best to minimise the risk to life during the operation. To the extent that the Court felt unable to reach any conclusions on the facts, they argued that the Court should hear evidence from the soldiers and police officers involved in the incident and the investigation.

86. The applicants further submitted that there had been no effective official investigation carried out into the killings, relying on the international standards set out in the Minnesota Protocol. They argued that the RUC investigation was inadequate and flawed by its lack of independence from the security forces involved in the operation, as well as a lack of publicity or input from the family. The DPP's own role was limited by the RUC investigation and he did not make public his reasons for not prosecuting. The inquest procedure was flawed by the delays, the limited scope of the enquiry which could not deal with issues of

training or planning or control of the operation, a lack of legal aid for relatives, a lack of access to documents and witness statements, the non-compellability of security force or police witnesses and the use of public interest immunity certificates. The Government could not rely on civil proceedings either, as this depended on the initiative of the deceased's family.

2. The Government

87. While the Government did not accept the applicants' claims under Article 2 that their relatives were killed by any excessive or unjustified use of force, they considered that it would be wholly inappropriate for the Court to seek itself to determine the issues of fact arising on the substantive issues of Article 2. This might involve the Court seeking to resolve issues, and perhaps examining witnesses and conducting hearings, at the same time as the High Court in Northern Ireland, with a real risk of inconsistent findings. It would also allow the applicants to forum-shop and would thus undermine the principle of exhaustion of domestic remedies. They submitted that there were in any event considerable practical difficulties for the Court to pursue an examination of the substantive aspects of Article 2 as the factual issues would be numerous and complex, involving live evidence with a substantial number of witnesses. This primary fact finding exercise should not be performed twice, in parallel, such an undertaking wasting court time and costs and giving rise to a real risk of prejudice in having to defend two sets of proceedings simultaneously.

88. Insofar as the applicants invited the Court to find a practice of killing rather than arresting terrorist suspects, this allegation was emphatically denied. The Government submitted that such a wide ranging allegation calling into question every anti-terrorist operation over the last thirty years went far beyond the scope of this application and referred to matters not before this Court. They denied that there had been any inadequacy in the investigation in this case. The police officers who investigated had no prior knowledge of, or involvement in the operation, and their independence and integrity were not compromised by the fact that they were stationed in Armagh. The soldiers were interviewed as soon as the interviewing officers were ready to do so and the number of soldiers involved resulted in the process taking several days. They were entitled to have their legal advisers present and were instructed not to discuss the incident beforehand or to bring statements ready prepared. There was no evidence of collusion in the statements given.

89. The Government further denied that domestic law in any way failed to comply with the requirements of this provision. They argued that the procedural aspect of Article 2 was satisfied by the combination of procedures available in Northern Ireland, namely, the police investigation, which was supervised by the ICPC and by the DPP, the inquest proceedings and civil proceedings. These secured the fundamental purpose of the procedural obligation, in that they provided for effective accountability for the use of lethal force by State agents. This did not require that a criminal prosecution be brought but that the investigation was capable of leading to a prosecution, which was the case in this application. They also pointed out that each case had to be judged on its facts since the effectiveness of any procedural ingredient may vary with the circumstances. In the present case, they submitted that the available procedures together provided the necessary effectiveness, independence and transparency by way of safeguards against abuse.

3. The Northern Ireland Human Rights Commission

90. Referring to relevant international standards concerning the right to life (e.g. the Inter-American Court's case-law and the findings of the UN Human Rights Committee), the Commission submitted that the State had to carry out an effective official investigation when an agent of the State was involved or implicated in the use of lethal force. Internal accountability procedures had to satisfy the standards of effectiveness, independence, transparency and promptness, and facilitate punitive sanctions. It was however, in their view, not sufficient for a State to declare that while certain mechanisms were inadequate, a number of such mechanisms regarded cumulatively could provide the necessary protection. They submitted that the investigative mechanisms relied on in this case, singly or combined, failed to do so. They referred, *inter alia*, to the problematic role of the RUC in Northern Ireland, the allegedly serious deficiencies in the mechanisms of police accountability, the limited scope of and delays in inquests, and the lack of compellability of the members of the security forces who have used lethal force to appear at inquests. They drew the Court's attention to the form of enquiry carried out in Scotland under the Sheriff, a judge of criminal and civil jurisdiction, where the next of kin have a right to appear. They urged the Court to take the opportunity to give precise guidance as to the form which investigations into the use of lethal force by State agents should take.

B. The Court's assessment

1. General principles

91. Article 2, which safeguards the right to life and sets out the circumstances when deprivation of life may be justified, ranks as one of the most fundamental provisions in the Convention, to which in peacetime no derogation is permitted under Article 15. Together with Article 3, it also enshrines one of the basic values of the democratic societies making up the Council of Europe. The circumstances in which deprivation of life may be justified must therefore be strictly construed. The object and purpose of the Convention as an instrument for the protection of individual human beings also requires that Article 2 be interpreted and applied so as to make its safeguards practical and effective (see the *McCann and Others v. the United Kingdom* judgment of 27 September 1995, Series A no. 324, pp. 45-46, §§ 146-147).

92. In the light of the importance of the protection afforded by Article 2, the Court must subject deprivations of life to the most careful scrutiny, taking into consideration not only the actions of State agents but also all the surrounding circumstances. Where the events in issue lie wholly, or in large part, within the exclusive knowledge of the authorities, as for example in the case of persons within their control in custody, strong presumptions of fact will arise in respect of injuries and death which occur. Indeed, the burden of proof may be regarded as resting on the authorities to provide a satisfactory and convincing explanation (see *Salman v. Turkey* [GC] no. 21986/93, ECHR 2000-VII, § 100, and also *Çakıcı v. Turkey*, [GC] ECHR 1999- IV, § 85, *Ertak v. Turkey* no. 20764/92 [Section 1] ECHR 2000-V, § 32 and *Timurtaş v. Turkey*, no; 23531/94 [Section 1] ECHR 2000-VI, § 82).

93. The text of Article 2, read as a whole, demonstrates that it covers not only intentional killing but also the situations where it is permitted to "use force" which may result, as an unintended outcome, in the deprivation of life. The deliberate or intended use of lethal force is only one factor however to be taken into account in assessing its necessity. Any use of force must be no more than "absolutely necessary" for the achievement of one or more of the purposes set out in sub-paragraphs (a) to (c). This term indicates that a stricter and

more compelling test of necessity must be employed from that normally applicable when determining whether State action is “necessary in a democratic society” under paragraphs 2 of Articles 8 to 11 of the Convention. Consequently, the force used must be strictly proportionate to the achievement of the permitted aims (the McCann judgment, cited above, §§ 148-149).

94. The obligation to protect the right to life under Article 2 of the Convention, read in conjunction with the State’s general duty under Article 1 of the Convention to “secure to everyone within [its] jurisdiction the rights and freedoms defined in [the] Convention”, also requires by implication that there should be some form of effective official investigation when individuals have been killed as a result of the use of force (see, *mutatis mutandis*, the McCann judgment, cited above, p. 49, § 161, and the Kaya v. Turkey judgment of 19 February 1998, *Reports of Judgments and Decisions* 1998-I, p. 329, § 105). The essential purpose of such investigation is to secure the effective implementation of the domestic laws which protect the right to life and, in those cases involving State agents or bodies, to ensure their accountability for deaths occurring under their responsibility. What form of investigation will achieve those purposes may vary in different circumstances. However, whatever mode is employed, the authorities must act of their own motion, once the matter has come to their attention. They cannot leave it to the initiative of the next of kin either to lodge a formal complaint or to take responsibility for the conduct of any investigative procedures (see, for example, *mutatis mutandis*, *İlhan v. Turkey* [GC] no. 22277/93, ECHR 2000-VII, § 63).

95. For an investigation into alleged unlawful killing by State agents to be effective, it may generally be regarded as necessary for the persons responsible for and carrying out the investigation to be independent from those implicated in the events (see e.g. Güleç v. Turkey judgment of 27 July 1998, *Reports* 1998-IV, §§ 81-82; *Öğur v. Turkey*, [GC] no. 21954/93, ECHR 1999-III, §§ 91-92). This means not only a lack of hierarchical or institutional connection but also a practical independence (see for example the case of Ergi v. Turkey judgment of 28 July 1998, *Reports* 1998-IV, §§ 83-84 where the public prosecutor investigating the death of a girl during an alleged clash showed a lack of independence through his heavy reliance on the information provided by the gendarmes implicated in the incident).

96. The investigation must also be effective in the sense that it is capable of leading to a determination of whether the force used in such cases was or was not justified in the circumstances (e.g. Kaya v. Turkey judgment, cited above, p. 324, § 87) and to the identification and punishment of those responsible. This is not an obligation of result, but of means. The authorities must have taken the reasonable steps available to them to secure the evidence concerning the incident, including *inter alia* eye witness testimony, forensic evidence and, where appropriate, an autopsy which provides a complete and accurate record of injury and an objective analysis of clinical findings, including the cause of death (see concerning autopsies, e.g. *Salman v. Turkey* cited above, § 106; concerning witnesses e.g. *Tanrikulu v. Turkey* [GC], no. 23763/94, ECHR 199-IV, § 109; concerning forensic evidence e.g. *Gül v. Turkey*, 22676/93, [Section 4], § 89). Any deficiency in the investigation which undermines its ability to establish the cause of death or the person responsible will risk falling foul of this standard.

97. A requirement of promptness and reasonable expedition is implicit in this context (see Yaşa v. Turkey judgment of 2 September 1998, *Reports* 1998-IV, pp. 2439-2440, §§ 102-104; *Cakıcı v. Turkey* cited above, §§ 80, 87 and 106; *Tanrikulu v. Turkey*, cited above, § 109; *Mahmut Kaya v. Turkey*, no. 22535/93, [Section I] ECHR 2000-III, §§ 106-107). It must be accepted that there may be obstacles or difficulties which prevent progress in an

investigation in a particular situation. However, a prompt response by the authorities in investigating a use of lethal force may generally be regarded as essential in maintaining public confidence in their adherence to the rule of law and in preventing any appearance of collusion in or tolerance of unlawful acts.

98. For the same reasons, there must be a sufficient element of public scrutiny of the investigation or its results to secure accountability in practice as well as in theory. The degree of public scrutiny required may well vary from case to case. In all cases, however, the next of kin of the victim must be involved in the procedure to the extent necessary to safeguard his or her legitimate interests (see *Güleç v. Turkey*, cited above, p. 1733, § 82, where the father of the victim was not informed of the decisions not to prosecute; *Öğur v. Turkey*, cited above, § 92, where the family of the victim had no access to the investigation and court documents; *Gül v. Turkey* judgment, cited above, § 93).

2. Application in the present case

a. Concerning alleged responsibility of the State for the death of the nine men at Loughgall

99. It is undisputed that the nine men at Loughgall were shot and killed by SAS soldiers. Three of the men at least were unarmed: Antony Hughes who was a civilian unconnected with the IRA, as well as the IRA members Declan Arthurs and Gerard O'Callaghan. This use of lethal force falls squarely within the ambit of Article 2, which requires any such action to pursue one of the purposes set out in second paragraph and to be no more than absolutely necessary for that purpose. A number of key factual issues arise in this case, in particular whether any warnings could have been given; whether the soldiers acted on an honest belief perceived for good reasons to be valid at the time but which turned out subsequently to be mistaken, namely, that they were at risk from the men who were shot, and whether any of the deceased were shot when they were already injured and on the ground in circumstances where it would have been possible to carry out an arrest. Determining these issues would involve *inter alia* careful scrutiny of the accounts of the soldiers as to the circumstances in which they fired their weapons during the operation. Assessment of the credibility and reliability of the various witnesses would play a crucial role.

100. These are matters which were raised in the civil proceedings lodged by seven of the families. The action in negligence brought by the family of Antony Hughes was settled, the family of Kevin McKearney have dropped their proceedings, whilst the claims of five other families are still pending (see paragraphs 42-46 above).

(i) Concerning the five families involved in pending civil proceedings

101. The Court considers that in the circumstances of this case it would be inappropriate and contrary to its subsidiary role under the Convention to attempt to establish the facts of this case by embarking on a fact finding exercise of its own by summoning witnesses. Such an exercise would duplicate the proceedings before the civil courts which are better placed and equipped as fact finding tribunals. While the European Commission of Human Rights has previously embarked on fact finding missions in cases from Turkey where there were pending proceedings against the alleged security force perpetrators of unlawful killings, it may be noted that these proceedings were criminal and had terminated, at first instance at least, by the time the Court was examining the applications. In those cases, it was an essential part of the applicants' allegations that the defects in the investigation were such as to render those criminal proceedings ineffective (see e.g. *Salman v. Turkey*, cited above, §

107, where the police officers were acquitted of torture due to the lack of evidence resulting principally from a defective autopsy procedure; *Gül v. Turkey*, cited above, § 89, where *inter alia* the forensic investigation at the scene and autopsy procedures hampered any effective reconstruction of events).

102. In the present case, the Court does not consider that there are any elements established which would deprive the civil courts of their ability to establish the facts and determine the lawfulness or otherwise of the deaths (see further below concerning the applicants' allegations about the defects in the police investigation, §§ 112-113).

103. Nor is the Court persuaded that it is appropriate to rely on the documentary material provided by the parties to reach any conclusions as to responsibility for the death of the applicants' relatives. The written accounts provided have not been tested in examination or cross-examination and would provide an incomplete and potentially misleading basis for any such attempt. The situation cannot be equated to a death in custody where the burden may be regarded as resting on the State to provide a satisfactory and plausible explanation.

104. The Court is also not prepared to conduct, on the basis largely of statistical information and selective evidence, an analysis of incidents over the past thirty years with a view to establishing whether they disclose a practice by security forces of using disproportionate force. This would go far beyond the scope of the present application.

105. Conversely, as regards the Government's argument that the availability of civil proceedings provided the applicants with a remedy which they have not exhausted as regards Article 35 § 1 of the Convention and, therefore, that no further examination of the case is required under the Article 2, the Court recalls that the obligations of the State under Article 2 cannot be satisfied merely by awarding damages (see e.g. *Kaya v. Turkey*, p. 329, § 105; *Yaşa v. Turkey*, p. 2431, § 74). The investigations required under Articles 2 and 13 of the Convention must be able to lead to the identification and punishment of those responsible. The Court therefore examines below whether there has been compliance with this procedural aspect of Article 2 of the Convention.

(ii) Concerning the family of Antony Hughes

106. The Court considers that in bringing civil proceedings for aggravated damages in respect of her husband Antony Hughes the applicant, Bridget Hughes, has used the local remedies available. It has not been shown that the state of domestic law *per se* fails to comply with the Convention standards or that there has been an administrative practice which would render civil procedures ineffective as a remedy for her complaints. Nor has it been shown that the applicant had no alternative to accepting the settlement offered by the authorities in those proceedings and therefore that the civil courts offered no prospect to the applicant of obtaining a finding of liability in her favour.

107. The Court therefore finds that in settling her claims in civil proceedings concerning the death of her husband, and in accepting and receiving compensation, the applicant has effectively renounced further use of these remedies. She may no longer, in these circumstances, claim to be a victim of a violation of the Convention as regards the alleged excessive or disproportionate force used in killing her husband. Her complaints concerning the procedural obligations under Article 2 will be considered below, with those of the other applicants.

(iii) Concerning the families who did not pursue or lodge any civil proceedings

108. The Court has noted above that civil proceedings offered the possibility of obtaining a determination of the issues of lawfulness of the use of force, including its proportionality, as well as providing the possibility of compensation. The applicants have stated that it was not worthwhile to embark on such proceedings as the practice of the State in offering settlements prevented any admissions of liability being issued by the courts, which was what they wanted rather than money as such.

109. The Court observes that in only one of the seven cases introduced by the applicants was a settlement offered by the authorities. In the previous case of *Caraher v. the United Kingdom*, (no. 24520/94, decision [Section 3] 11.01.00), where the applicant accepted a settlement of her action in respect of the killing of her husband by two soldiers, the Court did not find that the civil proceedings had been shown to be ineffective as a means of redress for the applicant's complaints. It finds nothing in the submissions of the applicants in this case to persuade it to reach another conclusion.

110. Consequently, as regards those applicants who did not take or pursue civil proceedings regarding the alleged unlawfulness of the deaths of their relatives, the Court finds that they have failed to make use of the available domestic remedies. It is therefore precluded from examining the applicants' complaints of a substantive violation of Article 2 due to the alleged excessive use of force or negligence in the planning or control of the operation. Their complaints concerning the procedural obligations under Article 2 will be considered below, with those of the other applicants.

b. Concerning the procedural obligation under Article 2 of the Convention

111. Following the deaths of the nine men at Loughgall, an investigation was commenced by the RUC. On the basis of that investigation, there was a decision by the DPP not to prosecute any soldier. An inquest was opened on 30 May 1995 and terminated on 2 June 1995 with verdicts that the nine men had died from serious and multiple gun shot wounds.

112. The applicants have made numerous complaints about these procedures, while the Government have contended that even if one part of the procedure failed to provide a particular safeguard, taken as a whole, the system ensured the requisite accountability of the police for any unlawful act.

(i) The police investigation

113. Firstly, concerning the police investigation, the Court finds little substance in the applicants' criticisms. It appears that the investigation started immediately after the operation ended. The necessary scene of the incident procedures were carried out and evidence secured. The appropriate forensic examinations were conducted. While the soldiers were not interviewed immediately, the interviews were concluded within three days, a not unreasonable period of time considering the numbers involved. While the applicants alleged that the soldiers were not kept apart from their colleagues and their statements showed similarities, the Court does not find any striking signs of stereotyping which would support a finding that the investigators had colluded in, or facilitated, the production of co-ordinated statements.

114. The applicants also complained that the RUC officers involved in the investigation could not be regarded as independent or impartial. While the investigating officers did not appear to be connected structurally or factually with the soldiers under investigation, the operation at Loughgall was nonetheless conducted jointly with local police officers, some of whom were injured, and with the co-operation and knowledge of the RUC in that area. Even

though it also appears that, as required by law, this investigation was supervised by the ICPC, an independent police monitoring authority, this cannot provide a sufficient safeguard where the investigation itself has been for all practical purposes conducted by police officers connected, albeit indirectly, with the operation under investigation. The Court notes the recommendation of the CPT that a fully independent investigating agency would help to overcome the lack of confidence in the system which exists in England and Wales and is in some respects similar (see paragraph 81 above).

115. It is furthermore the case that the investigation was not open to the public and did not involve the applicants or the families. Investigation files are not accessible in this way in the United Kingdom, the Government submitting that the efficiency of procedures requires that the contents be kept confidential until the later stages of a prosecution. The Court considers that disclosure or publication of police reports and investigative materials may involve sensitive issues with possible prejudicial effects to private individuals or other investigations and, therefore, cannot be regarded as an automatic requirement under Article 2. The requisite access of the public, or the victim's relatives may be provided for in other stages of the available procedures.

(ii) The role of the DPP

116. The Court recalls that the DPP is an independent legal officer charged with the responsibility to decide whether to bring prosecutions in respect of any possible criminal offences carried out by a police officer. He is not required to give reasons for any decision not to prosecute and in this case he did not do so. No challenge by way of judicial review exists to require him to give reasons in Northern Ireland, though it may be noted that in England and Wales, where the inquest jury may still reach verdicts of unlawful death, the courts have required the DPP to reconsider a decision not to prosecute in the light of such a verdict, and will review whether those reasons are sufficient. This possibility does not exist in Northern Ireland where the inquest jury is no longer permitted to issue verdicts concerning the lawfulness or otherwise of a death.

117. The Court does not doubt the independence of the DPP. However, where the police investigation procedure is itself open to doubts of a lack of independence and is not amenable to public scrutiny, it is of increased importance that the officer who decides whether or not to prosecute also gives an appearance of independence in his decision-making. Where no reasons are given in a controversial incident involving the use of lethal force, this may in itself not be conducive to public confidence. It also denies the family of the victim access to information about a matter of crucial importance to them and prevents any legal challenge of the decision.

118. In this case, nine men were shot and killed, of whom one was unconnected with the IRA and two others at least were unarmed. It is a situation which, to borrow the words of the domestic courts, cries out for an explanation. The applicants however were not informed of why the shootings were regarded as not disclosing a criminal offence or as not meriting a prosecution of the soldiers concerned. There was no reasoned decision available to reassure a concerned public that the rule of law had been respected. This cannot be regarded as compatible with the requirements of Article 2, unless that information was forthcoming in some other way. This however is not the case.

(iii) The inquest

119. In Northern Ireland, as in England and Wales, investigations into deaths may also be conducted by inquests. Inquests are public hearings conducted by coroners, independent judicial officers, normally sitting with a jury, to determine the facts surrounding a suspicious death. Judicial review lies from procedural decisions by coroners and in respect of any mistaken directions given to the jury. There are thus strong safeguards as to the lawfulness and propriety of the proceedings. In the case of *McCann and Others v. the United Kingdom* (cited above, p. 49, § 162), the Court found that the inquest held into the deaths of the three IRA suspects shot by the SAS on Gibraltar satisfied the procedural obligation contained in Article 2, as it provided a detailed review of the events surrounding the killings and provided the relatives of the deceased with the opportunity to examine and cross-examine witnesses involved in the operation.

120. There are however a number of differences between the inquest as held in the *McCann* case and those in Northern Ireland.

121. In inquests in Northern Ireland, any person suspected of causing the death may not be compelled to give evidence (Rule 9(2) of the 1963 Coroners Rules, see paragraph 56 above). In practice, in inquests involving the use of lethal force by members of the security forces in Northern Ireland, the police officers or soldiers concerned do not attend. Instead, written statements or transcripts of interviews are admitted in evidence. At the inquest in this case, none of the soldiers A to X appeared. They have therefore not been subject to examination concerning their account of events. The records of their statements taken in interviews with investigating police officers were made available to the Coroner instead (see paragraphs 16 to 23 above). This does not enable any satisfactory assessment to be made of either their reliability or credibility on crucial factual issues. It detracts from the inquest's capacity to establish the facts immediately relevant to the death, in particular the lawfulness of the use of force and thereby to achieve one of the purposes required by Article 2 of the Convention (see also paragraph 10 of the United Nations Principles on Extra-Legal Executions cited at paragraph 79 above).

122. It is also alleged that the inquest in this case is restricted in the scope of its examination. According to the case-law of the national courts, the Coroner is required to confine his investigation to the matters directly causative of the death and not extend his inquiry into the broader circumstances. This was the standard applicable in the *McCann* inquest also and did not prevent examination of those aspects of the planning and conduct of the operation relevant to the killings of the three IRA suspects. The Court is not persuaded therefore that the approach to inquests taken by the domestic courts necessarily contradicts the requirements of Article 2. The domestic courts accept that an essential purpose of the inquest is to allay rumours and suspicions of how a death came about. The Court agrees that a detailed investigation into policy issues or alleged conspiracies may not be justifiable or necessary. Whether an inquest fails to address necessary factual issues will depend on the particular circumstances of the case. It has not been shown in the present application that the scope of the inquest as conducted prevented any particular matters relevant to the death being examined. The inability to address issues of the planning, control and execution of the operation resulted primarily from the absence of the soldiers concerned.

123. Nonetheless, unlike the *McCann* inquest, the jury's verdict in this case could only give the identity of the deceased and the date, place and cause of death (see paragraph 53 above). In England and Wales, as in Gibraltar, the jury is able to reach a number of verdicts, including "unlawful death". As already noted, where an inquest jury gives such a verdict in England and Wales, the DPP is required to reconsider any decision not to prosecute and to

give reasons which are amenable to challenge in the courts. In this case, the only relevance the inquest may have to a possible prosecution is that the Coroner may send a written report to the DPP if he considers that a criminal offence may have been committed. It is not apparent however that the DPP is required to take any decision in response to this notification or to provide detailed reasons for not directing a prosecution as recommended.

124. Notwithstanding the useful fact finding function that an inquest may provide in some cases, the Court considers that in this case it could play no effective role in the identification or prosecution of any criminal offences which may have occurred and, in that respect, falls short of the requirements of Article 2.

125. The public nature of the inquest proceedings is not in dispute. Indeed the inquest appears perhaps for that reason to have become the most popular legal forum in Northern Ireland for attempts to challenge the conduct of the police and security forces in the use of lethal force. The applicants complained however that their ability to participate in the proceedings as the next of kin to the deceased was significantly prejudiced as legal aid was not available in inquests and documents were not disclosed in advance of the proceedings.

126. The Court notes that six of the families were represented by counsel at the inquest. Legal aid was also available for a judicial review application concerning the Coroner's procedural decisions. It has not been explained why the others were not represented by the same, or by another, counsel or indeed whether they wished to be represented at the inquest. It has not been established therefore that the applicants have been prevented, by the lack of legal aid, from obtaining any necessary legal assistance at the inquest.

127. As regards access to documents, the applicants were not able to obtain copies of any witness statements until the witness concerned was giving evidence. This was also the position in the McCann case, where the Court considered that this had not substantially hampered the ability of the families' lawyers to question the witnesses (cited above, p. 49, § 62). However it must be noted that the inquest in that case was to some extent exceptional when compared with the proceedings in a number of cases in Northern Ireland (see also the cases of *Jordan v. the United Kingdom*, no. 24746/94, *McKerr v. the United Kingdom*, no. 28883/95, and *Shanaghan v. the United Kingdom*, no. 37715/97). The promptness and thoroughness of the inquest in the McCann case left the Court in no doubt that the important facts relating to the events had been examined with the active participation of the applicants' experienced legal representative. The non-access by the next-of-kin to the documents did not, in that context, disclose any significant handicap. However, since that case, the Court has laid more emphasis on the importance of involving the next of kin of a deceased in the procedure and providing them with information (see *Öğur v. Turkey*, cited above, § 92).

Further, the Court notes that the practice of non-disclosure has changed in the United Kingdom in the light of the Stephen Lawrence Inquiry and that it is now recommended that the police disclose witness statements 28 days in advance (see paragraph 61 above).

128. In this case, it may be observed that problems of lack of access to the witness statements was the reason for several long adjournments before the inquest opened. This contributed significantly to prolonging the proceedings. The Court considers this further below in the context of the delay (see paragraphs 130-134). Once the inquest opened, the applicants who were represented requested an adjournment to apply for judicial review of the Coroner's decision not to give them prior access to witness statements. When this was refused, they instructed their lawyer to withdraw from the inquest. The inability of the families to have access to witness statements before the appearance of the witness must be regarded as having placed them at a disadvantage in terms of preparation and ability to

participate in questioning. This contrasts strikingly with the position of the RUC and army (Ministry of Defence) who had the resources to provide for legal representation and had access to information about the incident from their own records and personnel. The Court considers that the right of the family of the deceased whose death is under investigation to participate in the proceedings requires that the procedures adopted ensure the requisite protection of their interests, which may be in direct conflict with those of the police or security forces implicated in the events. The Court is not persuaded that the interests of the applicants as next-of-kin were fairly or adequately protected in this respect.

129. Reference has also been made to the allegedly frequent use of public interest immunity certificates in inquests to prevent certain questions or the disclosure of certain documents. However, no certificate in fact issued in the inquest in this case. There is therefore no basis for finding that the use of these certificates prevented examination of any circumstances relevant to the deaths of the applicants' relatives.

130. Finally, the Court has had regard to the delay in the proceedings. The inquest opened on 30 May 1995, more than eight years after the deaths occurred. Although the DPP's decision not to prosecute issued on 22 September 1988, the RUC did not forward the papers to the Coroner until 9 May 1990. No explanation has been forthcoming for this delay. There were then a series of adjournments before the inquest opened. Once it opened, it concluded within a matter of days, on 2 June 1995. The adjournments were as follows:

- The inquest was due to open on 24 September 1990. The Coroner agreed to an adjournment on 6 September 1990 at the request of the applicants pending the determination of the *Devine* case concerning access of relatives to witness statements. The *Devine* case concluded on 6 February 1992, some sixteen months later.
- The Coroner agreed to an adjournment pending the judicial review proceedings in the McKerr, Toman and Burns inquests concerning access to documents used by witnesses to refresh their memories. These concluded on 28 May 1993, fifteen months later.
- The adjournment continued pending the court proceedings in the McKerr, Toman and Burns inquests concerning access to the Stalker and Sampson Reports which allegedly concerned issues of a shoot-to-kill policy. These concluded on 20 April 1994, eleven months further on. The inquest however only resumed on 30 May 1995 more than a year later.

131. The Court observes that these adjournments were requested by, or consented to, by the applicants. They related principally to legal challenges to procedural aspects of the inquest which they considered essential to their ability to participate - in particular as regards their access to the documents. It may be noted that the judicial review proceedings which resulted in an adjournment from 6 September 1990 to 6 February 1992 (over one year and four months) concerned access to witness statements which are now being disclosed voluntarily due to developments in what is perceived as a desirable practice *vis-à-vis* a victim's relatives. The second set of judicial proceedings also concluded in favour of the families, since the courts held that Coroners should make available statements used by witnesses to refresh their memories. Nor can it be regarded as unreasonable that the applicants agreed to an adjournment to await the possible disclosure of an independent police enquiry which was alleged to concern issues of a deliberate policy of the security forces in using lethal force.

132. While it is therefore the case that the applicants contributed significantly to the delay in the inquest being opened, this has to some extent resulted from the difficulties facing relatives in participating in inquest procedures (see paragraphs 127-128 above concerning the non-disclosure of witness statements). It cannot be regarded as unreasonable that the

applicants had regard to the legal remedies being used to challenge these aspects of inquest procedure. The Court observes that the Coroner, who was responsible for the conduct of the proceedings, acceded to these adjournments. The fact that they were requested by the applicants do not dispense the authorities from ensuring compliance with the requirement for reasonable expedition (see *mutatis mutandis* concerning speed requirements under Article 6 § 1 of the Convention, *Scopelliti v. Italy* judgment of 23 November 1993, Series A no. 278, p. 9, § 25). If long adjournments are regarded as justified in the interests of procedural fairness to the deceaseds' families, it calls into question whether the inquest system was at the relevant time structurally capable of providing for both speed and effective access for the families concerned.

133. Nor did the inquest progress with diligence in the periods unrelated to the adjournments. The Court refers to the delay in commencing the inquest and the lapse of time in scheduling the resumption of the inquest after the adjournments.

134. Having regard to these considerations, the time taken in this inquest cannot be regarded as compatible with the State's obligation under Article 2 of the Convention to ensure that investigations into suspicious deaths are carried out promptly and with reasonable expedition.

(iv) Civil proceedings

135. As found above (see paragraph 102), civil proceedings would provide a judicial fact finding forum, with the attendant safeguards and the ability to reach findings of unlawfulness, with the possibility of damages. It is however a procedure undertaken on the initiative of the applicant, not the authorities, and it does not involve the identification or punishment of any alleged perpetrator. As such, it cannot be taken into account in the assessment of the State's compliance with its procedural obligations under Article 2 of the Convention.

(v) Conclusion

136. The Court finds that the proceedings for investigating the use of lethal force by the security forces have been shown in this case to disclose the following shortcomings:

- a lack of independence of the investigating police officers from the security forces involved in the incident;
- a lack of public scrutiny, and information to the victims' families of the reasons for the decision of the DPP not to prosecute any soldier;
- the inquest procedure did not allow for any verdict or findings which could play an effective role in securing a prosecution in respect of any criminal offence which might have been disclosed;
- the soldiers who shot the deceased could not be required to attend the inquest as witnesses;
- the non-disclosure of witness statements prior to the witnesses' appearance at the inquest prejudiced the ability of the applicants to participate in the inquest and contributed to long adjournments in the proceedings;
- the inquest proceedings did not commence promptly and were not pursued with reasonable expedition.

137. It is not for this Court to specify in any detail which procedures the authorities should adopt in providing for the proper examination of the circumstances of a killing by State agents. While reference has been made for example to the Scottish model of enquiry

conducted by a judge of criminal jurisdiction, there is no reason to assume that this may be the only method available. Nor can it be said that there should be one unified procedure providing all requirements. If the aims of fact finding, criminal investigation and prosecution are carried out or shared between several authorities, as in Northern Ireland, the Court considers that the requirements of Article 2 may nonetheless be satisfied if, while seeking to take into account other legitimate interests such as national security or the protection of the material relevant to other investigations, they provide for the necessary safeguards in an accessible and effective manner. In the present case, the available procedures have not struck the right balance.

138. The Court would observe that the shortcomings in transparency and effectiveness identified above run counter to the purpose identified by the domestic courts of allaying suspicions and rumours. Proper procedures for ensuring the accountability of agents of the State are indispensable in maintaining public confidence and meeting the legitimate concerns that might arise from the use of lethal force. Lack of such procedures will only add fuel to fears of sinister motivations, as is illustrated *inter alia* by the submissions made by the applicants concerning the alleged shoot-to-kill policy.

139. The Court finds that there has been a failure to comply with the procedural obligation imposed by Article 2 of the Convention and that there has been, in this respect, a violation of that provision.

III. ALLEGED VIOLATION OF ARTICLE 6 § 1 OF THE CONVENTION

140. The applicants invoked Article 6 § 1 which provides as relevant:

“1. In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. ...”

141. The applicants claimed that their relatives were arbitrarily killed in circumstances where an arrest could have been effected by the soldiers and that the soldiers deliberately killed their relatives as an alternative to arresting them. They referred to concerns expressed, for example, by Amnesty International that killings by the security forces in Northern Ireland reflected a deliberate policy to eliminate individuals rather than arrest them and bring them before a court for any determination of a criminal charge.

142. The Government submitted that the shooting of the applicants' relatives could not be regarded as a summary punishment for a crime. Nor could the alleged failure to prosecute raise any issues under Article 6 § 1 of the Convention.

143. The Court recalls that the lawfulness of the shooting of the nine men at Loughgall is pending consideration in the civil proceedings instituted by five of the applicants' families. The Hughes family have settled their civil claims, while three families have not considered it worthwhile to lodge or pursue proceedings (see paragraphs 42-46 above). In these circumstances and in the light of the scope of the present application, the Court finds no basis for reaching any findings as to the alleged improper motivation behind the incident. Any issues concerning the effectiveness of criminal investigation procedures fall to be considered under Articles 2 and 13 of the Convention.

144. There has, accordingly, been no violation of Article 6 § 1 of the Convention.

IV. ALLEGED VIOLATION OF ARTICLE 14 OF THE CONVENTION

145. The applicants invoked Article 14 of the Convention, which provides:

“The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status.”

146. The applicants submitted that the circumstances of the killing of their relatives disclosed discrimination. They alleged that, between 1969 and March 1994, 357 people had been killed by members of the security forces, the overwhelming majority of whom were young men from the Catholic or nationalist community. When compared with the numbers of those killed from the Protestant community and having regard to the fact that there have been relatively few prosecutions (31) and only a few convictions (four, at the date of this application), this showed that there was a discriminatory use of lethal force and a lack of legal protection vis-à-vis a section of the community on grounds of national origin or association with a national minority.

147. The Government replied that there was no evidence that any of the deaths which occurred in Northern Ireland were analogous or that they disclosed any difference in treatment. Bald statistics (the accuracy of which was not accepted) were not enough to establish broad allegations of discrimination against Catholics or nationalists.

148. Where a general policy or measure has disproportionately prejudicial effects on a particular group, it is not excluded that this may be considered as discriminatory notwithstanding that it is not specifically aimed or directed at that group. However, even though statistically it appears that the majority of people shot by the security forces were from the Catholic or nationalist community, the Court does not consider that statistics can in themselves disclose a practice which could be classified as discriminatory within the meaning of Article 14. There is no evidence before the Court which would entitle it to conclude that any of those killings, save the four which resulted in convictions, involved the unlawful or excessive use of force by members of the security forces.

149. The Court finds that there has been no violation of Article 14 of the Convention.

V. ALLEGED VIOLATION OF ARTICLE 13 OF THE CONVENTION

150. The applicants complained that they had no effective remedy in respect of their complaints, invoking Article 13 which provides:

“Everyone whose rights and freedoms as set forth in this Convention are violated shall have an effective remedy before a national authority notwithstanding that the violation has been committed by persons acting in an official capacity.”

151. The applicants referred to their submissions concerning the procedural aspects of Article 2 of the Convention, claiming that in addition to the payment of compensation where appropriate Article 13 required a thorough and effective investigation capable of leading to the identification and punishment of those responsible and including effective access for the complainant to the investigatory procedure.

152. The Government submitted that the complaints raised under Article 13 were either premature or ill-founded. They claimed that the combination of available procedures, which included the pending civil proceedings and the inquest, provided effective remedies.

153. The Court's case-law indicates that Article 13 of the Convention guarantees the availability at the national level of a remedy to enforce the substance of the Convention rights and freedoms in whatever form they might happen to be secured in the domestic legal

order. The effect of Article 13 is thus to require the provision of a domestic remedy to deal with the substance of an “arguable complaint” under the Convention and to grant appropriate relief, although Contracting States are afforded some discretion as to the manner in which they conform to their Convention obligations under this provision. The scope of the obligation under Article 13 varies depending on the nature of the applicant’s complaint under the Convention. Nevertheless, the remedy required by Article 13 must be “effective” in practice as well as in law (see the *Aksoy v. Turkey* judgment of 18 December 1996, *Reports* 1996-IV, p. 2286, § 95; the *Aydın v. Turkey* judgment of 25 September 1997, *Reports* 1997-VI, pp. 1895-96, § 103; the *Kaya v. Turkey* judgment cited above, pp. 329-30, § 106).

154. In cases of the use of lethal force or suspicious deaths, the Court has also stated that, given the fundamental importance of the right to the protection of life, Article 13 requires, in addition to the payment of compensation where appropriate, a thorough and effective investigation capable of leading to the identification and punishment of those responsible for the deprivation of life, including effective access for the complainant to the investigation procedure (see the *Kaya v. Turkey* judgment cited above, pp. 330-31, § 107). In a number of cases it has found that there has been a violation of Article 13 where no effective criminal investigation had been carried out, noting that the requirements of Article 13 were broader than the obligation to investigate imposed by Article 2 of the Convention (see also *Ergi v. Turkey*, cited above, p.1782, § 98; *Salman v. Turkey* cited above, § 123).

155. It must be observed that these cases derived from the situation pertaining in south-east Turkey, where applicants were in a vulnerable position due to the ongoing conflict between the security forces and the PKK and where the most accessible means of redress open to applicants was to complain to the public prosecutor, who was under a duty to investigate alleged crimes. In the Turkish system, the complainant was able to join any criminal proceedings as an intervenor and apply for damages at the conclusion of any successful prosecution. The public prosecutor’s fact-finding function was also essential to any attempt to take civil proceedings. In those cases, therefore, it was sufficient for the purposes of former Article 26 (now Article 35 § 1) of the Convention, that an applicant complaining of unlawful killing raised the matter with the public prosecutor. There was accordingly a close procedural and practical relationship between the criminal investigation and the remedies available to the applicant in the legal system as a whole.

156. The legal system pertaining in Northern Ireland is different and any application of Article 13 to the factual circumstances of any case from that jurisdiction must take this into account. An applicant who claims the unlawful use of force by soldiers or police officers in the United Kingdom must as a general rule exhaust the domestic remedies open to him or her by taking civil proceedings by which the courts will examine the facts, determine liability and if appropriate award compensation. These civil proceedings are wholly independent of any criminal investigation and their efficacy has not been shown to rely on the proper conduct of criminal investigations or prosecutions (see e.g. *Carafer v. the United Kingdom*, no. 24520/94, decision of inadmissibility [Section 3] 11.01.00).

157. In the present case, seven of the applicants lodged civil proceedings, of which five are still pending, the Hughes family having settled their claims and another family having ceased to pursue their claims. Two families did not consider that it was worthwhile bringing such proceedings. The Court has found no elements which would prevent civil proceedings providing the redress identified above in respect of the alleged excessive use of force (see paragraph 102 above).

158. As regards the applicants' complaints concerning the investigation into the death carried out by the authorities, these have been examined above under the procedural aspect of Article 2 (see paragraphs 111-139 above). The Court finds that no separate issue arises in the present case.

159. The Court concludes that there has been no violation of Article 13 of the Convention.

VI. APPLICATION OF ARTICLE 41 OF THE CONVENTION

160. Article 41 of the Convention provides:

"If the Court finds that there has been a violation of the Convention or the Protocols thereto, and if the internal law of the High Contracting Party concerned allows only partial reparation to be made, the Court shall, if necessary, afford just satisfaction to the injured party."

A. Damage

161. The applicants submitted that though their primary goal was to obtain a judgment from the Court to the effect that the respondent Government had violated the Convention, they considered that an award of damages should be made. They argued that, where there was a finding of a violation of a fundamental right, the Court should impose the only penalty it can on the offending State. Not to do so sent the wrong signal and appeared to penalise the victims rather than those responsible for the violation. This was particularly the case concerning Antony Hughes who was unconnected with the IRA though it was accepted that an amount of compensation had been given domestically in that case.

162. The Government disputed that any award of damages would be appropriate in the present case. They considered that the applicant, Mrs Bridget Hughes, had been fully compensated for the loss suffered as a result of the death of Antony Hughes as she had accepted the settlement in the civil proceedings. In their view, no loss flowed from any violation of the procedural elements of Article 2 of the Convention and a finding of violation in that context would in itself constitute just satisfaction.

163. The Court recalls that in the case of McCann and others (cited above, p. 63, § 219) it found a substantive breach of Article 2 of the Convention, concluding that it had not been shown that the killing of the three IRA suspects constituted the use of force which was no more than absolutely necessary in defence of persons from unlawful violence. However, the Court considered it inappropriate to make any award to the applicants, as personal representatives of the deceased, in respect of pecuniary or non-pecuniary damage, "having regard to the fact that the three terrorist suspects who were killed had been intending to plant a bomb in Gibraltar".

164. In contrast to the McCann case, the Court in the present case has made no finding as to the lawfulness or proportionality of the use of lethal force which killed the nine men at Loughgall, or as to the factual circumstances, including the activities of the deceased which led up to the killing, which issues are pending in the civil proceedings. Accordingly, no award of compensation falls to be made in this respect. On the other hand, the Court has found that the national authorities failed in their obligation to carry out a prompt and effective investigation into the circumstances of the death. The applicants must thereby have suffered feelings of frustration, distress and anxiety. The Court considers that the applicants sustained some non-pecuniary damage which is not sufficiently compensated by the finding

of a violation as a result of the Convention. It has not taken into account the settlement in the Hughes case, which related to the substantive claims of that applicant and not to the lack of procedural efficacy in the investigation.

165. Making an assessment on an equitable basis, the Court awards each applicant the sum of 10,000 pounds sterling (GBP).

B. Costs and expenses

166. The applicant claimed a total of GBP 54,594.20. This included GBP 5,218.20 and GBP 20,000 respectively for two counsel and GBP 29,276 for solicitors' fees, exclusive of VAT.

167. The Government submitted that these claims were excessive, noting that the issues in this case overlapped significantly with the other cases examined at the same time.

168. The Court recalls that this case has involved several rounds of written submissions and an oral hearing, and may be regarded as factually and legally complex. Nonetheless, it finds the fees claimed to be on the high side when compared with other cases from the United Kingdom and is not persuaded that they are reasonable as to quantum. Having regard to equitable considerations, it awards the global sum of GBP 30,000, plus any value added tax which may be payable. It has taken into account the sums paid to the applicants by way of legal aid from the Council of Europe.

C. Default interest

169. According to the information available to the Court, the statutory rate of interest applicable in the United Kingdom at the date of adoption of the present judgment is 7,5% per annum.

FOR THESE REASONS, THE COURT UNANIMOUSLY

1. *Holds* that there has been a violation of Article 2 of the Convention in respect of failings in the investigative procedures concerning the deaths of the applicants' relatives;
2. *Holds* that there has been no violation of Article 6 § 1 of the Convention;
3. *Holds* that there has been no violation of Article 14 of the Convention;
4. *Holds* that there has been no violation of Article 13 of the Convention;
5. *Holds*
 - (a) that the respondent State is to pay the applicants, within three months from the date on which the judgment becomes final according to Article 44 § 2 of the Convention, the following amounts, plus any value-added tax that may be chargeable;
 - (i) 10,000 (ten thousand) pounds sterling to each applicant in respect of non-pecuniary damage;
 - (ii) a global sum of 30,000 (thirty thousand) pounds sterling in respect of all their costs and expenses;

(b) that simple interest at an annual rate of 7,5% shall be payable from the expiry of the above-mentioned three months until settlement;

6. *Dismisses* the remainder of the applicants' claims for just satisfaction.

Done in English, and notified in writing on 4 May 2001, pursuant to Rule 77 §§ 2 and 3 of the Rules of Court.

S. DOLLÉ
Registrar

J.-P. COSTA
President

INTER-AMERICAN COURT OF HUMAN RIGHTS

**ADVISORY OPINION OC-18/03
OF SEPTEMBER 17, 2003,
REQUESTED BY THE UNITED MEXICAN STATES**

Juridical Condition and Rights of the Undocumented Migrants.

Those present*:

Antônio A. Cançado Trindade, President;
Sergio García Ramírez, Vice President;
Hernán Salgado Pesantes, Judge;
Oliver Jackman, Judge;
Alirio Abreu Burelli, Judge, and
Carlos Vicente de Roux Rengifo, Judge,

also present,

Manuel E. Ventura Robles, Secretary, and
Pablo Saavedra Alessandri, Deputy Secretary.

THE COURT

composed as above,

renders the following Advisory Opinion:

I

PRESENTATION OF THE REQUEST

1. On May 10, 2002, the State of the United Mexican States (hereinafter "Mexico" or "the requesting State"), based on Article 64(1) of the American Convention on Human Rights (hereinafter "the American Convention", "the Convention" or "the Pact of San José"), submitted to the Inter-American Court of Human Rights (hereinafter "the Inter-American Court" or "the Court") a request for an advisory opinion (hereinafter also "the request") on the "[...] deprivation of the enjoyment and exercise of certain labor rights [of migrant workers,] and its compatibility with the obligation of the American States to ensure the principles of legal equality, non-discrimination and the equal and effective protection of the law embodied in international instruments for the protection of human rights; and also with the subordination or conditioning of the observance of the obligations imposed by international human rights law, including those of an *erga omnes* nature, with a

* Judge Máximo Pacheco Gómez advised the Court that, owing to circumstances beyond his control, he would be unable to attend the sixtieth regular session of the Court; therefore, he did not take part in the deliberation and signature of this Advisory Opinion.

view to attaining certain domestic policy objectives of an American State.” In addition, the request dealt with “the meaning that the principles of legal equality, non-discrimination and the equal and effective protection of the law have come to signify in the context of the progressive development of international human rights law and its codification.”

2. Likewise, Mexico stated the considerations that gave rise to the request and, among these, it indicated that:

Migrant workers, as all other persons, must be ensured the enjoyment and exercise of human rights in the States where they reside. However, their vulnerability makes them an easy target for violations of their human rights, based, above all, on criteria of discrimination and, consequently, places them in a situation of inequality before the law as regards the effective enjoyment and exercise of these rights

[...]

In this context, the Government of Mexico is profoundly concerned by the incompatibility with the OAS human rights system of the interpretations, practices and enactment of laws by some States in the region. The Government of Mexico considers that such interpretations, practices and laws imply the negation of labor rights based on discriminatory criteria derived from the migratory status of the undocumented workers, among other matters. This could encourage employers to use those laws or interpretations to justify a progressive loss of other labor rights; for example: payment of overtime, seniority, outstanding wages and maternity leave, thus abusing the vulnerable status of undocumented migrant workers. In this context, the violations of the international instruments that protect the human rights of migrant workers in the region are a real threat to the exercise of the rights protected by such instruments.

3. Mexico requested the Court to interpret the following norms: Articles 3(1) and 17 of the Charter of the Organization of American States (hereinafter “the OAS”); Article II (Right to Equality before the Law) of the American Declaration on the Rights and Duties of Man (hereinafter “the American Declaration”); Articles 1(1) (Obligation to Respect Rights), 2 (Domestic Legal Effects), and 24 (Equality before the Law) of the American Convention; Articles 1, 2(1) and 7 of the Universal Declaration of Human Rights (hereinafter “the Universal Declaration”), and Articles 2(1), 2(2), 5(2) and 26 of the International Covenant on Civil and Political Rights.

4. Based on the preceding provisions, Mexico requested the Court’s opinion on the following issues:

In the context of the principle of equality before the law embodied in Article II of the American Declaration, Article 24 of the American Convention, Article 7 of the Universal Declaration and Article 26 of the [International] Covenant [of Civil and Political Rights ...]:

1) Can an American State establish in its labor legislation a distinct treatment from that accorded legal residents or citizens that prejudices undocumented migrant workers in the enjoyment of their labor rights, so that the migratory status of the workers impedes *per se* the enjoyment of such rights?

2.1) Should Article 2, paragraph 1, of the Universal Declaration, Article II of the American Declaration, Articles 2 and 26 of the [International] Covenant [of Civil and Political Rights], and Articles 1 and 24 of the American Convention be interpreted in the sense that an individual’s legal residence in the territory of an American State is a necessary condition for that State to respect and ensure the rights and freedoms recognized in these provisions to those persons subject to its jurisdiction?

2.2) In the light of the provisions cited in the preceding question, can it be considered that the denial of one or more labor right, based on the undocumented status of a migrant worker, is compatible with the obligations of an American State to ensure

non-discrimination and the equal, effective protection of the law imposed by the above-mentioned provisions?

Based on Article 2, paragraphs 1 and 2, and Article 5, paragraph 2, of the International Covenant on Civil and Political Rights,

3) What would be the validity of an interpretation by any American State which, in any way, subordinates or conditions the observance of fundamental human rights, including the right to equality before the law and to the equal and effective protection of the law without discrimination, to achieving migration policy goals contained in its laws, notwithstanding the ranking that domestic law attributes to such laws in relation to the international obligations arising from the International Covenant on Civil and Political Rights and other obligations of international human rights law that have an *erga omnes* character?

In view of the progressive development of international human rights law and its codification, particularly through the provisions invoked in the instruments mentioned in this request,

4) What is the nature today of the principle of non-discrimination and the right to equal and effective protection of the law in the hierarchy of norms established by general international law and, in this context, can they be considered to be the expression of norms of *ius cogens*? If the answer to the second question is affirmative, what are the legal effects for the OAS Member States, individually and collectively, in the context of the general obligation to respect and ensure, pursuant to Article 2, paragraph 1, of the [International] Covenant [on Civil and Political Rights], compliance with the human rights referred to in Articles 3 (l) and 17 of the OAS Charter?

5. Juan Manuel Gómez-Robledo Verduzco was appointed as the Agent and the Ambassador of Mexico to Costa Rica, Carlos Pujalte Piñeiro, as the Deputy Agent.

II PROCEEDING BEFORE THE COURT

6. In notes of July 10, 2002, the Secretariat of the Court (hereinafter "the Secretariat"), in compliance with the provisions of Article 62(1) of the Rules of Procedure of the Court (hereinafter "the Rules of Procedure"), transmitted the request for an advisory opinion to all the member States, to the Secretary General of the OAS, to the President of the OAS Permanent Council and to the Inter-American Commission on Human Rights. It also advised them of the period established by the President of the Court (hereinafter "the President"), in consultation with the other judges of the Court, for submission of written comments or other relevant documents with regard to this request.

7. On November 12, 2002, Mexico presented a communication, with which it forwarded a copy of a communication from its Ministry of Foreign Affairs providing information about an opinion of the International Labour Organization (ILO) related to labor rights for migrant workers.

8. On November 14, 2002, the State of Honduras presented its written comments. Some pages were illegible. On November 1, 2002, the complete version of the brief with comments was received.

9. On November 15, 2002, Mexico presented a communication in which it forwarded information that was complementary to the request, and included the English version of a formal opinion that it had requested from the International Labor Office of the International Labor Organization (ILO) and which, according to Mexico, "was of particular relevance for the [...] request procedure."

10. On November 26, 2002, the State of Nicaragua presented its written comments.
11. On November 27, 2002, the Legal Aid Clinic of the College of Jurisprudence of the Universidad San Francisco de Quito presented an *amicus curiae* brief.
12. On December 3, 2002, Mexico presented a communication, with which it forwarded the Spanish version of the formal opinion that it had requested from the International Labor Office of the International Labor Organization (ILO) (*supra* para. 9).
13. On December 12, 2002, the Delgado Law Firm presented an *amicus curiae* brief.
14. On January 8, 2003, Liliana Ivonne González Morales, Gail Aguilar Castañón, Karla Micheel Salas Ramírez and Itzel Magali Pérez Zagal, students of the Faculty of Law of the Universidad Nacional Autónoma de México (UNAM), presented an *amici curiae* brief by e-mail. The original of this communication was submitted on January 10, 2003.
15. On January 13, 2003, the States of El Salvador and Canada presented their written comments.
16. On January 13, 2003, the Inter-American Commission on Human Rights presented its written comments.
17. On January 13, 2003, the United States of America presented a note in which it informed the Court that it would not present comments on the request for an advisory opinion.
18. On January 13, 2003, the Harvard Immigration and Refugee Clinic of the Greater Boston Legal Services and the Harvard Law School, the Working Group on Human Rights in the Americas of the Harvard and Boston College Law Schools, and the Global Justice Center presented an *amici curiae* brief.
19. On January 16, 2003, the President issued an Order in which he convened "a public hearing on the request for Advisory Opinion OC-18, on February 24, 2002, at 9 a.m." so that "the member States and the Inter-American Commission on Human Rights [could] present their oral arguments."
20. On January 17, 2003, the State of Costa Rica presented its written comments.
21. On January 29, 2003, the Secretariat, on the instructions of the President, and in communication CDH-S/067, invited Gabriela Rodríguez, United Nations Special Rapporteur on the Human Rights of Migrants to attend the public hearing convened for February 24, 2003 (*supra* para. 19), as an observer.
22. On February 3, 2003, the Secretariat transmitted a copy of the complementary information to its request for an advisory opinion forwarded by Mexico (*supra* paras. 9 and 12), the written comments submitted by the States of Honduras, Nicaragua, El Salvador, Canada and Costa Rica (*supra* paras. 8, 10, 15

and 20), and by the Inter-American Commission (*supra* para. 16), to all the foregoing.

23. On February 6, 2003, Mario G. Obledo, President of the National Coalition of Hispanic Organizations, presented a brief supporting the request for an advisory opinion.

24. On February 6, 2003, Thomas A. Brill of the Law Office of Sayre & Chavez, presented an *amicus curiae* brief.

25. On February 6, 2003, Javier Juárez of the Law Office of Sayre & Chavez, presented an *amicus curiae* brief.

26. On February 7, 2003, Mexico presented a brief in which it substituted the Deputy Agent, Ambassador Carlos Pujalte Piñero, by Ricardo García Cervantes, actual Ambassador of Mexico to Costa Rica (*supra* para. 5).

27. On February 10, 2003, Beth Lyon forwarded, via e-mail, an *amici curiae* brief presented by the Labor, Civil Rights and Immigrants' Rights Organizations in the United States.

28. On February 13, 2003, the Harvard Immigration and Refugee Clinic of the Greater Boston Legal Services and the Harvard Law School, the Working Group on Human Rights in the Americas of the Harvard and Boston College Law Schools and the Global Justice Center forwarded the final, corrected version of the *amici curiae* brief that they had presented previously (*supra* para. 18).

29. On February 13, 2003, Rebecca Smith forwarded another copy of the *amici curiae* brief presented by the Labor, Civil Rights and Immigrants' Rights Organizations in the United States (*supra* para. 27).

30. On February 21, 2003, the Academy of Human Rights and International Humanitarian Law of the American University, Washington College of Law, and the Human Rights Program of the Universidad Iberoamericana of Mexico submitted an *amici curiae* brief.

31. On February 21, 2003, the Center for International Human Rights of the School of Law of Northwestern University submitted an *amicus curiae* brief. The original of this brief was presented on February 24, 2003.

32. On February 24, 2003, a public hearing was held at the seat of the Court, in which the oral arguments of the participating States and the Inter-American Commission on Human Rights were heard.

There appeared before the Court:

for the United Mexican States:

-Juan Manuel Gómez Robledo, Agent;
-Ricardo García Cervantes, Deputy Agent and
Ambassador of Mexico to Costa Rica;
-Víctor Manuel Uribe Aviña, Adviser;

-*Salvador Tinajero Esquivel*, Adviser, Director of Inter-institutional Coordination and NGOs of the Human Rights Directorate of the Ministry of Foreign Affairs, and
 -*María Isabel Garza Hurtado*, Adviser;

for Honduras: -*Álvaro Agüero Lacayo*, Ambassador of Honduras to Costa Rica, and
 -*Argentina Wellermann Ugarte*, First Secretary of the Embassy of Honduras in Costa Rica;

for Nicaragua: -*Mauricio Díaz Dávila*, Ambassador of Nicaragua to Costa Rica;

for El Salvador: -*Hugo Roberto Carrillo*, Ambassador of El Salvador to Costa Rica, and
 -*José Roberto Mejía Trabanino*, Coordinator of Global Issues of the Ministry of Foreign Affairs of El Salvador;

for Costa Rica: -*Arnoldo Brenes Castro*, Adviser to the Minister of Foreign Affairs;
 -*Adriana Murillo Ruin*, Coordinator of the Human Rights Division of the Foreign Policy Directorate;
 -*Norman Lizano Ortiz*, Official of the Human Rights Division of the Foreign Policy Directorate;
 -*Jhonny Marín*, Head of the Legal Department of the Directorate of Migration and Aliens, and
 -*Marcela Gurdíán*, Official of the Legal Department of the Directorate of Migration and Aliens; and

for the Inter-American Commission on Human Rights:

-*Juan Méndez*, Commissioner, and
 -*Helena Olea*, Assistant.

Also present as Observers:

for the Oriental Republic of Uruguay: -*Jorge María Carvalho*, Ambassador of Uruguay to Costa Rica;

for Paraguay: -*Mario Sandoval*, Minister, Chargé d'Affaires of the Embassy of Paraguay in Costa Rica;

for the Dominican Republic: -*Ramón Quiñones*, Ambassador, Permanent Representative of the Dominican Republic to the OAS;
 -*Anabella De Castro*, Minister Counselor, Head of the Human Rights Section of the Ministry of Foreign Affairs, and
 -*José Marcos Iglesias Iñigo*, Representative of the State of the Dominican Republic to the Inter-American Court of Human Rights;

- for Brazil:* -Minister *Nilmário Miranda*, Secretary for Human Rights of Brazil;
-*María De Luján Caputo Winkler*, Chargé d’Affaires of the Embassy of Brazil in Costa Rica, and
-*Gisele Rodríguez Guzmán*, Official of the Embassy of Brazil in Costa Rica;
- for Panama:* -*Virginia I. Burgoa*, Ambassador of Panama to Costa Rica;
-*Luis E. Martínez-Cruz*, Chargé d’Affaires of the Embassy of Panama in Costa Rica, and
-*Rafael Carvajal Arcia*, Director of the Legal Adviser’s Office of the Ministry of Labor and Employment;
- for Argentina:* -*Juan José Arcuri*, Ambassador of Argentina to Costa Rica;
- for Peru:* -*Fernando Rojas S.*, Ambassador of Peru to Costa Rica, and
-*Walter Linares Arenaza*, First Secretary of the Embassy of Peru in Costa Rica; and
- for the United Nations:* -*Gabriela Rodríguez*, Special Rapporteur on the Human Rights of Migrants.

33. On March 5, 2003, Mexico presented a brief with which it forwarded a copy of the “revised text of the oral argument made by the Agent” in the public hearing held on February 24, 2003 (*supra* para. 32).

34. On March 20, 2003, Mexico forwarded a copy of the press communiqué issued by its Ministry of Foreign Affairs on March 11, 2003.

35. On March 28, 2003, Mexico presented a brief in which it remitted the answers to the questions formulated by Judge Cañado Trindade and Judge García Ramírez during the public hearing (*supra* para. 32).

36. On April 7, 2003, the President issued an Order in which he convened “a public hearing on the request for Advisory Opinion OC-18, at 10 a.m. on June 4, 2003”, so that the persons and organizations that had forwarded *amici curiae* briefs could present their respective oral arguments. The Order also indicated that if any person or organization that had not presented an *amicus curiae* brief wished to take part in the public hearing, they could do so, after they had been accredited to the Court.

37. On May 15, 2003, the Center for Justice and International Law (CEJIL) presented an *amicus curiae* brief.

38. On May 16, 2003, the Center for Legal and Social Studies (CELS), the Ecumenical Service for the Support and Orientation of Refugees and Immigrants (CAREF) and the Legal Clinic for the Rights of Immigrants and Refugees of the School of Law of the Universidad de Buenos Aires, submitted an *amici curiae* brief by e-mail. The original of this brief was presented on May 28, 2003.

39. On June 4, 2003, a public hearing was held in the Conference Hall of the former Chamber of Deputies, Ministry of Foreign Affairs, in Santiago, Chile, during which the oral arguments presented as *amici curiae* by various individuals, universities, institutions and non-governmental organizations were presented.

There appeared before the Court:

- | | |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <i>for the Faculty of Law of the Universidad Nacional Autónoma de México (UNAM):</i> | <ul style="list-style-type: none"> - Itzel Magali Pérez Zagal, Student - Karla Micheel Salas Ramírez, Student - Gail Aguilar Castañón, Student and - Liliana Ivonne González Morales, Student |
| <i>for the Harvard Immigration and Refugee Clinic of Greater Boston Legal Services and the Harvard Law School, the Working Group on Human Rights in the Americas of Harvard and Boston College Law Schools and the Global Justice Center:</i> | <ul style="list-style-type: none"> - James Louis Cavallaro, Associate Director, Human Rights Program, Harvard Law School - Andressa Caldas, Attorney and Legal Director, Global Justice Center, Rio de Janeiro, Brazil and - David Flechner, Representative, Harvard Law Student Advocates for Human Rights |
| <i>for the Law Office of Sayre & Chavez:</i> | <ul style="list-style-type: none"> - Thomas A. Brill, Attorney at Law |
| <i>for the Labor, Civil Rights and Immigrants' Rights Organizations in the United States of America:</i> | <ul style="list-style-type: none"> - Beth Lyon, Assistant Professor of Law, Villanova University School of Law, and Rebecca Smith, Attorney, National Employment Law Project |
| <i>for the Center for International Human Rights of Northwestern University School of Law:</i> | <ul style="list-style-type: none"> - Douglas S. Cassel, Director, and - Eric Johnson |
| <i>for the Juridical Research Institute of the Researcher; Universidad Nacional Autónoma de México:</i> | <ul style="list-style-type: none"> - Jorge A. Bustamante, |
| <i>for the Center for Justice and International Law (CEJIL):</i> | <ul style="list-style-type: none"> - Francisco Cox, Lawyer; |
| <i>for the Center for Legal and Social Studies CELS, and (CELS), the Ecumenical Service for the Support and Orientation of Immigrants and Refugees (CAREF) and the Legal Clinic for the Rights of Immigrants and Refugees of the School of Law of the Universidad de Buenos Aires:</i> | <ul style="list-style-type: none"> - Pablo Ceriani Cernadas, Lawyer, Coordinator of the Legal Clinic; |

for the Office of the United Nations High Commissioner for Refugees (UNHCR): -Juan Carlos Murillo, Training Officer, Regional Legal Unit; and

for the Central American Council of Ombudsmen: -Juan Antonio Tejada Espino, President, Central American Council and Ombudsman of the Republic of Panama.

Also present as *Observers*:

for the United Mexican States: and - Ricardo Valero, Ambassador of Mexico in Chile
- Alejandro Souza, Official, General Coordination of Legal Affairs of the Ministry of Foreign Affairs Of Mexico; and

for the Inter-American Commission on Human Rights: - Helena Olea, Lawyer.

40. On June 4, 2003, during the public hearing held in Santiago, Chile, the Central American Council of Ombudsmen presented and *amicus curiae* brief.

41. On June 24, 2003, Jorge A. Bustamante remitted, by e-mail, an *amicus curiae* brief presented by the Juridical Research Institute of the Universidad Nacional Autónoma de México (UNAM). The original of this brief was presented on July 3, 2003.

42. On July 3, 2003, Thomas A. Brill, of the Law Office of Sayre & Chavez, presented his final written arguments.

43. On July 8, 2003, Beth Lyon forwarded, by e-mail, the final written arguments of the Labor, Civil Rights and Immigrants' Rights Organizations in the United States. The original of this brief was received on August 7, 2003.

44. On July 11, 2003, Liliana Ivonne González Morales, Gail Aguilar Castañón, Karla Micheel Salas Ramírez and Itzel Magali Pérez Zagal, Students of the Faculty of Law of the Universidad Nacional Autónoma de México (UNAM), presented their brief with final arguments by e-mail. The original of this brief was presented on July 18, 2003.

45. On July 11, 2003, the Center for International Human Rights of the School of Law of Northwestern University, presented its final written arguments, by e-mail. The original of this brief was presented on July 18, 2003.

46. On July 30, 2003, the Center for Legal and Social Studies (CELS), the Ecumenical Service for the Support and Orientation of Immigrants and Refugees (CAREF) and the Legal Clinic for the Rights of Immigrants and Refugees of the School of Law of the Universidad de Buenos Aires presented their final written arguments.

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47. The Court will now summarize the written and oral comments of the requesting State, the participating States and the Inter-American Commission, and also the briefs and oral arguments presented by different individuals, universities, institutions and non-governmental organizations as *amici curiae*:

The requesting State: *Regarding the admissibility of the request, Mexico stated in its brief that:*

By clarifying the scope of the State's international obligations with regard to the protection of the labor rights of undocumented migrant workers, irrespective of their nationality, the opinion of the Court would be of considerable relevance for effective compliance with such obligations by the authorities of States that receive those migrants.

The request submitted by Mexico does not expect the Court to rule in the abstract, "but to consider concrete situations in which it is called on to examine the acts of the organs of any American State, inasmuch as the implementation of such acts may lead to the violation of some of the rights protected in the treaties and instruments mentioned in the [...] request." Nor does it expect the Court to interpret the domestic law of any State.

In addition to the considerations that gave rise to the request and that have been described above (supra para. 2), the requesting State indicated that:

The protection of the human rights of migrant workers is also an issue of particular interest to Mexico, because approximately 5,998,500 (five million nine hundred and ninety-eight thousand five hundred) Mexican workers reside outside national territory. Of these, it is estimated that 2,490,000 (two million four hundred and ninety thousand) are undocumented migrant workers who, lacking regular migratory status, "become a natural target for exploitation, as individuals and as workers, owing to their particularly vulnerable situation."

In less than five months (from January 1 to May 7, 2002), the Mexican Government had to intervene, through its consular representatives, in approximately 383 cases to defend the human rights of Mexican migrant workers, owing to issues such as discrimination in employment-related matters, unpaid wages, and compensation for occupational illnesses and accidents.

The efforts made by Mexico and other States in the region to protect the human rights of migrant workers have been unable to avoid a resurgence of discriminatory legislation and practices against aliens seeking employment in a foreign country, or the regulation of the labor market based on discriminatory criteria, accompanied by xenophobia in the name of national security, nationalism or national preference.

With regard to the merits of the request, Mexico indicated in its brief:

Regarding the first question of the request (supra para. 4):

In the context of the principle of equality before the law embodied in Article II of the American Declaration, Article 24 of the American Convention, Article 7 of the Universal Declaration and Article 26 of the Covenant, any measures that promotes a harmfully different treatment for persons or groups of persons who are in the territory of an American State and subject to its jurisdiction, are contrary to the acknowledgment of equality before the law that prohibits any discriminatory treatment established by law.

Workers whose situation is irregular are subjected to harsh treatment owing to their migratory status and, consequently, are considered an inferior group in relation to the legal or national workers of the State in question.

An organ of a State party to the international instruments mentioned above which, when interpreting domestic legislation, establishes a different treatment in the enjoyment of a labor right, based solely on the migratory status of a worker, would be making an interpretation contrary to the principle of legal equality.

This interpretation could provide justification for employers to dismiss undocumented workers, under the protection of a prior decision entailing the suppression of certain labor rights because of an irregular migratory status.

The circumstance described above is particularly critical when we consider that this irregular situation of the undocumented worker leads to the latter being afraid to have recourse to the government bodies responsible for monitoring compliance with labor standards; consequently, employers who utilize such practices are not punished. It is more advantageous from a financial point of view to dismiss an undocumented worked

because, contrary to what happens when national or legal resident workers are dismissed, the employer is not obliged to compensate such dismissals in any way; and this is in "evident contradiction with the principle of equality before the law."

The right to equality before the law is not applicable only with regard to the enjoyment and exercise of labor rights, it also extends to all rights recognized in domestic legislation; thus it covers "a much broader universe of rights that the fundamental rights and freedoms embodied in international law." The scope of the right to equality "has important applications in the jurisdiction of human rights bodies." For example, the United Nations Human Rights Committee has examined complaints concerning discrimination of rights that are not expressly included in the International Covenant on Civil and Political Rights, and rejected the argument that it lacks the competence to hear complaints about discrimination in the enjoyment of rights protected by the International Covenant on Economic, Social and Cultural Rights.

Mexico referred to the contents of General Comment 18 of the Human Rights Committee on Article 26 of the International Covenant on Civil and Political Rights.

Regarding the second question of the request (supra para. 4):

The provisions of Articles 2(1) of the Universal Declaration, II of the American Declaration, 2 and 26 of the International Covenant on Civil and Political Rights, and 1 and 24 of the American Convention, underscore the obligation of States to ensure the effective exercise and enjoyment of the rights encompassed by those provisions, and also the prohibition to discriminate for any reason whatever.

The obligation of the American States to comply with their international human rights commitments "goes beyond the mere fact of having laws that ensures compliance with such rights." The acts of all the organs of an American State must strictly respect such rights, so that "the conduct of the State organs leads to real compliance with and exercise of the human rights guaranteed in international instruments."

Any acts of an organ of an American State resulting in situations contrary to the effective enjoyment of the fundamental human rights, would be contrary to that State's obligation to adapt its conduct to the standards established in international human rights instruments.

Regarding the third question of the request (supra para. 4):

It is “unacceptable” for an American State to subordinate or condition in any way respect for fundamental human rights to the attainment of migratory policy objectives contained in its laws, evading international obligations arising from the International Covenant on Civil and Political Rights and other obligations of international human rights law of an *erga omnes* nature. This is so, even when domestic policy objectives are cited, which are provided for in domestic legislation and considered legitimate for attaining certain ends from the Government’s point of view, “including, for example, the implementation of a migratory control policy based on discouraging the employment of undocumented aliens.”

Even in the interests of public order – which is the ultimate goal of the rule of law – it is unacceptable to restrict the enjoyment and exercise of a right. And, it would be much less acceptable to seek to do so by citing domestic policy objectives contrary to the public welfare.

“Although [...] in some cases and in very specific circumstances, an American State may restrict or condition the enjoyment of a particular right, in the situation brought to the attention of the Court [...] the requirements for these circumstances are not met.”

Article 5(2) of the International Covenant on Civil and Political Rights enshrines the pre-eminence of the norm most favorable to the victim; “this establishes the obligation to seek, in the *corpus iuris gentium*, the norm intended to benefit the human being as the ultimate owner of the rights protected in international human rights law.”

This is similar to transferring to international human rights law the *Martens* clause, which is part of international humanitarian law, and which confirms the principle of the applicability of international humanitarian law to all circumstances, even when existing treaties do not regulate certain situations.

The legal effects of obligations *erga omnes lato sensu* are not established only between the contracting parties to the respective instrument. These effects “are produced as rights in favor of third parties (*stipulation pour autrui*), thus recognizing the right, and even the obligation, for other States – whether or not they are parties to the instrument in question – to guarantee

their fulfillment." In this respect, Mexico invoked the decisions of the International Court of Justice in the *Barcelona Traction* (1970), *East Timor* (1995) and *Implementation of the Convention for the Prevention and Punishment of the Crime of Genocide* (1996) cases.

International case law, with the exception of that related to war crimes, "has not interpreted [...] fully the legal regime applicable to obligations *erga omnes*, or, at best, it has done so cautiously and perhaps with a certain trepidation. The Inter-American Court of Human Rights is hereby called on to play an essential role in establishing the applicable law and affirming the collective guarantee that is evident in Article 1 of its Statute."

Regarding the fourth question of the request (supra para. 4):

Abundant "teachings of the most highly qualified publicists of the various nations (Article 38, paragraph (d), of the Statute of the International Court of Justice)[,] have stated that the fundamental human rights belong *ab initio* to the domain of norms of *ius cogens*." Judges have also rendered individual opinions about the legal effect of recognition that a provision enjoys the attributes of a norm of *jus cogens*, in accordance with Article 53 of the Vienna Convention on the Law of Treaties.

Mexico referred to the commentary of the International Law Commission on Articles 40 and 41 of the then draft articles on State responsibility.

As in the case of obligations *erga omnes*, "case law has acted cautiously and even lagged behind the *opinio iuris communis* (the latter as a manifestation of the principle of universal morality) to establish the norms of *jus cogens* concerning the protection of the fundamental human rights definitively and to clarify the applicable legal norms."

Furthermore, in the brief submitted on November 15, 2002 (supra paras. 9 and 12), Mexico added that:

Regarding the first question of the request (supra para. 4):

This question "is intended to clarify the existence of fundamental labor rights which all workers should enjoy[,], and which are internationally recognized in different instrument [,] and to determine whether denying those rights to workers because of their

migratory status would signify according a harmful treatment, contrary to the principles of legal equality and non-discrimination.”

States may accord a distinct treatment to documented migrant workers and to undocumented migrant workers, or to aliens with regard to nationals. For example, political rights are only recognized to nationals. However, in the case of internationally recognized human rights, all persons are equal before the law and have the right to equal protection in accordance with Article 26 of the International Covenant on Civil and Political Rights.

A harmfully distinct treatment may not be accorded in the implementation of the fundamental labor rights, “even though, except as provided for in this basic body of laws, States are empowered to accord a distinct treatment.” Harmfully distinct treatment of undocumented migrant workers would violate fundamental labor rights.

Several international instruments permit us to identify the fundamental labor rights of migrant workers. For example, Articles 25 and 26 of the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families recognize fundamental labor rights to all migrant workers, irrespective of their migratory status.

In addition, on November 1, 2002, the International Labor Office of the International Labor Organization issued a formal opinion on the scope and content of ILO Convention No. 143 concerning Migrations in Abusive Conditions and the Promotion of Equality of Opportunity and Treatment of Migrant Workers and Recommendation No. 151 on Migrant Workers. This opinion elaborates on other fundamental labor rights of all migrant workers. Mexico agrees with the International Labor Office that there is a basic level of protection that is applicable to documented and undocumented workers.

Regarding the second question of the request (supra para. 4):

States may accord a different treatment to migrant workers, whose situation is irregular; however, under no circumstance are they authorized to take discriminatory measures as regards the enjoyment and protection of internationally recognized human rights.

Even though it is possible to identify fundamental labor rights based on the international instruments, “this

concept is evolving. As new norms arise and are incorporated into the body of fundamental labor rights, they should benefit all workers, irrespective of their migratory status.”

In response to the questions of some of the judges of the Court, Mexico added that:

The fundamental labor rights that may not be restricted are those that are established in international human rights instruments with regard to all workers, including migrants, irrespective of their regular or irregular situation. In this respect, there appears to be consensus, deriving from these international instruments, that there are “a series of rights that, by their very nature, are so essential to safeguard the principle of equality before the law and the principle of non-discrimination, that their restriction or suspension, for any reason, entails the violation of these two cardinal principles of international human rights law.” Some examples of these fundamental rights are: the right to equal remuneration for work of equal value; the right to fair and satisfactory remuneration, including social security and other benefits derived from past employment; the right to form and join trade unions to defend one’s interests; the right to judicial and administrative guarantees to determine one’s rights; the prohibition of obligatory or forced labor, and the prohibition of child labor.

Any restriction of the enjoyment of the fundamental rights derived from the principles of equality before the law and non-discrimination violates the obligation *erga omnes* to respect the attributes inherent in the dignity of the human being, and the principal attribute is equality of rights. Specific forms of discrimination can range from denying access to justice to defend violated rights to denying rights derived from a labor relationship. When such discrimination is made by means of administrative or judicial decisions, it is based on the thesis that the enjoyment of fundamental rights may be conditioned to the attainment of migratory policy objectives.

The individual has acquired the status of a real active and passive subject of international law. The individual may be an active subject of obligations as regards human rights, and also individually responsible for non-compliance with them. This aspect has been developed in international criminal law and in international humanitarian law. On other issues, such as the one covered by this request for an advisory opinion, it can be established that “in the case of fundamental norms, revealed by objective manifestations and provided there

is no doubt concerning their validity, the individual, such as an employer, may be obliged to respect them, irrespective of the domestic measures taken by the State to ensure or even violate, compliance with them."

The "transfer" of the *Martens* clause to the protection of the rights of migrant workers would imply that such persons had been granted an additional threshold of protection, according to which, in situations in which substantive law does not recognize certain fundamental rights or considers them less important, such rights would be justiciable. The safeguard of such fundamental human rights as those evident from the principles of equality before the law and non-discrimination, is protected by "the principles of universal morality," referred to in Article 17 of the OAS Charter, even in the absence of provisions of substantive law that are immediately binding for those responsible for ensuring that such rights are respected.

Honduras:

In its written and oral comments, Honduras stated that:

Regarding the first question of the request (supra para. 4):

Not every legal treatment establishing differences violates *per se* the enjoyment and exercise of the right to equality and to non-discrimination. The State is empowered to include objective and reasonable restrictions in its legislation in order to harmonize labor relations, provided it does not establish illegal or arbitrary differences or distinctions. "Legality is intended to guarantee the right to fair, equitable and satisfactory conditions."

The State may regulate the exercise of rights and establish State policies by legislation, without this being incompatible with the purpose and goal of the Convention.

Regarding the second question of the request (supra para. 4):

The legal residence of a person who is in an American State cannot be considered *conditio sine qua non* to ensure the right to equality and non-discrimination, as regards the obligation established in Article 1(1) of the American Convention and in relation to the rights and freedoms recognized to all persons in this treaty.

Article 22 of the American Convention guarantees freedom of movement and residence, so that every person lawfully in the territory of another State has the

right to move about in it and to reside in it subject to the provisions of the law. The American Convention and the International Covenant on Civil and Political Rights grant "States the right that those subject to their jurisdiction must observe the provisions of the law."

The regulation concerning legal residence established in the laws of the State does not violate the international obligations of the State if it has been established by a law – *strictu sensu* and including the requirements that are established – which does not violate the intent and purpose of the American Convention.

"[I]t cannot be understood that legislation establishes a harmfully distinct treatment for undocumented migrant workers, when the Convention determines that the movement and residence of an alien in the territory of a State party should be legal and is not incompatible with the intent and purpose of the Convention."

Regarding the third question of the request (supra para. 4):

Determining migratory policies is a decision for the State. The central element of such policies should be respect for the fundamental rights arising from the obligations assumed before the international community. An interpretation that violates or restricts human rights "subordinating them to the attainment of any objective[,] violates the obligation to protect such rights." The interpretation must not deviate from the provisions of the American Convention, or its intent and purpose.

The purpose of compliance with the provisions of the law is to protect national security, public order, public health or morality, and the rights and freedoms of others.

The General Study on Migrant Workers conducted by the International Labour Organization concluded that "it is permissible" to restrict an alien's access to employment, when two conditions are met: a) in the case of "limited categories of employment or functions"; and b) when the restriction is necessary in "the interests of the State." These conditions may refer to situations in which the protection of the State's interest justifies certain employments or functions being reserved to its citizens, owing to their nature.

Regarding the fourth question of the request (supra para. 4):

In certain cases, inequality in treatment by the law may

be a way of promoting equality or protecting those who appear to be weak from a legal standpoint.

The fact that there are no discriminatory laws or that the legislation of Honduras prohibits discrimination is not sufficient to ensure equality of treatment or equality before the law in practice.

The American States must guarantee a decorous treatment to the migrant population in general, in order to avoid violations and abuse of this extremely vulnerable sector.

Nicaragua:

In its written and oral comments, Nicaragua indicated that:

The request for an advisory opinion submitted by Mexico "is one more measure that can assist States, and national and international organizations, define the scope of their peremptory obligations[,] established in human rights treaties, and apply and comply with them, in particular, with regard to strengthening and protecting the human rights of migratory workers."

Article 27 of the Constitution of Nicaragua establishes that, in national territory, all persons enjoy State protection and recognition of the rights inherent in the human being, the respect, promotion and protection of human rights, and the full exercise of the rights embodied in the international human rights instruments acceded to and ratified by Nicaragua.

El Salvador:

In its written and oral comments, El Salvador indicated that:

It considers that the request should take into account provisions of the International Covenant on Economic, Social and Cultural Rights, the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights ("Protocol of San Salvador") and the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families, "because these treaties are relevant to the opinion requested on the protection of human rights in the American States."

"[T]he implementation and interpretation of secondary legislation cannot subordinate the international obligations of the American States embodied in international human rights treaties and instruments."

When an employment relationship is established between a migrant worker and an employer in an

American State, the latter is obliged to recognize and guarantee to the worker the human rights embodied in international human rights instruments, including those relating to the right to employment and to social security, without any discrimination.

Canada:

In its written comments, Canada stated that:

Three elements of Canadian legislation and policy relate to the subject of the request for an advisory opinion: first, the international support that Canada provides to matters concerning migrants; second, the categories of migrants and temporary residents (visitors) that are established in the Canadian Immigration and Refugee Protection Act; and, third, the protection of fundamental rights and freedoms in Canada.

Canada is concerned about the violations of the rights of migrants throughout the world. Canada supported the United Nations resolution establishing the Office of the Special Rapporteur on the Human Rights of Migrants and collaborated in drafting the mandate of this Office in order to make it strong and balanced.

Immigration is a key component of Canadian society. Attracting and selecting migrants can contribute to the social and economic interests of Canada, reuniting families and protecting the health, security and stability of Canadians.

The term "migrant" is not generally used in Canada. However, the term "migrants," as understood in the international context, covers three categories of person.

The first category corresponds to permanent residents. It includes migrants, refugees who come to live in Canada and asylum seekers who obtained this status through the corresponding procedure. All these persons have the right to reside permanently in Canada and to request citizenship after three years' residence.

The second category refers to persons who have requested refugee status, as defined in the 1951 United Nations Convention relating to the Status of Refugees and its 1967 Protocol, and who have not obtained the corresponding response. If it is established that the person fulfills the conditions to request refugee status, he has the right to represent himself or to be represented by a lawyer in the proceeding to determine his refugee status. Any person who represents a serious danger to Canada or to Canadian society may not proceed with a request for refugee status. In most cases, those who request refugee status have access to

provincial social services, medical care and the labor market. They and their minor children have access to public education (from pre-school to secondary). Once they are granted refugee status, they may request permanent residence and include their immediate family in their request, even if the latter are outside Canada.

The third category corresponds to temporary residents who arrive in Canada for a temporary stay. There are several categories of temporary residents according to the Immigration and Refugee Protection Act: visitors (tourists), foreign students and temporary workers.

Although temporary workers do not enjoy the same degree of freedom as Canadian citizens and permanent residents on the labor market, their fundamental human rights are protected by the Canadian Charter of Rights and Freedoms, enacted in 1982 as part of the 1982 Constitution Act. This Charter applies to all government legislation, programs and initiatives (federal, provincial, territorial and municipal). Most of the fundamental rights and freedoms protected by the Canadian Charter of Rights and Freedoms are guaranteed to all individuals who are in Canadian territory, irrespective of their migratory status or citizenship. Some of these rights are: freedom of association, the right to due process, the right to equality before the law, and the right to equal protection without discrimination of any kind owing to race, national or ethnic origin, color, religion, sex, age, or mental or physical disability. There are some exceptions, because the Canadian Charter of Rights and Freedoms guarantees some rights only to Canadian citizens, such as: the right to vote, and the right to enter, remain in and depart from Canada. The right to travel between the provinces, and the right to work in any province is guaranteed to citizens and permanent residents. Many of these guarantees reflect the right of sovereign States to control the movement of persons across international borders.

The right to equality guaranteed by section 15 of the Canadian Charter of Rights and Freedoms is of particular importance in the context of this request for an advisory opinion. In 1989, in *Andrews v. Law Society of British Columbia*, the Supreme Court of Canada established that the right to equality includes substantive rather than merely formal equality. Substantive equality usually refers to equal treatment of all individuals and, on some occasions, requires that the differences that exist be acknowledged in a non-discriminatory manner. For example, giving equal treatment to the disabled involves taking the necessary measures to adapt to such

differences and to promote the access and inclusion of such individuals in government programs.

In order to demonstrate that section 15 of the Canadian Charter of Rights and Freedoms has been violated, a person alleging discrimination must prove: 1) that the law has imposed on him a different treatment from that imposed on others, based on one or more personal characteristics; 2) that the differential treatment is due to discrimination based on race, national or ethnic origin, color, religion, sex, age, mental or physical disability, or nationality; and 3) that discrimination in the substantive sense exists, because the person is treated with less concern, respect and consideration, so that his human dignity is offended.

For example, in *Lavoie v. Canada*, most members of the Supreme Court of Canada decided that the preference given to Canadian citizens in competitions for employment in the federal public service discriminates on the grounds of citizenship, and therefore violates section 15(1) of the Canadian Charter of Rights and Freedoms.

In addition to constitutional protection, the federal provincial and territorial governments have enacted human rights legislation to promote equality and prohibit discrimination in employment and services. This legislation applies to the private sector acting as an employer and provider of services, and to the governments.

The Supreme Court of Canada has established that the courts must interpret human rights legislation so as to advance towards the goal of ensuring equal opportunities to all. Following this interpretation, the Supreme Court has reached a series of conclusions on the scope of human rights codes, including the principle of their precedence over regular legislation, unless the latter establishes a clear exception. Discriminatory practices can be contested, even when they are legal. Although the Canadian jurisdictions have different human rights legislation, they are subject to these general principles and must provide the same fundamental protections.

Inter-American Commission on Human Rights: In its written and oral comments, the Commission stated that:

Human Rights:

In international human rights law, the principle of non-discrimination enshrines equality between persons and imposes certain prohibitions on States. Distinctions based on gender, race, religion or national origin are

specifically prohibited in relation to the enjoyment and exercise of the substantive rights embodied in international instruments. Regarding these categories, any distinction that States make in the application of benefits or privileges must be carefully justified on the grounds of a legitimate interest of the State and of society, "which cannot be satisfied by non-discriminatory means."

International human rights law prohibits not only deliberately discriminatory policies and practices, but also policies and practices with a discriminatory impact on certain categories of persons, even though a discriminatory intention cannot be proved.

The principle of equality does not exclude consideration of migratory status. States are empowered to determine which aliens may enter their territory and under what conditions. However, the possibility of identifying forms of discrimination that are not specifically intended, but which constitute violations of the principle of equality must be preserved.

States may establish distinctions in the enjoyment of certain benefits between its citizens, aliens (with regular status) and aliens whose situation is irregular. Nevertheless, pursuant to the progressive development of norms of international human rights law, this requires detailed examination of the following factors: 1) the content and scope of the norm that discriminates between categories of persons; 2) the consequences that this discriminatory treatment will have on the persons prejudiced by the State's policy or practice; 3) the possible justifications for this differentiated treatment, particularly its relationship to the legitimate interest of the State; 4) the logical relationship between the legitimate interest and the discriminatory practice or policies; and 5) whether or not there are means or methods that are less prejudicial for the individual and allow the same legitimate ends to be attained.

The international community is unanimous in considering that the prohibition of racial discrimination and of practices directly associated with it is an obligation *erga omnes*. The *jus cogens* nature of the principle of non-discrimination implies that, owing to their peremptory nature, all States must observe these fundamental rules, whether or not they have ratified the conventions establishing them, because it is an obligatory principle of international common law. "Even though the international community has not yet reached consensus on prohibiting discrimination based on motives other than racial discrimination, this does not

lessen its fundamental importance in all international laws.”

To underscore the importance of the principle of equality and non-discrimination, human rights treaties expressly establish this principle in articles related to determined categories of human rights. In this respect, we should mention Article 8.1 of the American Convention, owing to its particular relevance for this request for an advisory opinion. Equality is an essential element of due process.

Any distinction based on one of the elements indicated in Article 1 of the American Convention entails “a strong presumption of incompatibility with the treaty.”

Basic human rights must be respected without any distinction. Any differences established with regard to the respect and guarantee of the fundamental rights must have limited application and comply with the conditions indicated in the American Convention. Some international instruments explicitly establish certain distinctions.

At times the principle of equality requires States to adopt positive measures to reduce or eliminate the conditions that cause or facilitate the perpetuation of the discrimination prohibited by the treaties.

The American States are obliged to guarantee the basic protection of the human rights established in the human rights treaties to all persons subject to their authority, “and [this] does not depend[...] for its application on factors such as citizenship, nationality or any other aspect of the person, including his migratory status.”

The rights embodied in the human rights treaties may be regulated reasonably and the exercise of some of them may be subject to legitimate restrictions. The establishment of such restrictions must respect the relevant formal and substantive limits; in other words, it must be accomplished by law and satisfy an urgent public interest. Restrictions may not be imposed for discriminatory purposes, nor may they be applied in a discriminatory manner. Furthermore, “any permissible restriction of rights may never imply the total negation of the right.”

The elaboration and execution of migratory policies and the regulation of the labor market are legitimate objectives of the State. To achieve such objectives, States may adopt measures that restrict or limit some rights, provided they respect the following criteria: 1)

some rights are non-derogable; 2) some rights are reserved exclusively for citizens; 3) some rights are conditioned to the status of documented migrant, such as those relating to freedom of movement and residence; and 4) some rights may be restricted, provided the following requirements are met: a) the restriction must be established by law; b) the restriction must respond to a legitimate interest of the State, which has been explicitly stated; c) the restriction must have a "reasonable relationship to the legitimate objective", and d) there must not be "other means to achieve these objectives that are less onerous for those affected."

It is the State's responsibility to prove that it is "permissible" to restrict or exclude a specific category of persons, such as aliens, from the application of some provision of the international instrument. "Migratory status can never be grounds for excluding a person from the basic protections granted to him by international human rights law."

In addition, the Inter-American Commission on Human Rights indicated that labor rights are protected in international human rights instruments and, in this respect, referred to the Declaration on Fundamental Principles and Rights at Work of the International Labor Organization (ILO) and the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families.

Bearing in mind the development of international human rights law and international labor law, it can be said that "there are a series of fundamental labor laws that derive from the right to work and are at the very center of it."

Lastly, the Inter-American Commission on Human Rights requested the Court to systematize the rights related to employment "ranking them in order to show that some of these labor rights are considered fundamental" and that, consequently, such rights would "comprise the category of rights regarding which no discrimination is allowed, not even owing to migratory status."

Costa Rica:

In its written and oral comments, Costa Rica stated that it would not refer to the last question formulated by the requesting State. Before making its comments on the other three questions, it set out the following considerations on the "protection of the human rights of migrants in Costa Rica" and on the "principle of reasonableness in the differential treatment of nationals and aliens."

The Costa Rican Constitution establishes a situation of

equality in the exercise of rights and obligations between nationals and aliens, with certain exceptions, such as the prohibition to intervene in the country's political affairs, and others established in legal norms. Those exceptions may not violate the other rights enshrined in the Constitution.

"Despite legal measures and executive actions, some situations of a less favorable treatment for illegal immigrant workers unfortunately occur in the area of employment." The General Law on Migration and Aliens prohibits the employment of aliens residing in the country illegally; however, it also establishes that those who do employ such persons are not exempt from the obligation to provide workers with the wages and social security benefits stipulated by law. In this respect, the Legal Department of the Directorate of Migration and Aliens has established that all workers, irrespective of their migratory status, have the right to social security.

The principles of equality and non-discrimination do not imply that all aspects of the rights of aliens must be equated with the rights of nationals. Each State exercises its sovereignty by defining the legal status of aliens within its territory. To this end, "the principle of reasonableness should be used to define the scope of the activities of aliens in a country."

The Constitutional Chamber of the Supreme Court of Justice of Costa Rica has established that reasonableness is a fundamental requirement for an exclusion or restriction to the rights of aliens compared to nationals to be constitutional. Exclusion is when a right is not recognized to aliens, denying them the possibility of performing some activity. Examples of constitutional exclusions relating to aliens are the prohibition to intervene in political affairs and to occupy certain public offices. To the contrary, restrictions recognize a right to the alien, but restrict or limit it reasonably, taking into account the protection of a group of nationals or a specific activity, or the fulfillment of a social function. Restrictions based exclusively on nationality should not be imposed because xenophobic factors, unrelated to parameters of reasonableness, could exist.

The Constitutional Chamber also indicated that "[e]vidently, the equality of aliens and nationals declared in Article 19 of the Constitution is related to that core of human rights regarding which no distinctions are admissible for any reason whatsoever, particularly owing to nationality. However, the Constitution reserves the exercise of political rights to

nationals, because such rights are an intrinsic consequence of the exercise of the sovereignty of the people[...].”

The Constitutional Court has emphasized that any exception or restriction to the exercise of a fundamental rights affecting an alien must have constitutional or legal rank, and that the measures should be reasonable and proportional and should not be contrary to human dignity.

The Constitutional Court has declared some norms unconstitutional because it considered them irrational or illogical. They include: legal restrictions for aliens to take part as merchants in a “bonded warehouse”; the prohibition for aliens to be notaries, for advertisements recorded by aliens to be broadcast, and for aliens to act as private security agents; and the exclusion of foreign children as possible beneficiaries of the basic education allowance.

Regarding the first question of the request (supra para. 4):

No human right is absolute and, therefore, the enjoyment of human rights is subject to certain restrictions. The legislator may establish logical exceptions arising from the natural difference between nationals and aliens, but may not establish distinctions that imply a void in the principle of equality. “It should be recalled that, in all countries, there are differences of treatment – which do not conflict with international standards of protection – for reasons such as age and gender.”

There can be no differences as regards salary, and working conditions or benefits.

As in most countries, Costa Rican law establishes that aliens who reside illegally in the country may not work or carry out paid or lucrative tasks, either for their own or someone else’s account with or without a relation of dependency. Accordingly, the irregular situation of a person in a State of which he is not a national results *per se* in a considerable limitation in his conditions of access to many workers’ rights. Many social benefits for health and employment security and those that are strictly related to employment “entail a series of bureaucratic procedures which cannot be carried out when a person is undocumented.”

When the domestic legislation of a State establishes essential requirements that a persons must fulfill to be

eligible for a specific service, this cannot be considered to signify a harmfully distinct treatment for undocumented migrant workers. "Moreover, if an employer includes the names of his undocumented workers in certain records, it would imply that he is violating migratory legislation, which would make him liable to punishment."

Owing to the way in which States organize their administrative structure, in practice, there are a series of provisions that indirectly prevent undocumented migrant workers from enjoying their labor rights.

Notwithstanding the above, an employer who has engaged undocumented workers is obliged to pay them wages and other remunerations. Furthermore, "the irregular status of a person does not prevent him from having recourse to the courts of justice to claim his rights"; in other words, "as regards access to judicial bodies, irregular immigrant workers and members of their families have the right to judicial guarantees and judicial protection in the same conditions as nationals."

Regarding question 2(1) of the request (supra para. 4): Respect for the principles of equality and non-discrimination does not mean that some restrictions or requirements for the enjoyment of a specific right cannot be established, using a criterion of reasonableness. The classic example is the exercise of political rights, which is reserved for nationals of a country.

There are other rights that may not be restricted or limited in any way and must be respected to all persons without distinction. In Costa Rica, the right to life is one of these rights. This implies, for example, that a directive ordering border guards to fire on those who try and enter national territory through a non-authorized border post would be a flagrant violation of human rights.

Regarding question 2(2) of the request (supra para. 4): The legal residence of an alien in a recipient State is not a necessary condition for his human and labor rights to be respected. All persons, regardless of whether or not they are authorized to enter or remain in Costa Rica, may have recourse to the Constitutional Chamber of the Supreme Court of Justice to uphold or re-establish their constitutional and other fundamental rights.

Regarding the third question of the request (supra para. 4):

To answer this question, we must refer to the rank of human rights in domestic law. The human rights instruments in force in Costa Rica "are not only of similar weight to the Constitution, but, to the extent that they grant greater rights or guarantees to individuals, they have prevalence over the Constitution." The Constitutional Chamber of the Supreme Court of Justice has taken international human rights legislation as the benchmark for interpreting the Constitution or as a parameter of the constitutionality of other lesser legal norms.

Any migratory norm or policy contrary to the provisions of the International Covenant on Civil and Political Rights would be totally null and void, even if adopted as law by the Legislature.

The Legal Clinics of the College of In their brief of November 27, 2002, indicated that:

Jurisprudence of the Universidad San Francisco de Quito:

Regarding the first question of the request (supra para. 4):

Undocumented migrant workers should not lack protection before the State; migratory status does not deprive them of their human condition. The violation of domestic legislation cannot be considered grounds to deprive a person of the protection of his human rights; in other words, it does not exempt States from complying with the obligations imposed by international law. "To affirm the contrary would be to create an indirect means of discriminating against undocumented migrant workers by, to a certain extent, denying them legal personality and creating legal inequality between persons."

There is no provision of the International Covenant on Civil and Political Rights or the International Covenant on Economic, Social and Cultural Rights that allows the right to work to be restricted owing to migratory status. Article 26 of the International Covenant on Civil and Political Rights is explicit when referring to national origin as grounds that may not be used to discriminate against a person; moreover, it adds that neither can "other status" be cited to deny a person equal treatment by the law. "The norm is clear: the documented or undocumented status may not be used as grounds to deny the exercise of any human right and, consequently, to be treated unequally by the law." Moreover, no interpretation of Article 24 of the American Convention allows equality to be subordinated to a

person's legal residence or citizenship.

Nowadays, migrants are faced with discriminatory State legislation and labor practices and, what is worse, they are constantly denied access to governmental bodies and guarantees of due process; "this is a serious situation for migrants who are documented, but even more so for those who have been unable to legitimize their legal status in the country in which they reside."

The United Nations and the International Labour Organization (ILO) have drawn up norms to guard against the lack of legal protection for migrants. For example, when referring to migrant workers, the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families does not establish any difference on the basis of their legal status, "in other words, it recognizes to migrant workers all the human, civil, political, social, cultural or labor rights, whether or not they are documented." Furthermore, in a previous effort to improve the human rights situation of migrants, ILO Convention No. 143 concerning Migrant Workers (Supplementary Provisions) of 1975, contains important provisions in this respect.

The General Conference of the International Labor Organization has issued two relevant recommendations. However, Recommendation No. 86 on Migrant Workers (revised in 1949) "is discriminatory, inasmuch as it only applies to workers who are accepted as migrant workers. It appears that it does not apply to undocumented migrant workers. In 1975, the International Labor Organization issued Recommendation No. 151 on Migrant Workers, which also only refers to documented migrants. "In other words, although there is concern for migrant workers, they are recognized rights only because of their legal status, and not because of their status as human beings."

In this respect, the route followed by the United Nations in the field of international law has been more coherent. For example, resolution 1999/44 of the Commission on Human Rights recognizes that the principles and standards embodied in the Universal Declaration of Human Rights apply to everyone, including migrants, without making any reference to their legal status.

The International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families refers to the migrant worker without differentiating between the documented and the undocumented migrant worker.

States may not provide different treatment to migrants who are in their territory, whatever their migratory status. “[T]he Court must respond to the first question by affirming that[,] in accordance with the international norms in force, a harmfully different treatment may not be established for undocumented migratory workers.”

Regarding the second question of the request (supra para. 4):

States may not establish discrimination because a person’s residence has not been regularized, and it may not disregard the guarantees necessary for the protection of universal fundamental rights. “It is unacceptable for a State not to guarantee and protect the human rights of all persons in its territory.”

The articles mentioned in the questions at issue establish categorically that all persons are equal before the law. An individual does not acquire the status of person when he is admitted legally into a certain territory; it is an intrinsic quality of the human being. Furthermore, the provisions referred to contain a list of grounds on which a person may not be discriminated against and conclude with phrases such as “nor any other” or “any other condition.” The rights and freedoms proclaimed in international instruments “belong to all individuals, because they are persons, and not because of the recognition a State grants them, owing to their migratory status.” “[I]nternational law does not permit any grounds for distinction that would allow human rights to be impaired or restricted.”

The State may not deny any person the labor rights embodied in many international norms. The denial of one or more labor rights, based on the undocumented status of a migrant workers is entirely incompatible with the obligations of the American States to ensure non-discrimination and the equal and effective protection of the law, to which the said provisions commit them.

According to Article 5 of the International Covenant on Civil and Political Rights and Article 29 of the American Convention, “it cannot be alleged that a State has the right to accept or not a certain individual into its territory and to limit the right to equality before the law, or any of the rights established in the said instrument.”

Regarding the third question of the request (supra para. 4):

“[I]t is unacceptable to restrict the enjoyment and

exercise of a human right citing domestic policy objectives, even when public order (*ordre public*), the ultimate goal of any State, is involved.”

Human rights cannot be subordinated to domestic laws, whether these relate to migratory or any other policy. The right to non-discrimination cannot be conditioned to compliance with migratory policy objectives, even when such objectives are established in domestic legislation. “In accordance with international obligations, laws that restrict the equal enjoyment of human rights of any person are inadmissible and the State is obliged to abolish them.” Moreover, since they are of an *erga omnes* nature, these obligations may be applied to third parties that are not a party to the Convention recognizing them.

In addition to convention-related obligations concerning the prohibition to discriminate, all States have the obligation *erga omnes*, namely, to the international community, to prevent any form of discrimination, including discrimination derived from their migratory policy. The prohibition to discriminate is of fundamental importance to the international community; “consequently, no domestic policy may be aimed at tolerating or permitting discrimination in any form that affects the enjoyment and exercise of human rights.”

“[T]he Court must answer this question by indicating that any subordination of the enjoyment and exercise of human rights to the existence of migratory policies and the achievement of the objectives established in those policies is unacceptable.”

Regarding the fourth question of the request (supra para. 4):

International human rights law establishes limits to the exercise of power by States. These limits are determined in conventions and in customary law provisions and peremptory or *jus cogens* norms.

“Like obligations *erga omnes*, *jus cogens* contains elements of fundamental importance for the international community, elements that are so essential that they are more important than State consent, which, in international law, determines the validity of norms.”

There is little disagreement about the existence of these peremptory norms in international law. In this respect, the Vienna Convention on the Law of Treaties does not set limits to the content of *jus cogens*; that is, it does not determine what these peremptory norms are, but

merely cites some examples. Article 53 of the Convention establishes four requisites for determining whether a norm is of a *jus cogens* character. They are: it must be a norm of general international law, it must be accepted and recognized by the international community, it must be non-derogable, and it may only be modified by a subsequent norm having the same character.

"Therefore, we must ask ourselves whether it would offend the human conscience and public morality if a State [should reject] the principle of non-discrimination and the right to equal and effective protection of the law. The answer is evidently in the affirmative."

"The Court must evaluate whether the principle of non-discrimination and the right to equal and effective protection of the law fulfill the four requirements of a *jus cogens* norm."

If the Court accepts that both the principle of non-discrimination and the right to equal and effective protection of the law are *jus cogens* norms, this would have several legal effects. In this regard, the European Court of Human Rights has indicated that such effects include: recognition that the norm ranks higher than any norm of international law, except other *jus cogens* norms; should there be a dispute, the *jus cogens* norm would prevail over any other norm of international law and any provision contrary to the peremptory norm would be null or lack legal effect.

The legal effects derived, individually and collectively, from the norms contained in Article 3(1) and 17 of the OAS Charter must be determined. According to these norms, the States parties assume a commitment, both individually and collectively, to "prevent, protect and punish" any violation of human rights. The spirit of Article 17 of the OAS Charter is to create binding principles for the States, even if they have not accepted the competence of the Court, so that they respect the fundamental rights of the individual. The Charter proclaims that human rights should be enjoyed without any distinction. Both the States parties and the OAS organs have the obligation to prevent any violation of human rights and to allow them to be enjoyed fully and absolutely.

"If the Court decides that the principle of non-discrimination is a rule of *jus cogens*[,] then we may infer that these norms are binding for States, whether or not the international conventions have been ratified; since [...] the principles [of] *jus cogens* create

obligations *erga omnes*." If this principle were to be considered a norm of *jus cogens* it would form part of the fundamental rights of the human being and of universal morality.

The Court must answer this question by stating that the principle of non-discrimination is a peremptory international norm, "therefore, the provisions of Articles 3(1) and 17 of the OAS Charter must be interpreted similarly."

The Delgado Law Firm:

In its brief of December 12, 2002, stated that:

The decision of the United States Supreme Court in *Hoffman Plastic Compounds Inc. v. National Labor Relations Board* has given rise to uncertainty with regard to the rights of migrants in that country – a situation which could have serious implications for migrants.

In the area of labor law, the United States does not treat irregular migrants with equality before the law. The United States Supreme Court decided that a United States employer could violate the labor rights of an irregular migrant worker without having to give him back pay. In the *Hoffman Plastic Compounds* case, the United States Supreme Court did not impose a fine on the employer who violated the labor rights of an irregular migrant worker and did not order any compensation for the worker.

According to the decision in the *Hoffman Plastic Compounds* case, a migrant worker incurs in "serious misconduct" when he obtains employment in breach of the Immigration Reform and Control Act (IRCA). However, in this case, the United States Supreme Court did not deny that the employer had dismissed the worker for trying to organize a union, which entailed the responsibility of the employer for having committed an evident violation of the labor laws. Even though the employer committed this violation, he was not treated equally by the Supreme Court.

Although the United States affirms that its domestic policy discourages illegal immigration, in practice, it continues to take measures that make it less expensive and therefore more attractive for United States employers to engage irregular migrant workers. For example, even in the United States, it is agreed that the decision in the *Hoffman Plastic Compounds* case will result in an increase in discrimination against undocumented workers, because employers can allege that they did not know that the worker was

undocumented so as to avoid any responsibility for violating the rights of their workers.

This discriminatory treatment of irregular migrants is contrary to international law. Using cheap labor without ensuring workers their basic human rights is not a legitimate immigration policy.

The effects of the Immigration Reform and Control Act and the *Hoffman Plastic Compounds* case indicate that there is an increase in discrimination against undocumented migrant workers. Indeed, the reasoning of the United States Supreme Court suggests that allowing irregular workers to file actions or complaints would only "encourage illegal immigration."

In the United States, irregular workers are exposed to "dangerous" working conditions. Domestic immigration policy should not be distorted in order to use it to exonerate employers who expose irregular migrant workers to unreasonable risk of death.

The United States continue to benefit daily from the presence in its workforce of a significant number of irregular migrant workers. Conservative estimates suggest that there are at least 5.3 million irregular migrants working in the United States and that three million of them are Mexicans. No State should be allowed to benefit knowingly and continuously from the labor of millions of migrant workers, while pretending it does not want such workers and, hence, does not have to guarantee them even the most basic rights. Migrant workers have the right to equal protection of the law, including the protection of their human rights.

Undocumented workers who have filed complaints about remuneration and working conditions in the United States have been intimidated by their employers, who usually threaten to call the Immigration and Naturalization Service.

Moreover, in the *Hoffman Plastic Compounds* case, the United States Supreme Court stated that, owing to his migratory status, no individual whose situation in the country was irregular could require his former employer to pay back wages.

The principle of equality before the law embodied in Article 26 of the International Covenant on Civil and Political Rights obliges States not to enact legislation that creates differences between workers based on their ethnic or national origin.

The principle of equality before the law applies to the enjoyment of civil, political, economic and social rights, without any distinction.

All workers have the right to recognition of their basic human rights, including the right to earn their living and to be represented by a lawyer, despite their migratory status.

The International Labor Organization has drafted important treaties, such as Convention No. 143 concerning Migrations in Abusive Conditions and the Promotion of Equal Opportunity and Treatment of Migrant Workers. This Convention establishes equal treatment between migrants and nationals as regards security of employment, rehabilitation, social security, employment-related rights and other benefits.

Many of the rights included in the International Labor Organization conventions are considered international customary law. These rights are also included in the most important human rights conventions, such as the International Covenant on Economic, Social and Cultural Rights, the International Covenant on Civil and Political Rights, and the International Convention on the Elimination of All Forms of Racial Discrimination.

Lastly, it should be stressed that human rights extend to all migrant workers, whether their situation in a State is regular or irregular.

*Students of the Law
Faculty of the
Universidad Nacional
Autónoma de México
(UNAM):*

In their written and oral statements, indicated that:

Regarding the admissibility of the consultation:

The advisory opinion requested is clearly important, "not only for Mexico, but also for all Latin America, owing to the number of migrants in an irregular situation in other countries and because they are considered a vulnerable group, prone to systematic violation of their human rights."

Regarding the first question of the consultation (supra para. 4):

Even though labor rights have been included among the economic, social and cultural rights, in reality, they form part of an indissoluble whole of all human rights, with no hierarchy, because they are inherent to human dignity.

"The problem of discrimination occurs particularly in

labor-related matters." Undocumented migrants endure several disadvantages; for example, they are paid low wages, receive few or no social benefits or health expenses, are not allowed to join unions and are under constant threat of dismissal or being reported to the migration authorities. "This is confirmed institutionally." Some United States laws and decisions establish a distinction between undocumented migrants, nationals and residents "that is neither objective nor reasonable and, consequently, results in evident discrimination."

The principle of non-discrimination applies to all rights and freedoms, pursuant to domestic law and international law, in accordance with the provisions of Article II of the American Declaration and Articles 1(1) and 24 of the American Convention.

Obviously, States have the sovereign authority to enact labor laws and regulations and establish the requirements they consider appropriate for aliens who become part of their workforce. However, this authority may not be exercised disregarding the international human rights *corpus juris*.

"Human rights do not depend on the nationality of an individual, on the territory where he is, or on his legal status, because they are inherent in him. Upholding the contrary would be akin to denying human dignity. If the exercise of authority is limited by human rights, State sovereignty cannot be cited to violate them or prevent their international protection."

Regarding the second question of the consultation (supra para. 4):

Human rights treaties are based on a notion of collective guarantee; consequently, they do not establish mutual obligations between States; rather, they determine the State obligation to respect and guarantee the rights contained in such instruments to all persons.

Any interpretation of the international human rights instruments must take into account the *pro homine* principle; in other words, they must be interpreted so as to give preference to the individual, "it is therefore unacceptable that Article 2, paragraph 1, of the Universal Declaration, Article II of the American Declaration, and Articles 2 and 26 of the Covenant, as well as Articles 1 and 24 of the American Convention should be interpreted as limiting the human rights of a group of persons, merely because of their undocumented status."

An interpretation of any international instrument that leads to the restriction of a right or freedom of an individual, who is not legally resident in the country where he resides, is contrary to the object and purpose of all international human rights instruments.

Regarding the third question of the consultation (supra para. 4):

States have the sovereign authority to issue migratory laws and regulations and to establish differences between nationals and aliens, provided that such domestic norms are compatible with their international human rights obligations. These differences must have an objective, reasonable justification; consequently, they should have a legitimate objective and there must be a reasonable relationship of proportionality between the means used and the aim sought.

A State party to the International Covenant on Civil and Political Rights which enacts a law that clearly violates this instrument or takes measures that limit the rights and freedoms embodied in this treaty to the detriment of a group of persons incurs international responsibility,

Equality before the law and non-discrimination are essential principles that apply to all matters. Therefore, any act of the State, including an act in keeping with its domestic laws, which subordinates or conditions the fundamental human rights of a group of persons, entails the State's non-compliance with its obligations *erga omnes* to respect and guarantee those rights. Consequently, it results in the increased international responsibility of the State and any subject of international law may legitimately cite this.

Regarding the fourth question of the consultation (supra para. 4):

The 1969 Vienna Convention on the Law of Treaties has recognized the existence of norms of *jus cogens*, by establishing them as peremptory norms of international law. However, it did not define them clearly.

Norms of *jus cogens* respond to the need to establish an international public order (*ordre public*), because a community ruled by law requires norms that are superior to the will of those who form part of it.

The international community has repudiated violations of the principle of non-discrimination and the right to the equal and effective protection of the law.

The principle of non-discrimination and the right to equality before the law are of transcendental importance in relation to the situation of undocumented migrant workers, because their violation involves the systematic violation of other rights.

The principle of non-discrimination and the right to equal protection of the law, "which are the essence of human rights, are norms of *ius cogens*." Norms of *ius cogens* are enforceable *erga omnes*, because they contain elemental values and concerns of mankind based on universal consensus, owing to the special nature of the prerogative they protect.

Javier Juárez, of the Law Office of Sayre & Chavez: *In his brief of February 6, 2003, stated that:*

On March 27, 2002, the United States Supreme Court decided that undocumented migrant workers, who had been unduly dismissed because they had organized unions, did not have the right to back pay under the National Labor Relations Act.

For undocumented workers, this decision creates a clear legal exception to the guarantees granted to other workers; therefore, it contravenes the provisions of the international agreements that seek to ensure equal protection for migrant workers and it increases the vulnerability that distinguishes them from other groups in the general population.

The case cited involves Mr. Castro, a worker employed in the plant of the *Hoffman Plastic Compounds* company in Los Angeles, California. In 1989, when Mr. Castro helped organize a union to improve working conditions in the plant, he was dismissed. In January 1992, the National Labor Relations Board decided that Mr. Castro's dismissal was illegal and ordered payment of back pay and his reinstatement.

In June 1993, during the hearing held before an administrative judge of the National Labor Relations Board to determine the amount of back pay, Mr. Castro indicated that he had never been legally admitted or authorized to work in the United States. As a result of this statement, the administrative judge decided that he could not grant payment of back pay, because this would conflict with the 1986 Immigration Control and Reform Act, which prohibits employers from knowingly employing undocumented workers, and employees from using false documents in order to seek employment.

In September 1998, the National Labor Relations Board revoked the decision of the administrative judge and indicated that the most effective way to promote immigration policies was to provide undocumented workers with the same guarantees and remedies as those granted to other employees under the National Labor Relations Act.

The National Labor Relations Board decided that, even though the undocumented worker did not have the right to be reinstated, he should receive back pay and the interest accrued for the three years' lost work.

The United States Court of Appeal denied the request for review filed by *Hoffman Plastic Compounds* and reaffirmed the decision of the National Labor Relations Board.

On March 27, 2002, the United States Supreme Court considered the case and annulled the payment that was to be made to the worker.

The decision of the United States Supreme Court rejecting the payment to the worker stated that allowing the National Labor Relations Board to allow payment of back pay to illegal aliens would prejudice statutory prohibitions that were essential to the federal immigration policy. This would help individuals avoid the migratory authorities, pardon violations of immigration laws and encourage future violations.

The minority opinion of the United States Supreme Court indicated that the decision adopted in the *Hoffman Plastic Compounds* case would undermine labor legislation and encourage employers to hire undocumented workers. The dissenting opinion in the case established that payment of back pay is not contrary to the national immigration policy.

This dissenting opinion also indicated that, by failing to apply the labor legislation, those persons who most needed protection were left open to exploitation by employers. It added that the immigration law did not weaken or reduce legal protection, or limit the power to remedy unfair practices carried out against undocumented workers.

In its broadest sense, the decision of the United States Supreme Court implies that undocumented workers do not have the right to file proceedings to obtain payment of overtime, or to claim violations of the minimum wage or discrimination.

However, in two different cases related to violations of the minimum wage, a district court and a superior court decided that the migratory status of workers was not relevant in order to request payment of the minimum wage for the period of employment.

Several state authorities were mentioned which consider that the decision of the United States Supreme Court in the *Hoffman Plastic Compounds* case has a negative impact on the labor rights of migrant workers.

Most migrant workers are unwilling to exercise their rights and, on many occasions, do not report the abuses to which they are subjected.

Corporate associations also confirm the legal, social and economic vulnerability of undocumented workers. Recently, the Center for Labor Market Studies of Northwestern University conducted a study on the impact of migrants in the United States. The study director indicated that, over the last 100 years, the economy of the United States has become more dependent on migrant labor. He added that many of these new migrant workers, possibly half of them, are in the United States without legal documents, which means that the economy depends on individuals who are in a "legal no-man's land."

In summary, the decision of the United States Supreme Court in the *Hoffman Plastic Compounds* case may be seen as one of the latest additions to the legal structure that, directly or indirectly, has denied migrants the basic guarantees required to alleviate their social and economic vulnerability.

Many differences in treatment are derived directly from the undocumented status of workers and, at times, these differences also extend to documented migrants.

Harvard Immigration and Refugee Clinic of Greater Boston Legal Services and the Harvard Law School, the Working Group on Human Rights in the Americas of Harvard and Boston College Law Schools, and the Global Justice Center:

In their written and oral statements, indicated that:

They are interested in this case and, in particular, in the labor rights of migrant workers in the Americas.

They endorse Mexico's argument that the facts show that migrant workers do not enjoy universal human rights in fair and equitable conditions. The disparity between existing international norms that protect migrant workers and national discriminatory practices and legislation is the greatest challenge faced by migrant workers.

They proceeded to review the laws and practice of

some American States in order to understand the disparity that exists between the rights of migrant workers and the relevant public policy.

Regarding laws and practices in Argentina:

According to the Argentine General Migration Act only migrants admitted as permanent residents enjoy all the civil rights guaranteed in the Constitution, including the right to work. The right to work granted to temporary or transitory migrants is more limited, while migrants who are in breach of the General Migrations Act do not have the right to work and may be detained and expelled.

It is almost impossible for many undocumented migrants to comply with the requirements for obtaining legal residence in Argentina established in Decree No. 1434/87, which stipulates that the Migrations Department may deny legal residence to migrants who: 1) entered the country avoiding migratory control; 2) remained in the country for more than 30 days, in violation of the law; or 3) work without the legal authorization of the Migrations Department. Likewise, the Ministry of the Interior has extensive discretionary powers to deny legal residence to migrants.

In the practice, because most migrants in Argentina have few resources, are not professionals and do not have Argentine relatives, the best way to regularize their migratory status is to present an employment contract entered into with an Argentine employer. However, as the regulations are very complex, many migrants are obliged to maintain their illegal status. Consequently, they have to accept precarious working conditions and very low salaries, and endure other abuse from their employers.

Regarding laws and practice in Brazil:

The 1988 Federal Constitution of Brazil guarantees the legitimacy of the rights embodied in the international treaties to which Brazil is a party. The Federal Constitution also establishes equal treatment for nationals and aliens.

Brazilian labor laws make no distinction between nationals and aliens. Undocumented workers have the right to receive wages and social benefits for work performed. Moreover, there are no provisions that limit access to justice because of the complainant's nationality.

In practice, irregular workers in Brazil endure many

difficulties, including long working hours and lower than minimum wages. Many irregular migrants never report abuses for fear of being deported. This fear also means that irregular migrants do not send their children to school, request driving licenses, buy goods, or visit their countries of origin.

Likewise, these workers have little information about their rights and can only claim them when they receive help from non-governmental organizations working with migrants.

Regarding laws and practice in Chile:

According to Chilean laws and regulations, national and foreign workers have equal labor rights.

Under Chilean labor legislation, an employment contract does not have to be in writing; however, the migratory law requires migrant workers to have a written contract drawn up before a public notary, in which the employer commits himself to paying the migrant's transport back to his country of origin on termination of the contract.

Migrant workers working in Chile without a written contract often receive very low wages, do not have access to social security benefits and can be dismissed at any time without monetary compensation. This situation is especially difficult for irregular migrant workers, because they fear being identified by the immigration authorities.

Likewise, given that irregular workers often do not possess national identity documents, they do not have access to many public services, including medical care and public housing.

The labor legislation does not expressly regulate the rights of workers without a contract, so the Labor Department and the Inspections Unit regulate their situation. Information on how these labor authorities interpret the law is not readily available to migrant workers. Chilean legislation on foreign workers has not been updated and provides them with very little protection, particularly in labor disputes.

Regarding laws and practice in the Dominican Republic:

The greatest obstacle to the protection of the rights of migrant workers in the Dominican Republic is the difficulty that Haitians face in establishing legal residence there. Once they have obtained their legal status, the law guarantees migrants the same civil

rights as Dominicans. The law does not distinguish between citizens and documented aliens as regards their economic, social and cultural rights. Basic labor rights are guaranteed to all workers, regardless of whether or not they are legally resident in the country.

There are diverse problems in the workplace. For example, the minimum wage is insufficient to enjoy a decent life; the requirements for collective negotiation are unattainable; the fines imposed on employers are insufficient to prevent the violation of workers' rights, and many health and security inspectors are corrupt.

Most Haitian migrant workers in the Dominican Republic face long working hours, low wages and lack of employment security. Their living conditions are inadequate. Most workers do not have drinking water, latrines, medical care or social services.

Haitian migrant workers have a very limited possibility of combating these unfair working conditions. They have to face political and social attitudes that are generally hostile. At the same time, most of these workers do not have access to legal aid and, consequently, to the labor courts.

The way that the migratory and citizenship laws are applied in the Dominican Republic contributes to perpetuating the permanent illegality of Haitians and Dominicans of Haitian descent. Moreover, given their poverty and illiteracy, it is very difficult for migrant workers to comply with the requirements to obtain temporary employment permits. The status of Haitian workers as irregular migrants affects their children, even those born in the Dominican Republic. The children of Haitians, who are born in the Dominican Republic, are not considered citizens, because Haitians are classified as aliens in transit. This situation has meant that Haitians are subject to deportation at any time and mass expulsions have been carried out in violation of due process.

For decades, the Dominican Republic has benefited from the cheap labor of Haitians and the State has developed a system that maintains this flow of migrant workers without taking the minimum measures to ensure their fundamental rights.

Regarding laws and practice in the United Mexican States:

Pursuant to Articles 1 and 33 of the Constitution, which refer to equal protection, constitutional labor rights

must be guaranteed to all migrants.

According to its Constitution, Mexico is obliged to implement the bilateral and multilateral treaties on the labor rights of migrant workers to which it has acceded. These treaties ensure equal protection and non-discrimination, as well as other more specific guarantees.

The Federal Labor Act allows migrants to work legally in Mexico as visitors. However, there are professional restrictions on certain categories of visitors; these categories include most migrant workers from Central America, who are usually less qualified. Therefore, workers from Central America can only enter Mexico legally under the "Migratory Form for Agricultural Visitors" or under the "Migratory Form for Local Border Visitors." Some provisions of the Federal Labor Act allow preferential treatment in contracting Mexican workers in relation to migrant workers.

The most common violations of the rights of migrant workers are: long working hours; inadequate living, health and transport conditions; below minimum wages; deductions from wages for food and housing; retention of wages and employment documents and racial discrimination. Owing to the bleak social and economic conditions in their countries of origin, many migratory agricultural workers are obliged to accept these abuses.

Although the "Migratory Form for Agricultural Visitors" and the "Migratory Form for Local Border Visitors" programs exist, and measures have been taken to protect the rights of migrant workers, these programs have been managed inadequately and have not prevented the abuse of workers. For example, the Local Arbitration and Conciliation Committees settle disputes between workers and employers, but the process is often slow. Also, many workers resort to the Committees without any legal representation and are summarily deported, even when their cases are pending.

Regarding laws and practice in the United States of America:

As a State party to the OAS Charter, the United States are subject to the obligations established by the American Declaration, which guarantee the right to work and to fair wages, as well as the right to organize unions and to receive equal treatment before the law. The Universal Declaration also guarantees the right to

form trade unions and to equal remuneration for work of equal value. The International Covenant on Civil and Political Rights, to which the United States is a party, guarantees the right to equality before the law, without discrimination, and establishes the right to form trade unions. Lastly, the International Labor Organization conventions protect the labor rights of irregular workers.

Under existing labor legislation in the United States, irregular workers are recognized as "employees," which gives them the right to the protection indicated in the principal federal labor laws. However, in practice they are not treated equally.

The National Labor Relations Act (NLRA) authorizes the National Labor Relations Board (NLRB) to establish remedies for employees who are victims of unfair labor practices. For example, in cases of unjustified dismissal, the remedy might consist of reinstatement and payment of back pay. In *Hoffman Plastic Compounds v. National Labor Relations Board* (2002), the United States Supreme Court decided that an irregular worker did not have the right to back pay, even when he had been dismissed for taking part in the organization of a union to obtain fair pay. In this case, the Supreme Court determined that "migratory policy had precedence over labor policy." According to the Supreme Court's decision in *Sure-Tan v. National Labor Relations Board* (1984), workers can be handed over to the Immigration and Naturalization Service even when the employer's reason for doing so is unlawful retaliation against a worker who is carrying out an activity protected by the National Labor Relations Act. With these decisions, the Supreme Court has created inequality in the labor laws of the United States, based on migratory status.

Many irregular workers in the United States face serious problems owing to poor health and security conditions in the workplace, because they are paid less than the legal minimum. Migrant workers are also the target of discrimination and violence by third parties. Several States deny irregular workers access to education and medical care. Also, irregular workers who defend their rights run the risk of being reported to the Immigration and Naturalization Service. Undocumented migrants do not have access to legal aid, which makes it more difficult for workers to insist on their rights.

The difficult situation faced by irregular workers also affects migrant workers who are covered by the "H2A"

and "H2B" visa programs. The rights of such workers are extremely restricted; for example, they are not covered by the law that establishes payment for overtime. In addition, the permit to be in the country legally is conditioned to remaining in a job with one employer, which restricts the worker's possibility of insisting on his rights.

Lastly, approximately 32 million workers, including many migrants who provide domestic services or work on farms, are not protected by the provision of the National Labor Relations Act establishing the right to organize unions or by any state legislation.

Thomas Brill, of the Law Office of Sayre & Chavez: *In his written and oral statements, indicated that:*

In March 2002, the United States Supreme Court decided, in *Hoffman Plastic Compounds v. National Labor Relations Board*, that an undocumented worker did not have the right to the payment of lost wages, after being illegally dismissed for trying to exercise rights granted by the National Labor Relations Act.

Hoffman Plastic Compounds engaged José Castro in May 1988. In December 1988, Mr. Castro and other workers began a campaign to organize a union. In January 1989, the company dismissed Mr. Castro and three other workers for trying to create and join a union. In January 1992, the National Labor Relations Board ordered *Hoffman Plastic Compounds* to reinstate Mr. Castro and to give him the back pay he would have received, had it not been for the company's decision to dismiss him because he was involved in union activities. The company refused to give Mr. Castro the back pay, because he admitted that he did not have an employment permit.

In September 1998, the National Labor Relations Board decided that *Hoffman Plastic Compounds* must pay Mr. Castro back pay corresponding to the period from his dismissal up until the date on which he admitted that he did not have the documentation corresponding to the employment permit. In its decision, the National Labor Relations Board said that "[t]he most effective way to adapt and promote the United States immigration policies [...] is to provide the guarantees and remedies of the National Labor Relations Act to undocumented workers in the same way as to other workers." The National Labor Relations Board ordered *Hoffman Plastic Compounds* to pay Mr. Castro the amount of US\$66,951 (sixty-six thousand nine hundred and fifty-one United States dollars) for the concept of back pay. *Hoffman Plastic Compounds* refused to pay

Mr. Castro and filed an appeal. In 2001, the Federal Appeals Court confirmed the decision of the National Labor Relations Board and *Hoffman Plastic Compounds* filed an appeal before the United States Supreme Court.

In its decision of March 2002, the Supreme Court revoked the decisions of the Appeals Court and the National Labor Relations Board. It denied Mr. Castro's request for back pay and stated that, in the case of irregular workers who are dismissed for carrying out union-related activities, the prohibition to work without an authorization contained in the immigration legislation prevailed over the right to establish and join a union.

The National Employment Law Project, an American non-profit agency that examined the effect of the decision in the *Hoffman Plastic Compounds* case, determined that, as of that decision, employers have tried to deteriorate further the rights of irregular workers in the United States.

Many employers have infringed the rights of their employees since the decision in the *Hoffman Plastic Compounds* case was published. Indeed, employers can argue that irregular workers cannot file a complaint with the justice system when they are discriminated against or when their right to the minimum salary is violated. Clearly, the decision in the *Hoffman Plastic Compounds* case has led employers to discriminate against their irregular workers, arguing that the latter have no right to take legal action when their labor rights are violated. Thus, engaging irregular workers has been encouraged, because they are cheaper for the employer, and so as not to employ citizens or residents who can demand the protection of their rights before the courts.

However, it is important to note that the decision in the *Hoffman Plastic Compounds* case was not adopted unanimously by the United States Supreme Court, but by a majority of 5 votes to 4; the author of the dissenting opinion was Judge Breyer. He indicated that allowing irregular migrants access to the same legal remedies as citizens was the only way to ensure that migrants' rights were protected. Judge Breyer carefully examined the possible impact of the decision on irregular workers and stated that if undocumented workers could not receive back pay when they were illegally dismissed, employers would dismiss such workers when they tried to establish trade unions, because there would be no consequences for the

employer, at least the first time he used this method.

Likewise, as Judge Breyer stated, there is no provision in the United States immigration legislation that prohibits the National Labor Relations Board from allowing irregular workers to file remedies or actions when their rights are violated. However, the majority opinion of the United States Supreme Court eliminated the possibility that an irregular worker could file a claim for back pay before the courts, based on the alleged conflict between the National Labor Relations Act and the 1986 Immigration Reform and Control Act.

Both the National Labor Relations Board and the Supreme Court approached the *Hoffman Plastic Compounds* case as one that required a balance between labor legislation and immigration legislation. The National Labor Relations Board and the four judges of the Supreme Court in the minority gave priority to labor laws, while the five judges who comprised the majority granted priority to immigration laws.

In their decisions, the National Labor Relations Board and the Supreme Court did not take international human rights law and the norms of international labor law into consideration. Nor did they consider the obligations of the United States, pursuant to international law, to "ensure, in cooperation with the United Nations, the universal and effective respect for the fundamental rights and freedoms of man."

In summary, the decision in the *Hoffman Plastic Compounds* case denies a group of workers their inherent labor rights that have been recognized by the international community.

One of the principal entities that has referred to the topic of human rights is the Organization of American States (OAS). The United States and Mexico are two of the 35 States parties actively involved in the OAS administration and, in theory, they adhere to the general principles and standards established by this international organization.

In this respect, it is important to cite Articles 3(I) and 17 of the OAS Charter, which refer to equality and non-discrimination. These principles are also mentioned in the American Declaration.

However, Mexico has not requested the Court to examine the United States immigration legislation. The right of each State to establish immigration rules is not questioned. Nevertheless, when the legislators of any

specific State establish policies that discriminate against certain categories of workers in the labor market, it can have a devastating result on the protection of human rights. Fundamental human rights must prevail over the objective of preventing certain workers from enjoying the benefits granted by law.

For the above reasons, it is considered that the recent decision of the United States Supreme Court in *Hoffman Plastic Compounds v. National Labor Relations Board* creates a system that violates international law.

*Labor, Civil Rights and
Immigrants' Rights
Organizations in the United
States of America:*

In their written and oral statements, they stated that:

The brief was prepared in representation of 50 civil rights, labor and immigrant organizations in the United States.

Migrant workers in the United States are among those workers who receive the lowest wages and most unfair treatment. Attempts by organizations to protect the rights of migrants, including "unauthorized" workers, have been obstructed by United States laws that discriminate based on the status of alien and migrant and, above all, owing to the decision of the United States Supreme Court in *Hoffman Plastic Compounds v. National Labor Relations Board*. Moreover, federal and state labor legislation violate international human rights law, which is obligatory for the United States. There is an urgent need for strong regional standards for the protection of migrant workers.

The expression "unauthorized worker" is used to describe migrant workers who are not authorized to be employed legally in the United States. This group includes workers who, for different reasons, are legally in the United States but are not authorized to work. The expression "undocumented" migrant is used to describe migrants whose presence in the United States is illegal. These workers form a subgroup of the migrant population that is not authorized to work. Most decisions taken by the courts are based on the authorization to work.

The United States has the largest migrant population in the world. For the purposes of this brief, the figure of 5.3 million persons (an approximate calculation of the total number of undocumented workers in the United States), will be sufficient to establish that this population represents a sizeable economic factor and an issue of political and human concern. Undocumented workers perform most of their work in sectors characterized by low salaries and high risk.

The practice of threatening migrant workers with reporting them to the Immigration and Naturalization Service (INS), in order to limit the exercise of their labor rights, has been common for many years and has not decreased since the decision in *Hoffman Plastic Compounds v. National Labor Relations Board*.

Penalties for employers who hire "unauthorized" workers are ineffective in the United States. The 1986 Immigration Reform and Control Act (IRCA) establishes that an employer must verify the identity and eligibility of the personnel he engages. However, the law allows employers to review the documents superficially. Employers have very little reason to fear that the Immigration and Naturalization Service will penalize them for engaging undocumented migrants; rather, they see this as a legitimate decision that saves them money. Even when employers break the law, the penalties and fines they receive are low and infrequent. Therefore, under current legislation, employers can engage "unauthorized" workers, benefit from them and threaten to report them to the Immigration and Naturalization Service, without fear of possible Government action.

Some migrant workers, particularly those who are "unauthorized", are expressly excluded from the possibility of receiving certain reparations that are available to United States citizens. For examples in the *Hoffman Plastic Compounds* case, the United States Supreme Court decided that "unauthorized" workers could not receive back pay following a dismissal in reprisal for union activities, which is illegal under by the National Labor Relations Act that protects the right to organize unions and negotiate collectively. The Equal Employment Opportunity Commission (EEOC), the governmental agency that applies most of the federal labor laws on discrimination, has indicated that it is reviewing the practice of ordering payment of back pay to undocumented workers in light of the decision in the *Hoffman Plastic Compounds* case.

Lastly, the decision in the *Hoffman Plastic Compounds* case leaves intact the right to a minimum wage and the payment of overtime, under the Fair Labor Standards Act, because it referred only to the payment of back pay for work that had not been performed. However, the US Department of Labor, the federal agency responsible for applying the Fair Labor Standards Act, has not defined its opinion on the right of "unauthorized" migrants to payment of back pay arising from dismissals for reprisals, and has said that

"it is still considering the effect of the *Hoffman [Plastic Compounds]* case on this reparation."

Even before the *Hoffman Plastic Compounds* case, some United States laws discriminated explicitly against workers in certain migratory categories, including "unauthorized" workers and those who held specific types of visas. In most states, "unauthorized" workers have the right to receive compensation for occupational accidents or incapacity. In general, such compensation is regulated by state legislation and this varies in each state. Workers usually receive medical expenses, a partial reimbursement of their salaries, pensions, benefits in case of death and, at times, training for new employment. While the legislation on compensations in almost all the states applies to "unauthorized" workers, the laws of the state of Wyoming explicitly exclude them from the benefits of compensation, while other judicial decisions and provisions restrict payment of compensation for factors such as rehabilitation, death and back pay.

Workers included in the H-2A visa program (for agricultural employment), who are mostly from Mexico, are denied many basic federal labor measures protection. They are excluded from the protection of the Migrant and Seasonal Agricultural Worker Protection Act (MSAWPA), the principal labor act regulating agricultural workers. Therefore, their employer is not controlled by the United States Labor Department. In addition, the permit for H-2A workers to remain legally in the United States is linked to a single employer. Consequently, these workers are not at liberty to change employment.

The right of migrant workers to legal representation is also seriously restricted. The 1974 Legal Services Corporation Act created the Legal Services Corporation, and its programs are prohibited from providing legal aid for, or in representation of, most migrants who are not legal permanent residents.

Once an alien is physically in the territory of a country and has found employment, the refusal to provide him with labor protection measures violates the human right to non-discrimination. Numerous international instruments that are obligatory for the United States establish a universal norm of non-discrimination that protects all persons within the jurisdiction of a State. Differences in treatment based on nationality or migratory status, such as those established in the above-mentioned United States labor laws, violate Articles 2 and 26 of the International Covenant on Civil

and Political Rights, and Article II of the American Declaration. The wording of these provisions and that of the conventions of the International Labor Organization indicate that the guarantee of equality and non-discrimination, as well as others related to work, are universal and apply "to all persons."

States may not discriminate on the basis of nationality or any other condition, according to the International Covenant on Civil and Political Rights, but only to establish distinctions based on reasonable and objective criteria. The argument that some United States labor laws establish discriminations that violate Articles 2 and 26 of the International Covenant on Civil and Political Rights is supported by the interpretation of the United Nations Committee on Human Rights. In *Gueye et al. v. France*, the Committee reasserted its position that the provisions of the International Covenant on Civil and Political Rights are applicable to non-nationals, provided that the contrary is not expressly established. It was also shown that distinctions based on being an alien violate Article 26 of the International Covenant on Civil and Political Rights, even though this treaty does not expressly guarantee the substantive benefit in dispute (in this case, the right to a pension or, for example, the right to fair wages, adequate working conditions and an effective remedy with legal assistance). The decision in this case states that a distinction based on a person's status as an alien is inadmissible, when it lacks reasonable and objective grounds, even though the substantive rights, in themselves, are not fundamental and are not recognized by the International Covenant on Civil and Political Rights. Finally, the decision establishes that if the distinction in the employment benefit is reasonable and objective and, therefore, permissible, a court must examine the implicit purpose of the labor law in order to determine whether the distinction is relevant for attaining the proposed objective. United States labor rights laws that discriminate on the basis of alien or migratory status do not resist this examination. Once an alien has been engaged, his nationality and his legal status are irrelevant for the purpose of protecting an individual in his place of employment and preventing his exploitation. Migratory control cannot be considered the principal aim of labor protection legislation, and restrictions imposed by the United States on the labor protection of aliens does not contribute objectively or reasonably to this end.

The language and the arguments *expresio unius* established in the International Covenant on Civil and

Political Rights also apply to the American Declaration and Convention. The language of the inter-American instruments is universal and does not establish express distinctions based on alien or migratory status. The case law of the inter-American system on non-discrimination agrees substantially with case law relating to the International Covenant on Civil and Political Rights and helps us conclude that the United States labor laws discriminate unduly against migrant workers.

Other international treaties and declarations applicable to the United States, including the International Covenant on Economic, Social and Cultural Rights and Convention No. 111 of the International Labour Organization, confirm that the basic principles of non-discrimination apply to labor protection without distinction owing to nationality or migratory status.

In addition to violating the principle of international law of non-discrimination, United States labor legislation does not protect the freedom of association of "unauthorized" workers and other migrant workers and violates the fundamental international principle of freedom of association. The International Labor Organization has expressly recognized freedom of association as one of the four fundamental human rights that protect all workers, including "unauthorized" and undocumented workers. Other international instruments (such as the American Declaration, the American Convention, the OAS Charter and the International Covenant on Civil and Political Rights), applicable to the United States, allow exceptions to the right to freedom of association only in limited circumstances, which do not justify the failure to guarantee this right to aliens and "unauthorized" migrants.

The decision of the United States Supreme Court in the *Hoffman Plastic Compounds* case that back pay cannot be paid to "unauthorized" workers when they are improperly dismissed for taking part in union activities, affects the right to freedom of association of such workers. Since these workers do not have the right to reinstatement when they are improperly dismissed, payment of back pay is the only available effective reparation for violations of the National Labor Relations Act.

The Academy of Human Rights and International Humanitarian Law of the American University,

In their brief of February 21, 2003, indicated that:

This request for an advisory opinion should take into consideration the "autonomous clauses" of the

Washington College of Law, and the Human Rights Program of the Universidad Iberoamericana de México:

international treaties and instruments cited by the requesting State; that is, Articles II of the American Declaration, 24 of the American Convention, 7 of the Universal Declaration and 26 of the International Covenant on Civil and Political Rights. Regarding the norms that embody the principle of non-discrimination subordinated to the existence of a violation of one of the rights protected in these instruments, "there is no doubt that Articles 1(1) of the American Convention and 2(1) of the International Covenant on Civil and Political Rights should be excluded from the analysis, because these instruments do not guarantee labor rights. The situation concerning Article 2 of the Universal Declaration is different, because this instrument effectively guarantees such rights, including, in particular, what could be considered minimum standards of protection in this area."

The human rights norms cited by the requesting State do not expressly forbid making distinctions based on the nationality or migratory status of an alien. However, the provisions being examined do not establish a specific or exhaustive list of reasons for which distinctions may not be established; to the contrary, "they appear to admit that, in principle, a distinction on some specific grounds may result in discriminatory treatment."

The provisions applicable to this request have all been interpreted under international human rights law, in the sense that a measure is discriminatory only when the distinction in treatment is not based on objective and reasonable grounds; in other words, when it does not pursue a legitimate goal or when the relationship between the means used and the goal that the measure is intended to achieve is not proportionate. However, States enjoy a certain margin of maneuver to evaluate whether a difference in treatment between persons who are in a similar situation is justified.

This analysis makes no specific reference to Mexico's two final questions, because the answer to those questions is subsumed in the analysis of the other questions.

Although the requesting State referred to "labor rights" in their broadest sense in its questions, this analysis focuses specifically on the "right of all persons to wages and benefits for work performed"; therefore, there is no doubt that, in international human rights law applicable to the American States, this minimum labor protection must be guaranteed to every individual, including undocumented workers. In this respect, it is important to clarify that, for the purposes of this *amici curiae*, the

definition of "remuneration and benefits for work performed" includes not only the so-called back pay, but also other accessory labor rights such as the right to join a union or the right to strike.

Regarding the first question of the consultation (supra para. 4):

In different international instruments, international human rights law enshrines a wide variety of norms on workers' rights. The labor rights provisions contained in instruments adopted or ratified by OAS Member States are: Article 23 of the Universal Declaration; Articles 34(g), 45(b) and 45(c) of the OAS Charter, and Article XIV of the American Declaration. Other relevant international instruments also determine the scope of regional human rights obligations with regard to workers' rights, they include: Articles 6, 7 and 8 of the International Covenant on Economic, Social and Cultural Rights; the American Convention; the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights; Convention No. 97 of the International Labour Organization concerning Migrant Workers; the Constitution of the International Labour Organization; and the International Convention on the Protection of the Rights of all Migrant Workers and their Families.

The right of all persons to receive remuneration for work performed is one of a group of rights that "are closer to civil and political rights, either because they have a direct impact on rights such as the right to property or the right to legal personality [...] or because of their immediate and urgent nature, which is implicitly or explicitly reiterated in many [...] instruments".

Articles 34(g) and 45(b) of the OAS Charter presume the existence of the worker's right to receive remuneration for work performed, a right that is so obvious that it was not necessary to enshrine it explicitly. The right is explicitly protected in Article XIV of the American Declaration. The OAS Charter and the American Declaration do not differentiate between a citizen and an alien whose status is irregular, but refer in general to "person" or "worker."

Article 23 of the Universal Declaration reflects implicitly and explicitly the general principle that if a person has worked, he should receive the corresponding remuneration.

Mexico did not cite the International Covenant on Economic, Social and Cultural Rights in its request for an advisory opinion; however, this treaty also contains

relevant references to the right to receive remuneration for work performed. In the same way, Article 7 of the Additional Protocol of the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights "Protocol of San Salvador" guarantees the right to a "fair and equal wages for equal work, without distinction." The International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families explicitly embodies minimum guarantees, including the right of undocumented migrant workers to the remuneration for which they have already worked.

As irregular migrant workers and the members of their families are a particularly vulnerable sector of society, the State has the special obligation "to grant particular protection or, in this case, to abstain from taking excessively oppressive measures that restrict the labor rights of such persons and that, evidently, are not only unnecessary to achieve the legitimate goal sought, but also have the contrary effect."

In addition to any legal construct relating to international instruments, "the most elemental sense of justice requires that a person who has worked should be guaranteed that he will receive his remuneration"; the contrary would mean the acceptance of a modern form of slave labor.

The general practice of States, reflected in international instruments, and the perception of those States that it is a legal norm sustaining the notion of *opinio juris*, suggest the existence of an international norm of customary law concerning the right of the worker to receive remuneration for work performed. Moreover, it appears that States do not oppose recognizing this right, which excludes the possibility of arguing that there has been a persistent objection to this norm.

Human rights, such as the right to equality or the right to remuneration may be restricted, but limitations must respond to criteria of necessity and proportionality in order to attain a legitimate objective. Implementing measures to control irregular immigration into a State's territory is a legitimate objective. However, if such measures are intended to strip irregular migrant workers of the right to receive remuneration for work performed, it is urgent to examine the proportionality and the need and, to do this, we must consider whether there are other measures that are less restrictive of the said right.

There are other mechanisms that can be adopted to

control irregular immigration into a State's territory. They include the possibility of penalizing those who employ undocumented workers administratively or criminally, reinforcing border immigration controls, establishing mechanisms to verify legal status in order to avoid the falsification of documents, deporting undocumented persons, and investigating and punishing those who commit offences. It does not appear proportionate or necessary to adopt measures aimed at stripping migrant workers of the remuneration for which they have already worked. Such measures "appear to be a 'punishment' that excessively affects not only the worker but also the members of his family." The International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families can serve as a guide to confirm that some restrictions to the right to receive remuneration for work performed are neither necessary nor proportionate.

Likewise, the right to receive remuneration for work performed cannot be limited by indirect measures, such as the adoption of measures restricting the right of the worker whose situation is irregular to take legal action to claim his wages; for example, by demanding that he should be physically present in the jurisdiction of the recipient State in order to be able to make this claim, after he has been deported and will not be granted authorization to enter the said State again.

Regarding question 2(1) of the request (supra para. 4): Regarding the provisions of the Universal Declaration – except for Articles 21 and 13 – there is agreement that, under norms of customary law, States have the obligation to respect and guarantee fundamental human rights to aliens under their jurisdiction, including those whose resident status is irregular.

International customary law obliges States to guarantee the principle of equality before the law and non-discrimination to all aliens resident in their jurisdiction and to prohibit differences in treatment between citizens and aliens that could be considered unreasonable. However, the rights and freedoms are not absolute and certain restrictions regulated in Article 29(2) of the Universal Declaration may be established.

In conclusion, the international instruments cited by Mexico in the request guarantee the right to equality before the law to all persons subject to the jurisdiction of a State, irrespective of their nationality or migratory status. However, this right is not absolute; consequently, it may be subject to reasonable restrictions. Moreover, under the International Covenant

on Civil and Political Rights and the American Convention, the right to equality before the law is not considered a non-derogable norm; in other words, it may be suspended under certain circumstances.

Regarding question 2(2) of the request (supra para. 4): We must bear in mind that the existence of discrimination is not determined in the abstract, but because of the concrete circumstances of each case. In the specific context of the request made by Mexico, the grounds for distinguishing between irregular migrant workers and other workers, for the recognition of minimum labor rights, is the migratory status of the former and not their nationality.

The different treatment that certain States afford irregular workers, owing to their migratory status, does not imply discrimination *per se*. Pursuant to constant international case law, a difference in treatment will be discriminatory when it is not based on objective and reasonable grounds; that is, when it does not have a legitimate objective or when there is no proportionality between the means used and the end sought with the questioned measure or practice. Likewise, the right to equality is not absolute; consequently, it may be subject to permissible restrictions and its exercise may be suspended in states of emergency. When examining the proportionality of the difference in treatment, the fact that labor rights are in question and that they would be denied to a vulnerable population should be taken into consideration.

Also, even though States enjoy a margin of discretion to establish differences in treatment between nationals and aliens in the application of immigration laws, this margin is considerably reduced when the rights at stake are so fundamental that their restriction or deprivation affects the minimum principles of respect for human dignity.

In circumstances when denying rights could place a person in a situation similar to forced labor, “[the] Honorable Court should restrict to a minimum the State’s freedom to decide and exercise strict control on the justifications put forward by the latter as the basis for its policies.”

Only in exceptional situations, with characteristics such as those of a state of emergency, and in the case of measures strictly limited to the requirements of the situation, can a different treatment be justified as regards the enjoyment of the minimum labor rights previously indicated, between aliens in an irregular migratory situation and nationals or legal residents.

The practice of some American States to subordinate recognition of the right to remuneration, understood in its broadest sense, to compliance with norms of immigration law, is unreasonable and incompatible with the obligation to respect and guarantee the right to equality before the law.

Denying minimum labor standards to undocumented workers does not help restrict the entry of irregular migrants into States. To the contrary, it encourages unscrupulous employers to hire more workers whose situation is irregular, owing to the possibility of subjecting them to extreme working conditions without any penalty from the State. If undocumented workers unite to claim their rights, employers can report their irregular situation and thus avoid complying with minimum labor standards.

A more appropriate policy to control immigration would be to apply severe penalties to those who employ irregular migrants, despite knowing or having the obligation to know their migratory status, so as to benefit from being able to offer inferior labor guarantees. Several American States do not have legislation penalizing this type of conduct and, in the States that have established fines, it is recognized that these are not sufficiently severe to discourage the employment of workers whose situation is irregular.

The standard of interpretation proposed does not restrict the right of States to apply the corresponding penalties, such as the deportation of those who fail to comply with the provisions of immigration legislation or who violate in any way the criminal provisions of domestic law. Nevertheless, even when an individual is subject to deportation for having been found to be in the territory of a State illegally, the latter must fulfill its obligations to respect the fundamental rights embodied in international human rights instruments.

In conclusion, denying undocumented workers minimum labor standards, understood as the right to remuneration in the broadest sense, based on their migratory status, is contrary to the right to equality before the law, because it is a disproportionate measure to achieve the immigration policy objectives of the States who adopt this practice.

*The Center for Justice
and International Law
(CEJIL):*

In its written and oral statements, indicated that:

Mexico's request is directly related to a very serious concrete situation; it will therefore be very useful for the region.

This *amicus curiae* focuses on questions 1(1), 2(1) and 2(2) of the request for an advisory opinion.

In law, the principle of equality is considered a fundamental right and the obligation not to discriminate is one of the essential prohibitions of international human rights law. This principle "is a basic rule, applicable to all rights."

In practice, the right to equality may be violated in different ways; for example, by the issue or implementation of discriminatory norms, the establishment or implementation of rules that are *prima facie* neutral, but have a negative differentiated effect on an individual or a group of individuals, and the establishment of measures or practices that are directly harmful to an individual or a group.

Although no instrument of the inter-American system is exclusively devoted to protecting migrant workers from discrimination, the American Convention and the American Declaration contain provisions that establish a commitment for States to ensure equality before the law and the exercise of the rights enshrined in the different conventions, without any discrimination. The inter-American system extends protection from non-discrimination to rights protected at the national level by means of the article on equality before the law. Therefore, Member States must ensure that their legislation does not contain discriminatory provisions and that there are no measures, practices, acts or omissions that cause harm to a group or to an individual.

Article 26 of the International Covenant on Civil and Political Rights does not simply reiterate the provisions of Article 2(1) of this instrument, but "extends autonomous protection because it prohibits any discrimination on any grounds as well as protection before the public authorities." This principle is directly applicable to economic, social and cultural rights because it is included in the International Covenant on Economic, Social and Cultural Rights.

The rights embodied in the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families must be guaranteed to all migrant workers, regardless of their migratory status.

The principle of equality and non-discrimination is recognized in the American Declaration, the American Convention and other international treaties, which coincide in ensuring to all persons the rights embodied

in these instruments, without any discrimination based on sex, language, religion, national or social origin, or other status.

The potential grounds for discrimination are not limited to those expressly included in the inter-American instruments. The texts of the American Convention, the American Declaration and other international instruments presume the existence of other possible grounds for discrimination. The United Nations Committee on Human Rights has indicated that the non-discrimination clause applies to cases that are not specifically set out in the international covenants. In this respect, the European Court has examined discriminatory treatment on the grounds of sexual orientation and age.

Likewise, the grounds that can create a "suspect category" are not exhausted in the list that appears in the inter-American instruments. The establishment of these categories "relates to the characteristics of discrimination at a specific time in a country or region." The relevance of the identification of a "suspect category" will depend largely on examination of the specific situation that is being regulated. Hence, in the case of migrant workers, it is essential to examine the concrete issues regulated by labor law.

To establish whether an act arising from the differentiation of two actual situations is discriminatory under the inter-American system, we must first evaluate whether we are faced with a situation that is truly and objectively unequal; then, we must assess whether the norm or measure that has made the distinction seeks a legitimate goal; and, finally, we must establish whether there is a relationship of proportionality between the differences established by the norm or measure and its aims.

Many States have become originators or recipients of persons who emigrate in search of work. A study of 152 States by the International Labor Organization found that, from 1979 to 1990, the number of States classified as major recipients of migrants in search of employment increased from 39 to 67, and the number of States considered major originators of migrants for economic reasons/employment increased from 29 to 55. In recent decades, the principal reason for which individuals have abandoned their country of origin has been to find better employment opportunities or to have access to better wages.

Irregular immigration has been growing as a result of

extreme poverty and lack of opportunities in the States of origin. This has encouraged the appearance of the "migration industry." Employers opt to employ undocumented migrants, so as not to pay adequate salaries or make an effort to provide suitable working conditions. "The recipient States are not unaware of the exploitation, since they also benefit from that 'industry', since their economy grows by dint of this irregular situation."

On the American continent, migrant workers, whose status is irregular, are subject to many discriminatory and abusive practices, which may be observed in their traumatic entry into the recipient State, in the discrimination and the xenophobic attacks they endure in their daily life, in the ill-treatment they receive at work, and in the way in which they are expelled from the recipient State.

The inequality of conditions between the employer and the undocumented migrant worker is more critical than in other labor relations, because of the latter's irregular situation. Owing to their precarious economic situation, undocumented migrant workers are ready to accept inferior working conditions to those of other persons who are legally resident in the country. The occupations to which migrant workers have access vary according to each country; however, "as regards wages, the employment they obtain is always the least attractive and, as regards hygiene and health, it is always the most dangerous."

Migrant workers whose situation is irregular have limited possibilities (*de facto* and *de jure*) of obtaining the protection of their rights when confronted by precarious situations or exploitation. In general, there is a system of immunity for those who abuse the vulnerability of these workers and a system of punishment for the latter.

All these conditions which undocumented migrant workers are subjected to convert them into a disadvantaged group that is the victim of systematic discriminatory practices throughout the region. Furthermore, the situation of migrant women merits special mention because they are victims of double discrimination: first as women and then as migrants.

Frequently, the departure of migrants from recipient States takes place in the context of arbitrary procedures. Deportation procedures are not always conducted in accordance with the required minimum guarantees.

"In conclusion, studies by supranational and non-governmental organizations describe the precarious situation of irregular migrants workers, both men and women, as regards the enjoyment and exercise of their human rights in the countries which receive them. In particular, they stress the systematic discrimination to which such migrant workers are subject in the workplace."

Owing to the vulnerability of irregular migrant workers, it is essential to pay special attention to any distinction in treatment based on their migratory status, because such a situation creates a "suspect category." Identification of a "suspect category" requires a presumption that the distinction is illegal.

The definition of situations that create a "suspect category" should include those that depict the realities of actual systematic discrimination and abuse in the region.

The first justification for recognizing that irregular migrant workers comprise a "suspect category" is that discrimination against this group is closely linked to its nationality, ethnic origin or race, which is always different from the majority in the State of employment. In this respect, nationality, race or ethnic origin are explicitly prohibited as grounds for distinction. In its decision in *Trimble v. Gordon*, the United States Supreme Court considered that classifications based on national origin were "first cousin" to those based on race; accordingly, they related to areas where it was necessary to apply the principle of equality and equal protection.

The second justification for recognizing that irregular migrant workers comprise a "suspect category" is the special vulnerability of this group, particularly because of the systematic discrimination they suffer in the workplace in recipient States. Undocumented migrant workers are discriminated against in several areas of their lives. However, discrimination is most clearly visible in the workplace.

Human rights treaties refer to the rights of "all persons" and treaties that establish workers' rights speak of the rights of "all workers," without making distinctions as to their migratory status. Similarly, the International Convention on the Protection of the Rights of All Migrant Workers and their Families recognizes the rights of migrant workers irrespective of whether they are documented or undocumented.

Distinctions in treatment owing to national or ethnic origin or race are explicitly prohibited in the American Convention, the American Declaration and other international instruments. The European Court of Human Rights has considered that cases of discrimination based on nationality should be closely examined and that, in the case of rights to social security, national origin should be considered a "suspect category." In *Gaygusuz v. Austria*, the European Court indicated that very powerful reasons must be alleged for difference in treatment, based solely on nationality, to be considered compatible with the European Convention and decided that Article 14 of the Convention had been violated by denying unemployment insurance to a Turkish worker based on his nationality.

The prohibition to afford a different treatment based on nationality, added to the systematic discrimination to which irregular migrant workers are subjected in the workplace, requires that any distinction between undocumented migrant workers and legal migrant workers or citizens in the workplace "must bear a relationship to the aim sought."

The elaboration and implementation of migratory policies and the regulation of the labor market can justify restrictions to the labor rights of migrants, provided such restrictions are necessary. "[A] legal or practical distinction between undocumented migrants on the one hand and documented residents and citizens on the other hand, which denies the former the right to enjoy dignified and equitable working conditions, limited working days, paid vacations, fair wages and promotion, or any other labor right recognized in the recipient country's legislation, or which disregards their right to join unions to defend their interests or denies their right to social security, can never be necessary for the regulation of migratory or labor market policies."

In principle, there is no "relationship of necessity" between, on the one hand, the elaboration and implementation of migratory policies and the regulation of the labor market and, on the other hand, possible restrictions of labor rights while a contract is in force, which would allow those restrictions to be defined as proportionate to the aims sought. "Such restrictions are not the kind that clearly seek an essential social interest, or the kind that restrict the protected right to a lesser degree."

The labor rights contained in international covenants correspond to workers because they are workers, irrespective of their nationality or migratory status. The

unprotected situation in which undocumented migrant workers find themselves cannot be aggravated or perpetuated, citing as an aim, "the formulation and implementation of migratory policies or the regulation of the labor market."

Restricting the enjoyment of labor rights by irregular migrant workers is unreasonable and unnecessary. Such restrictions encourage the employment of undocumented migrants and increase the vulnerability of a sector of the population that faces a situation of systematic discrimination and serious defenselessness.

The aims of migratory policies and labor market regulation can be achieved through measures that are less onerous for the protection of the rights of irregular migrant workers. For example, increased control, through migrant entry policies or monetary penalties for employers.

The International Convention on the Protection of the Rights of All Migrant Workers and their Families shows that the aim of regulating the labor market can be achieved by measures that are less onerous for migrant workers, when it establishes that "[t]he recourse of the employment of migrant workers who are in an irregular situation will be discouraged if the fundamental human rights of all migrant workers are more widely recognized."

The costs of a policy that does not protect the labor rights of irregular migrant workers, but provides economic benefits by exploiting their work should be identified. "If international law is intended to strengthen democratic societies, States should be encouraged to provide generous protection to undocumented migrant workers, both men and women, based on labor law, international law and human rights law, instead of permitting the continuation of situations of exclusion, which are merely another means of penalizing migrants."

In conclusion, no difference should be established in the scope of labor law protection with regard to undocumented migrants. The actual conditions of irregular migrant workers engender a "suspect category," so that any potential restriction of their labor rights should be strictly monitored. Irregular migrant workers who are employed to perform a task should enjoy all labor rights.

The State can respond to the special vulnerability of irregular migrant workers in different ways, but their

special situation of systematic discrimination and defenselessness cannot be ignored. “[I]n the face of this reality, special or differentiated measures should be taken in order to ensure equality.”

During the World Conference against Racism, Racial Discrimination, Xenophobia and Related Forms of Intolerance, held in Durban in 2001, the need to eliminate discrimination against migrant workers was reaffirmed. Likewise, it was recommended that all possible measures should be adopted to ensure that migrants can enjoy human rights, in particular the rights related to: fair wages and equal remuneration for work of equal value, without any distinction; the right to insurance in case of unemployment, illness, disability, death of a spouse, old age, or any other lack of means of subsistence owing to circumstances beyond their control; and to social benefits, including social security.

Among the measures tending to eliminate such discriminations, States must modify discriminatory conduct and examine their legislation and practices in order to repeal all provisions that restrict the rights of migrant workers. Nevertheless, States may “promote public policies to foment respect for diversity, discourage discrimination and encourage public institutions to adopt concrete measures to promote equality.” The State may also organize educational and awareness-raising campaigns aimed at its officials and the general public.

The existence of conditions of genuine inequality makes it necessary to adopt compensatory measures that help reduce or eliminate the obstacles and restrictions that impede or reduce the effective defense of the interests of migrant workers.

In addition, a fundamental measure to ensure the effective protection of the labor rights of irregular migrant workers is “to establish procedures for the justice system to listen to their complaints,” because the mere existence of substantive rights is not enough to guarantee their exercise. Likewise, when migrants have returned to their State of origin, the recipient State must also guarantee access to justice. If employers treat migrants in a manner contrary to the norms of international human rights law, the latter can demand the corresponding reparation, irrespective of their migratory status. “Therefore, the State should provide irregular migrant workers with free or low-cost legal assistance so that they may file complaints using a simple and prompt remedy.” This principle is included in Article 18 of the International Convention on the

Rights of All Migrant Workers and Members of Their Families.

Reforms established by the State to improve the situation of irregular migrants should have effect in both the public and the private sector, because violations of rights "that occur in the private sector, insofar as they have been perpetrated with the consent or complicity of the State[,] may be attributed to the State." In this respect, the United Nations Committee on Human Rights, in its General Comment 28, has stated that States must eliminate discriminatory activities in both the public and the private sector.

The migratory status of migrant workers cannot be a variable that is taken into consideration to recognize them their labor rights while they are employed. They must be guaranteed not only the fundamental labor rights, but also all the labor rights recognized in the international covenants applicable in the Americas.

Human rights are interrelated, not only as regards different categories of rights, but also "all the rights that are included in a single category of rights, such as labor rights, in this case." In particular, the International Convention on the Rights of All Migrant Workers and the Members of Their Families establishes that the labor rights of migrant workers, whether they are documented or undocumented, cannot be restricted in any way.

For the purposes of this *amicus curiae*, the rights included in the international covenants include: 1) labor rights in the context of the employment contract; 2) rights of association, and 3) rights to social security.

The Center for Legal and Social Studies (CELS), Ecumenical Service for the Support and Orientation of Immigrants and Refugees (CAREF) and the Legal Clinic for the Rights of Immigrants and Refugees of the School of Law of the Universidad de Buenos Aires:

In its written and oral statements, indicated that:

This *amici curiae* merely answers questions 2(1) and 3.

Migratory status has been and continues to be an obstacle for the access of all migrants to their fundamental human rights. There are a series of legal and non-legal norms, which are contrary to the provisions of the American Convention and the American Declaration and other international instruments, and which deprive individuals of their human rights because of their migratory status.

Regarding the second question (supra para. 4):

The preamble to the American Convention recognizes the universal and essential nature of human rights, which are based upon attributes of the human

personality and not on nationality. Consequently, the protection of the individual encompasses all persons; in other words, it is universal in nature.

When acceding to and ratifying international human rights treaties, States assume a series of mandatory obligations towards all persons subject to their jurisdiction. These obligations have been extensively clarified by the different treaty-monitoring bodies, "either generically, with regard to a particular social group, or with reference to each specific right."

When interpreting the International Covenant on Civil and Political Rights recently, the Human Rights Committee, in its General Comment 15, emphasized that the enjoyment of the rights recognized by the Covenant *is not limited to the citizens* of States parties *but* should *also* be accessible to all individuals irrespective of their nationality or statelessness, including those requesting asylum, refugees, *migrant workers and other persons who are within the territory or subject to the jurisdiction* of the State party.

According to international human rights instruments, and their interpretation by monitoring bodies and legal writings, all persons who are within the territory of a State may require the State to protect their rights. The principle of non-discrimination is an essential element of international human rights law and is embodied in all international human rights instruments.

The millions of migrants throughout the world, who do not have regular residence in the country they live in, constitute a group in a particular "social condition." The principle of non-discrimination should be considered intimately and inseparably linked to the concept of a group in an extremely vulnerable situation that requires special protection. Therefore, the situation of vulnerability and the "social condition" of migrants, particularly those whose status is irregular, could determine the existence of grounds on which discrimination is prohibited, according to the principle of non-discrimination.

The United Nations has organized three world conferences against racism and discrimination and, at all of them, extensive reference has been made to discrimination against migrants, with express mention of their residence status. Moreover, special rapporteurs have been appointed at the regional and global level to verify the human rights situation of migrants and the discrimination they suffer owing to their status as aliens or their residence status.

Likewise, national legislation has included the concept of "migratory status" as a social condition that should be considered grounds that are prohibited, according to the principle of non-discrimination.

State obligations arising from international instruments cannot be bypassed because of the nationality, migratory status or residence status of a person. On this question, the bodies created by virtue of the Charter of the United Nations or the human rights treaties have conclusively stated that migrants, irrespective of their migratory status, are protected by all the international human rights instruments ratified by the State where they live.

The United Nations Inter-governmental Working Group of Experts on the Human Rights of Migrants has stated that "[a]ll persons, regardless of their place of residence, have a right to the full enjoyment of all the rights established in the Universal Declaration of Human Rights. States must respect the fundamental human rights of migrants, irrespective of their legal status." It has also emphasized that "[a] basic principle of human rights is the fact of entering a foreign country, violating the immigration laws of that country, does not lead to losing the human rights of an 'immigrant with an irregular status.' Nor does it eliminate the obligation of a Member State to protect them."

In conclusion, the response to question 2(1) may be summarized as "[t]he obligations and responsibility of States within the framework of international human rights law are not altered in any way by the residence status of an individual in the State in which he resides. The rights arising from international human rights law apply to all persons because they are human beings and should be respected, protected and guaranteed, without any discrimination on prohibited grounds (including, the migratory status of the person). In addition [...], all persons are subject to the jurisdiction of the State on whose territory they reside, irrespective of their migratory status. Consequently, the monitoring bodies of the human rights treaties – and also those deriving from the Charter of the United Nations – have repeatedly stressed that human rights must be respected and guaranteed to all persons, irrespective of their migratory status."

Regarding the third question (supra para. 4):

Each State has the authority – based on the principle of sovereignty – to formulate its own migratory policy and, consequently, to establish criteria for the admission and

residence of migrants. However, this does not mean that the said policy is exempt from the obligations of each State under international human rights law.

Migratory policy and legislation should respect all the provisions of the international human rights instruments recognized by each State. According to the provisions of international human rights law and their interpretation by the competent bodies, the sovereign authority to establish migratory policy – and also other policies emanating from State sovereignty – *“does not in any way exempt or restrict the obligations of respect, protection and guarantee to all persons subject to the jurisdiction of each State.”*

With regard to migratory legislation, as in any other area of State policy, each law or policy defined by the State or its absence could constitute the violation of rights embodied in the international instruments to which that State is a party. To avoid this situation, international human rights law establishes a series of principles, standards and limits that each State must respect when it institutes any policy, including migratory policy and legislation.

At the Durban Conference, the States committed themselves to “revising, when necessary, their immigration laws, policies and practices, to ensure that they are free of all racial discrimination and that they are compatible with the obligations of the States under international human rights instruments.” Similarly, at the regional conference for the Americas, the Governments committed themselves to “reviewing their immigration policies and practices in order to eliminate those that discriminate against migrants in a way that is not coherent with the obligations assumed under international human rights instruments.”

Each international human rights instrument has been careful to establish expressly the criteria and requirements that each State party must respect when regulating and restricting the rights recognized in such instruments.

Any restrictions to the exercise of human rights must be established in accordance with certain formal requirements and substantive conditions.

Article 30 of the American Convention indicates the formal requirements for such restrictions. The need for a formal law implies that States have the obligation to adopt all necessary measures to ensure that any norm that does not originate from “democratically elected and constitutionally empowered bodies” should not establish

any illegal restriction or violation or affect a right recognized in the Convention.

In order to comply with this obligation in the case of the rights of migrants, States must first examine the norms issued by agencies specializing in migratory matters. Then they must analyze the different decisions (resolutions, decrees, etc.) issued in all sectors and policies of the State that have or may have a serious and indisputable influence on the violation of the rights of migrants, as a result of their migratory status.

The fact that the restriction must be promulgated by law "supposes a norm of general application that should be compatible with respect for the principle of equality and not be arbitrary, meaningless or discriminatory."

To be legitimate, in addition to complying with the formal requirement, the restriction of a human right must be addressed at attaining a specific valid objective.

According to the provisions of the international instruments, the objectives that justify or legitimize a restriction of human rights – in other words the basic requirements – are concepts such as "democratic necessity", "public order (*ordre public*)", "national security", "the common good", "public health" and "morality." Each of these concepts was then examined.

The questions posed by Mexico can only have one answer: "international human rights law is intended for the universal protection of all persons, without any discrimination on prohibited grounds (including a person's migratory status)."

In conclusion, any migratory policy or legislation must conform to the international and regional standards in force with regard to legitimate restrictions to human rights. First, rights may only be limited to the extent that the restriction is aimed at achieving a legitimate end provided for in international human rights instruments. Second, the restriction must be established by a formal law, which must respect the principle of equality and be neither arbitrary nor discriminatory. Third, there should be no alternative that would be less restrictive of the rights in question. Lastly, in each specific case, the State must justify not only the reasonableness of the measure, but also examine rigorously whether it damages the principle of illegitimacy that affects all measures that restrict a right based on grounds that are prohibited by the principle of non-discrimination.

"[P]eople who migrate for reasons related to poverty have previously been deprived of their rights (including the right to employment, education, housing, health, etc.). Confronted by this lack of protection by their own State (or rather the human rights violations committed by the State), the person decides to migrate to another country, in which he hopes to be able to enjoy the rights guaranteed in international instruments [...]. Consequently, it is particularly inadmissible that millions of persons can be excluded from the international system for the protection of human rights, this time owing to their migratory status in the country to which they have migrated."

*United Nations High
Commissioner for
Refugees (UNHCR):*

In its oral statement UNHCR indicated that:

Nowadays it is meaningless to trace a strict line between voluntary and enforced displacement of persons, because the motives for migration are complex and imply a combination of political, economic and social factors. The nature and complexity of current displacements make it difficult to draw a clear line between migrants and refugees. As of the 1990s, UNHCR has been studying the link between asylum and migration and, in particular, the need to protect refugees within the migratory flows. However, there is still no international mechanism that deals exclusively with migration.

Although migratory policies fall within the sphere of State sovereignty, human rights instruments establish limits to the adoption and implementation of such policies. These limits include those stipulated in the American Convention, the 1951 Convention Relating to the Status of Refugees and its 1966 Protocol, and the International Convention for the Protection of the Rights of all Migrant Workers and Members of their Families. These instruments should also guide the decision of the Court in this request for an advisory opinion, pursuant to Article 29 of the American Convention and the *pro homine* principle.

Regarding the connection between asylum and migration, it is worth mentioning that, in the current circumstances, migrants and other persons who seek protection, such as asylum seekers and refugees, are all part of the same migratory flows and all require protection. Although not all these persons qualify as refugees under the international instruments, safeguards should be established that allow different migratory categories to be identified and granted protection. Since there are limited legal options for the entry into and residence in determined territories,

"asylum systems are increasingly being used to give certain migratory categories the possibility of remaining in a country.

Nowadays, it is presumed not only that aliens who enter a territory are migrants, but also that, when they are categorized as such, "what is meant is that they do not have rights and, therefore, that the State, in exercise of its sovereignty, may expel or deport them, or violate their basic rights." Likewise, the lack of legal options for migration and the restrictive policies on asylum and migration mean that refugees and migrants "face inhuman conditions, with an uncertain legal status and, in many cases, with their rights openly restricted," are more vulnerable to the problem of trafficking in persons, and are subject to greater discrimination and xenophobia in most recipient States.

The irregular status of a migrant should not deprive him of the enjoyment and exercise of the fundamental rights established in the American Convention and other human rights instruments. The State must protect all persons subject to its jurisdiction, whether or not they are nationals.

The vulnerability of migrants should be underscored and this is exacerbated not only by the limited number of countries that have ratified the international instruments protecting them, but also by the absence of an international organization with the specific mandate of protecting the fundamental rights of such persons. In this respect, it is important to point out that the Statute of the International Organization for Migration (IOM) refers to the management and administration of migration, which does not necessarily correspond to the protection of the fundamental rights of migrants.

In a context where most American States are parties to the international conventions on refugees, it should be stressed that most of them do not have appropriate instruments to identify those persons who require protection. This does not refer only to asylum seekers and refugees, but also to migrants who do not have the necessary safeguards to guarantee the minimum respect for their fundamental rights, embodied in the American Convention.

Also, the implementation of increased migratory controls and interception policies means that, in most cases, anonymity and irregular residence are chosen; thus, contrary to what occurred in the past, today we can speak of "*de facto* refugees", because most do not wish to be recognized by the States or are being returned.

Moreover, although a refugee's right to work is embodied in the 1951 Convention relating to the Status of Refugees, unfortunately this international instrument, which establishes minimum rights for that migratory category, does not refer to asylum seekers. In this respect, a simplistic interpretation could even say that asylum seekers and migrants have no labor rights. This interpretation is not only contrary to the spirit of the international instruments; it is also an evident step backward as regards the progressive nature of human rights.

Consequently, the protection parameters established by this request for an advisory opinion may be applicable, by analogy, to the protection of the labor rights of asylum seekers.

Migratory status "is and must be prohibited grounds for discrimination in our hemisphere, based on the American Declaration and the American Convention on Human Rights". The principle of non-discrimination is embodied in all human rights instruments.

The United Nations Committee on Human Rights has expanded the grounds for non-discrimination, based on Article 2(1) of the International Covenant on Civil and Political Rights. It has established that any differentiation must be reasonable, objective and aimed at achieving a legitimate goal. In the case of the International Covenant on Economic, Social and Cultural Rights, the United Nations Committee on Economic, Social and Cultural Rights has established the grounds of discrimination for "other status," which would be equivalent to "other condition"; in other words, there could be cases of discrimination for grounds that are not explicitly set out in that Covenant.

That line of reasoning is relevant for the present advisory opinion, because the American Declaration establishes that there may be discrimination for "other" distinctions, in addition to race, sex, language and religion. In the case of the American Convention on Human Rights, this treaty prohibits any kind of discrimination of rights and freedoms, establishing twelve grounds, including nationality and "any other social status."

Since the principle of non-discrimination is a basic rule of international human rights law and in light of statements made by the monitoring bodies of the United Nations international treaties, we must conclude that "the grounds for non-discrimination established in the inter-American instruments are equally indicative and

illustrative and never exhaustive or restrictive, as that would distort the object and purpose of the American Convention on Human Rights, which is the protection of the fundamental rights and freedoms in our hemisphere."

In particular, based on the exceptionally vulnerable situation of asylum seekers, refugees and migrants, it may validly be inferred that, according to the American Declaration and the American Convention, any other social condition or "*any other factor*" would provide sufficient grounds to indicate that, in our hemisphere, there is a specific prohibition to discriminate.

We should point out that, in the Americas, the vulnerability of migrants, asylum seekers and refugees has been explicitly recognized in the Inter-American Convention on the Prevention, Punishment, and Eradication of Violence against Women, the Convention of Belém do Pará, which stipulated that, "with respect to the adoption of the measures in this chapter, the States Parties shall take special account of the vulnerability of women to violence by reason of, among others, their race or ethnic background or their status as migrants, refugees or displaced persons."

In view of the above, we must conclude that the prohibited discriminations include "any distinction, exclusion, restriction or preference based on any grounds such as nationality" aimed at invalidating the recognition, enjoyment or exercise of the rights established in the international instruments, in equal conditions.

Likewise, the judicial and legal guarantees established in Articles 8 and 25 of the American Convention are equally applicable when determining a situation that affects the rights of asylum seekers or refugees, but they should also guide the protection of migrants in the hemisphere.

The Central American Council of Ombudsmen with the support of its Technical Secretariat (the Inter-American Institute of Human Rights):

In its written and oral statements, indicated that:

Regarding the first question (supra para. 4):

It is necessary to recognize the distinction between the human right not to be subjected to discriminatory treatments (in either the formulation of the law or its implementation) and the obligation of States not to make any discrimination in the enjoyment and exercise of human rights with regard to persons subject to their jurisdiction.

In international human rights law, the principle of equality has two dimensions: a) equality in the

enjoyment and exercise of human rights; and b) the right of all persons to be treated equally before the law. The importance of these two dimensions is not merely their recognition in a constitutional text, but also that the State should implement all pertinent measures to ensure that the obstacles to equality among persons are removed in practice, in accordance with Article 1 of the American Convention and Article 2(1) of the International Covenant on Civil and Political Rights. The State must not only abstain from generating *de jure* discriminations, but must also eliminate the factors that give rise to *de facto* discrimination in relation to civil and political rights and also to economic, social and cultural rights.

The answer to the first question alludes to labor-related human rights that are regulated in an extensive series of norms in the inter-American system, which has two levels of recognition: one applicable to OAS member States which are not parties to the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights; and a second applicable to OAS member States who are also parties to the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights, "Protocol of San Salvador." These two levels entail two distinct legal situations regarding the protection of labor rights: the States who belong to the first group are obliged by Articles 30, 34 and 45 of the OAS Charter and Articles XIV, XV and XVI of the American Declaration; while the States parties to the Protocol, in addition to being obliged by the preceding provisions, have obligations arising from Articles 3, 4, 5, 6, 7, 8 and 9 of the Protocol.

To understand the expression "labor legislation" in Mexico's request, we should mention that, in the legal systems of all OAS member States, the international obligations they have assumed arising from conventions, "may be classified as legislation; in other words, as an integral part of their domestic law." Thus, the expression "labor legislation" included in the requesting State's first question refers to the domestic law of the States. The norms of international law indicated above do not admit a restrictive or discriminatory interpretation or implementation, in particular because they are based on a specific migratory status. "From the legal perspective of migration, the regular or irregular situation does not alter or affect the scope of the State obligation" to respect and ensure human rights. Domestic labor legislation includes more rights than those protected in the international norms cited above. States have the right to exercise control on migratory matters and to

adopt measures to protect their national security and public order; but States must exercise this control, respecting human rights.

A detailed answer to Mexico's first question would require a specific examination of each State. Nevertheless, we can say that, like human rights, labor rights correspond to all persons and are required in the context of labor relations. Consequently, the ability to perform a productive activity depends exclusively on professional training and skill, and is never related to the migratory status of a person.

The causes of migration, particularly irregular migration, are different from the conditions of persecution that give rise to the existence of refugees, who are protected by refugee law. Irregular migration is associated with socio-economic conditions and the search for better opportunities and means of subsistence than those the person has in his State of origin. In practice, high levels of irregular migrants increase the offer of manpower and affect how it is valued. Since the irregular migrant does not want to be discovered by the State authorities, he refuses to have recourse to the courts, and this encourages the violation of his human rights in the workplace.

A person who migrates to another State and enters into an employment relationship "activates his human rights" in that context, irrespective of his migratory status. He also "activates" the obligations of the recipient State contained in the OAS Charter, the American Declaration (in the case of an OAS member State) and the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights (where the State is also a party to the latter). This "activation" of rights implies that a measure taken by the State with the aim of producing a denial of the enjoyment and exercise of labor human rights based on the migratory status of a person "would lead to a differentiated treatment that would give rise to arbitrariness, and consequently discrimination."

Accordingly, we consider that the answer to Mexico's first question is: OAS member States and States parties to the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights, "may not apply a distinct treatment that is harmful to undocumented migrant workers as regards the enjoyment of their labor rights," understanding such rights to be those contained in Articles 30, 34(g) and 45 of the OAS Charter; Articles XIV, XV and XVI of the American Declaration; and Articles 6, 7, 8 and 9 of the

said Protocol, as well as those recognized in the domestic legislation of the States, using the migratory status of the said workers as a basis for this distinct treatment. Those human rights are enjoyed as soon as an employment relationship is established and do not depend on migratory status.

Regarding the second question (supra para. 4):

The obligations to respect and guarantee human rights do not arise from Article 1(1) of the American Convention or from Article 2 of the International Covenant on Civil and Political Rights, but from the nature of human rights and human dignity, which does not depend on a classification based on some positive act of the State. Thus, the enforceability of these obligations does not depend on a State's accession to or ratification of the American Convention; it depends only on its justiciability before the organs of the inter-American system. In this respect, the obligations of respect and guarantee are not conditional obligations because they derive from human dignity.

Consequently, we consider that the answer to the first part of the second question is that the State obligations to respect and guarantee human rights, in general, and the human right not to be subjected to discriminatory treatment or unequal treatment before the law, in particular, cannot be interpreted as conditioning the content of such obligations to a person's regular migratory status in the territory of a State. Migratory status is not a necessary condition for a State to respect and guarantee the human rights contained in Articles 2(1) of the Universal Declaration, II of the American Declaration, 2 and 26 of the International Covenant on Civil and Political Rights, and 1 and 24 of the American Convention.

The second part of the second question should be answered bearing in mind the human right not to be subjected to discriminatory treatment or unequal treatment before the law, which the State is obliged to respect and guarantee. Accordingly, the State may not deny a worker one or more of his labor rights based on his irregular migratory status, since if it did so, it would be failing to comply with its obligation to guarantee those rights and could be attributed with this act of denial under international law.

Regarding the third question (supra para. 4):

The source of the obligation to respect and guarantee human rights is international law; consequently, in accordance with the Vienna Convention on the Law of

Treaties, domestic norms cannot be alleged to try and justify non-compliance with this obligation. Moreover, this generic obligation is enforceable with regard to all human rights.

Notwithstanding the generalized practice of most States, the pre-eminence of international law over domestic law is not determined by the latter. In application of the *pro homine* principle, international human rights law accords prevalence to the norm intended to protect human dignity (the one that provides a more comprehensive recognition of human rights), regardless of the source of the obligation in question. Hence, the laws of a State are valid insofar as they are congruent with human rights.

The answer to the third question is that no State is authorized to use its domestic law to interpret the human rights resulting from a source of international law, when this will diminish the degree to which such rights are recognized. An interpretation of this type is not valid and cannot produce legal effects. However, a State may develop an interpretation of the human rights deriving from a source of international law using its domestic law, when the result of this interpretation will give preference to the option that provides the most extensive degree of recognition.

Regarding the fourth question (supra para. 4):

There is no finite list of *jus cogens* norms, because, there appear to be no criteria that allow them to be identified. It is the courts that determine whether a norm can be considered *jus cogens*, "for the purposes of invalidating a treaty." Such norms establish limits to the will of States; consequently, they create an international public order (*ordre public*), and thus become norms of enforceability *erga omnes*. Owing to their transcendence, human rights norms are norms of *jus cogens* and, consequently, a source of the legitimacy of the international legal system. All human rights must be respected equally, because they are rooted in human dignity; therefore, they must be recognized and protected based on the prohibition of discrimination and the need for equality before the law.

The answer to the first part of the fourth question is that, owing to the progressive development of international human rights law, the principle of non-discrimination and the right to the equal and effective protection of the law must be considered norms of *jus cogens*. They are norms of peremptory international law, which create an international public order that cannot be opposed validly by other norms of

international law, and particularly by the domestic legislation of States. Norms of *jus cogens* rank higher than other legal norms, so that the validity of the latter depends on their congruency with the former.

An OAS member State which is a party to the International Covenant on Civil and Political Rights is obliged to respect and guarantee the rights recognized therein and also in the American Declaration, because "human rights form a single, indivisible, interrelated and interdependent *corpus iuris*."

The answer to the second part of the fourth question is that, in the case of the American States, the legal effect of the recognition of the principle of non-discrimination and the right to equal and effective protection of the law as norms of *jus cogens* is that any act of the State that conflicts with this principle and right has no legal effect or validity.

*Jorge A. Bustamante,
Juridical Research
Institute, Universidad
Nacional Autónoma de
México (UNAM):*

In his written and oral statements, indicated that:

The legal framework for evaluating the actual situation of Mexican migrants in both their own country and the United States, as the recipient State of almost all international Mexican migrants, should be considered in two different analytical contexts: the international context, deriving from the international nature of migration (analysis of the State which receives immigration and the relationship of the migrants with the State and the society that receives them); and the national context (analysis of the migrants as subjects of human rights in their State of origin).

The vulnerability that affects the human rights of international migrants is of a structural nature and arises from the way in which most States define nationals and aliens in their Constitutions. Most States afford nationals a certain priority in their legislation with regard to aliens, so that the structural situation of the vulnerability of migrants as subjects of human rights is equal to the social inequality between them and the nationals of the recipient State.

The vulnerability of migrants as subjects of human rights in their national context arises from the ideological association that the members of civil society in their State of origin make between the social definition of a migrant and any other socially undervalued condition (woman, girl/boy child, indigenous person, disabled person, member of a religious order, etc.) or any other condition which society in the State of origin considers inferior to the

rest of the non-migrants in that society. This association has an ideological dimension and a historical context that is different for each State, in the same way as the degree to which this situation of inferiority is assigned to migrants varies.

There is an objective dimension of vulnerability, according to which the greater the distance between a migrant and his home, the greater his vulnerability as a subject of human rights. Although this hypothesis may be valid for all migrants, it is more so in the national context of internal migrants than for the international context of migration.

There is an asymmetry of power that is transformed into a context of social relations between nationals and aliens-migrants, that is confirmed by the State through the establishment of differential access to public resources for the two categories; this gives rise to a legal framework of social relations that enters into contradiction with the more extensive concept of human rights.

In this asymmetry of power, it is probable that the alien will find himself in a position of subordination to the national. This results in a situation of structural vulnerability for aliens.

The position of subordination imposed on aliens/migrants is something that the recipient State "confirms." Here, the vulnerability is potentially supplemented by the role of the State, either by act or omission, but always in the context of this differential treatment that the recipient State grants to nationals compared to aliens.

The asymmetries of power between the States of origin and the States that receive international migrants may be clearly seen by the limited number of recipient States that have ratified the International Convention on the Rights of all Migrant Workers and Members of their Families.

"[T]he integration of migrants/aliens as equals of nationals before the law and the State implies a legal authorization or empowerment of aliens/migrants, which would result in the disappearance of the vulnerability of the migrants as subjects of human rights." This "empowerment" is associated with the pre-eminence of human rights in the domestic law of the recipient State, based on which aliens/migrants may defend themselves from discrimination and the abuse of their human rights, by acquiring conditions of equality with nationals before

the law and the State.

The death of almost two thousand Mexican and some Central American migrants is the strongest evidence that the United States has violated and continues to violate human rights by maintaining the so-called "Operation Guardian." This thesis is strengthened by the fact that a report of the United States General Accounting Office expressly recognized the link between "Operation Guardian" and the deaths of migrants. The State has the obligation to repair the harm caused by the acts that it has planned, implemented and maintained, by the payment that corresponds to the next of kin for the loss of life of a productive member of their family. "It is very strange that the Government of Mexico has not filed any claim," establishing the relationship between: the planning, implementation and continuity of "Operation Guardian" and State responsibility arising from these governmental acts.

One factor that prevents Mexico from being able to formulate this claim against the United States for the latter's responsibility in the deaths of Mexican migrants on its border, is the absence of Mexico's express recognition of its co-responsibility in those deaths, arising from the fact that its economic policy has caused Mexicans to migrate in search of employment in the United States. This migratory phenomenon is the result of the interaction of factors on both sides of the border; namely, the interaction between a demand for migrant manpower in the United States and an offer of manpower from Mexico. The causal relationship between Mexico's economic policy and the generation of the factors that produce this supply of manpower, give rise to "State responsibility" with regard to migration and, hence, to the co-responsibility of Mexico in the deaths of migrants on the border with the United States.

The recognition of responsibility by Mexico should be considered an element in the bilateral negotiation of an agreement on migrant workers between the two Governments. In this context, negotiations could be based on Mexico's express recognition of co-responsibility for the deaths of the migrants and co-participation in the payment of compensation to repair the harm arising from those deaths and the agreement of the United States to suspend "Operation Guardian."

III COMPETENCE

48. This request for an advisory opinion was submitted to the Court by Mexico, in exercise of the faculty granted to it by article 64(1) of the Convention, which establishes that:

[t]he member states of the Organization may consult the Court regarding the interpretation of this Convention or of other treaties concerning the protection of human rights in the American states. Within their spheres of competence, the organs listed in Chapter X of the Charter of the Organization of American States, as amended by the Protocol of Buenos Aires, may in like manner consult the Court.

49. This faculty has been exercised in compliance with the following requirements established in the Court's Rules of Procedure: precise formulation of the questions on which the Court's opinion is sought; identification of the norms to be interpreted; presentation of the considerations giving rise to the request; name and address of the Agent (Article 59 of the Rules of Procedure), and indication of the international treaties other than the American Convention to be interpreted (Article 60(1) of the Rules of Procedure).

50. Compliance with the regulatory requirements for formulating a request does not imply that the Court is obliged to respond to it. In this respect, the Court must bear in mind considerations that go beyond the merely formal aspects related to the generic limits that the Court has recognized to the exercise of its advisory function¹. These considerations will be examined in the following paragraphs.

51. The application submits four questions to the consideration of the Court regarding the "[...] deprivation of the enjoyment and exercise of certain labor rights [of migrant workers,] and its compatibility with the obligation of the American States to guarantee the principles of legal equality, non-discrimination and equal and effective protection of the law embodied in international instruments for the protection of human rights; and also with the subordination or conditioning of the observance of the obligations imposed by international human rights law, including those of an *erga omnes* nature, to the attainment of certain domestic policy objectives of an American State." The request also deals with "the status that the principles of legal equality, non-discrimination and equal and effective protection of the law have achieved in the context of the progressive development of international human rights law and its codification."

52. Specifically, Mexico has asked the following questions:

In the context of the principle of equality before the law embodied in Article II of the American Declaration, Article 24 of the American Convention, Article 7 of the Universal Declaration and Article 26 of the [International] Covenant [on Civil and Political Rights],

1) Can an American State establish in its labor legislation a distinct treatment from that accorded legal residents or citizens that prejudices undocumented migrant workers in the enjoyment of their labor rights, so that the migratory status of the workers impedes *per se* the enjoyment of such rights?

2.1) Should Article 2, paragraph 1, of the Universal Declaration, Article II of the American Declaration, Articles 2 and 26 of the [International] Covenant [on Civil and

¹ Cf. *Legal Status and Human Rights of the Child*. Advisory Opinion OC-17/02 of August 28, 2002. Series A No. 17, para. 19; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*. Advisory Opinion OC-16/99 of October 1, 1999. Series A No. 16, para. 31; *Reports of the Inter-American Commission on Human Rights* (Art. 51 of the American Convention on Human Rights). Advisory Opinion OC-15/97 of November 14, 1997. Series A No.15, para. 31; and "*Other treaties*" subject to the *Advisory Jurisdiction of the Court* (Art. 64 of the American Convention on Human Rights). Advisory Opinion OC-1/82 of September 24, 1982. Series A No. 1, para. 13.

Political Rights] and Articles 1 and 24 of the American Convention be interpreted in the sense that an individual's legal residence in the territory of an American State is a necessary condition for that State to respect and ensure the rights and freedoms recognized in these provisions to those persons subject to its jurisdiction?

2.2) In the light of the provisions cited in the preceding question, can it be considered that the denial of one or more labor right, based on the undocumented status of a migrant worker, is compatible with the obligations of an American State to ensure non-discrimination and the equal, effective protection of the law imposed by the above-mentioned provisions?

Based on Article 2, paragraphs 1 and 2, and Article 5, paragraph 2, of the International Covenant on Civil and Political Rights,

3) What would be the validity of an interpretation by any American State which, in any way, subordinates or conditions the observance of fundamental human rights, including the right to equality before the law and to the equal and effective protection of the law without discrimination, to achieving migration policy goals contained in its laws, notwithstanding the ranking that domestic law attributes to such laws in relation to the international obligations arising from the International Covenant on Civil and Political Rights and other obligations of international human rights law that have an *erga omnes* character?

In view of the progressive development of international human rights law and its codification, particularly through the provisions invoked in the instruments mentioned in this request,

4) What is the nature today of the principle of non-discrimination and the right to equal and effective protection of the law in the hierarchy of norms established by general international law and, in this context, can they be considered to be the expression of norms of *ius cogens*? If the answer to the second question is affirmative, what are the legal effects for the OAS Member States, individually and collectively, in the context of the general obligation to respect and ensure, pursuant to Article 2, paragraph 1, of the [International] Covenant [on Civil and Political Rights], compliance with the human rights referred to in Articles 3 (l) and 17 of the OAS Charter?

53. From these questions, it is evident that the requesting State requires an interpretation of the American Convention, as well as of other international treaties and declarations. The Court has established some guidelines on the interpretation of international norms other than the American Convention. Principally, it has considered that Article 64(1) of the Convention, when referring to the authority of the Court to provide an opinion on "other treaties concerning the protection of human rights in the American States," is broad and non-restrictive. In other words:

[...] the advisory jurisdiction of the Court can be exercised, in general, with regard to any provision dealing with the protection of human rights set forth in any international treaty applicable in the American States, regardless of whether it be bilateral or multilateral, whatever be the principal purpose of such a treaty, and whether or not non-Member States of the inter-American system are or have the right to become parties thereto.²

54. In this respect, the Court has established that it can "examine the interpretation of a treaty provided that the protection of human rights in a member State of the inter-American system is directly involved"³, even though the said instrument does not belong to the regional system of protection⁴, and that:

² "Other treaties" subject to the Advisory Jurisdiction of the Court, *supra* note 1, first operative paragraph.

³ *Legal Status and Human Rights of the Child*, *supra* note 1, para. 22; and *cf. The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 36; *International Responsibility for the Promulgation and Enforcement of Laws in violation of the Convention* (Arts. 1 and 2, American Convention on Human Rights). Advisory Opinion OC-14/94 of

[n]o good reason exists to hold, in advance and in the abstract, that the Court lacks the power to receive a request for, or to issue, an advisory opinion, about a human rights treaty applicable to an American State merely because non-American States are also parties to the treaty or because the treaty has not been adopted within the framework or under the auspices of the inter-American system.⁵

55. Therefore, the Court considers that it is competent to rule on the questions posed by Mexico which also requests the interpretation of the American Declaration, the American Convention, the Universal Declaration and the International Covenant on Civil and Political Rights, all of them instruments that protect human rights and that are applicable to the American States.

56. With regard to the Charter of the Organization of American States, in another opinion, the Court indicated, referring to the American Declaration, that:

[...]Article 64(1) of the American Convention authorizes [it], at the request of a member state of the OAS [...] to render advisory opinions interpreting the American Declaration of the Rights and Duties of Man, provided that in doing so the Court is acting within the scope and framework of its jurisdiction in relation to the Charter and Convention or other treaties concerning the protection of human rights in the American States.⁶

Moreover, at the same time, the Court has indicated that "the Charter of the [OAS] cannot be interpreted and applied, as far as human rights are concerned, without relating its norms, consistent with the practice of the organs of the OAS, to the corresponding provisions of the [American] Declaration."⁷

57. This means that the Court has competence to render advisory opinions on the interpretation of the OAS Charter, taking into consideration the relationship of the Charter to the inter-American system for the protection of human rights, specifically within the framework of the American Declaration, the American Convention, or other treaties on the protection of human rights in the American States.

58. Nevertheless, should the Court restrict its ruling to those States that have ratified the American Convention, it would be difficult to separate this Advisory Opinion from a specific ruling on the legislation and practices of States that have not ratified the Convention with regard to the questions posed. The Court considers that this would restrict the purpose of the advisory proceeding, which, as has been

December 9, 1994. Series A No. 14, para. 21; and "Other treaties" subject to the Advisory Jurisdiction of the Court, *supra* note 1, para. 21.

⁴ *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, paras. 71 and 109; and "Other treaties" subject to the Advisory Jurisdiction of the Court, *supra* note 1, para. 38.

⁵ "Other treaties" subject to the Advisory Jurisdiction of the Court, *supra* note 1, para. 48. See also, paras. 14, 31, 37, 40 and 41.

⁶ *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 36; and *Interpretation of the American Declaration of the Rights and Duties of Man Within the Framework of Article 64 of the American Convention on Human Rights*. Advisory Opinion OC-10/89 of July 14, 1989. Series A No. 10; sole operative paragraph and *cf.* para.44.

⁷ *Interpretation of the American Declaration of the Rights and Duties of Man Within the Framework of Article 64 of the American Convention on Human Rights*, *supra* note 6, para. 43.

mentioned, "is designed [...] to enable OAS Member States and OAS organs to obtain a judicial interpretation of a provision embodied in the Convention or other human rights treaties in the American States."⁸

59. Likewise, if the opinion only encompassed those OAS Member States that are parties to the American Convention, the Court would be providing its advisory services to a limited number of American States, which would not be in the general interest of the request.

60. Consequently, the Court decides that everything indicated in this Advisory Opinion applies to the OAS Member States that have signed either the OAS Charter, the American Declaration, or the Universal Declaration, or have ratified the International Covenant on Civil and Political Rights, regardless of whether or not they have ratified the American Convention or any of its optional protocols.

61. Following its practice in advisory matters, the Court must determine whether rendering the opinion might "have the effect of altering or weakening the system established by the Convention in a manner detrimental to the individual human being."⁹

62. The Court may use various factors when considering this matter. One of them, which coincides with much of the international jurisprudence in this area,¹⁰ refers to the problem that, a ruling on an issue or matter that might eventually be submitted to the Court in the context of a contentious case could be obtained prematurely, using a request for an opinion.¹¹ However, this Court has noted subsequently that the existence of a difference concerning the interpretation of a provision does not, *per se*, constitute an impediment for exercise of the advisory function.¹²

63. In the exercise of its advisory function, the Court is not called on to resolve questions of fact, but to determine the meaning, purpose and reason of international

⁸ *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 36, para. 40; and *Restrictions to the Death Penalty* (Arts. 4(2) and 4(4) American Convention on Human Rights). Advisory Opinion OC-3/83 of September 8, 1983. Series A No. 3; para. 22.

⁹ *Legal Status and Human Rights of the Child*, *supra* note 1, para. 31; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 43; *Reports of the Inter-American Commission on Human Rights*, *supra* note 1, para. 31; and "Other treaties" subject to the Advisory Jurisdiction of the Court, *supra* note 1, second operative paragraph.

¹⁰ *Cf. Applicability of Article VI, Section 22, of the Convention on the Privileges and Immunities of the United Nations*, Advisory Opinion, I.C.J. Reports 1989, p. 177, para 29-36; *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276 (1970)*, Advisory Opinion, I.C.J. Reports 1971, p. 16, para. 27-41; *Western Sahara*, Advisory Opinion, I.C.J. Reports 1975, p. 12; *Reservations to the Convention on Genocide*, Advisory Opinion, I.C.J. Reports 1951, p. 15, (19, 20); and I.C.J.: *Interpretation of Peace Treaties*, Advisory Opinion, I.C.J. Reports 1950, p. 65 (71, 72).

¹¹ *Cf. Legal Status and Human Rights of the Child*, *supra* note 1, para. 32; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 45; and *Reports of the Inter-American Commission on Human Rights*, *supra* note 1, paras. 37 and 40.

¹² *Cf. Legal Status and Human Rights of the Child*, *supra* note 1, para. 32; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 45; and *Compatibility of Draft Legislation with Article 8(2)(h) of the American Convention on Human Rights*. Advisory Opinion OC-12/91 of December 6, 1991. Series A No. 12, para. 28.

human rights norms. In this context, the Court fulfills an advisory function¹³. On several occasions, the Court has upheld the distinction between its advisory and contentious competence. In Advisory Opinion OC-15/97 on *Reports of the Inter-American Commission on Human Rights*, it indicated that:

[t]he advisory jurisdiction of the Court differs from its contentious jurisdiction in that there are no "parties" involved in the advisory procedure nor is there any dispute to be settled. The sole purpose of the advisory function is "the interpretation of this Convention or of other treaties concerning the protection of human rights in the American states." The fact that the Court's advisory jurisdiction may be invoked by all the Member States of the OAS and its main organs defines the distinction between its advisory and contentious jurisdictions.

[...] The Court therefore observes that the exercise of the advisory function assigned to it by the American Convention is multilateral rather than litigious in nature, a fact faithfully reflected in the Rules of Procedure of the Court, Article 62(1) of which establishes that a request for an advisory opinion shall be transmitted to all the "Member States", which may submit their comments on the request and participate in the public hearing on the matter. Furthermore, while an advisory opinion of the Court does not have the binding character of a judgment in a contentious case, it does have undeniable legal effects. Hence, it is evident that the State or organ requesting an advisory opinion of the Court is not the only one with a legitimate interest in the outcome of the procedure.¹⁴

64. When affirming its competence in this matter, the Court recalls the broad scope of its advisory function, unique in contemporary international law, which "enables the Court to perform a service to all the members of the inter-American system, and is designed to assist them in fulfilling their international human rights commitments,"¹⁵ and

to assist states and organs to comply with and to apply human rights treaties without subjecting them to the formalism and the sanctions associated with the contentious judicial process.¹⁶

65. The Court observes that the use of examples serves the purpose of referring to a specific context and illustrates the different interpretations that could be given to the legal issue raised in the advisory opinion in question, without implying that the Court is rendering a legal ruling on the situation described in such examples¹⁷. Likewise, the latter allow the Court to show that its advisory opinion is not mere

¹³ *Legal Status and Human Rights of the Child*, supra note 1, para. 33; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, supra note 1, para. 47; and cf. *International Responsibility for the Promulgation and Enforcement of Laws in violation of the Convention*, supra note 3, para. 23.

¹⁴ *Reports of the Inter-American Commission on Human Rights*, supra note 1, paras. 25 and 26.

¹⁵ *Legal Status and Human Rights of the Child*, supra note 1, para. 34; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, supra note 1, para. 64; and "Other treaties" subject to the Advisory Jurisdiction of the Court, supra note 1, para. 37 and 39.

¹⁶ *Legal Status and Human Rights of the Child*, supra note 1, para. 34; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, supra note 1, para. 64; and cf. *Compatibility of Draft Legislation with Article 8(2)(h) of the American Convention on Human Rights*, supra note 12, para. 20.

¹⁷ *Legal Status and Human Rights of the Child*, supra note 1, para. 35; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, supra note 1, para. 49; and cf. *Judicial Guarantees in States of Emergency* (Arts. 27(2), 25 and 8 American Convention on Human Rights). Advisory Opinion OC-9/87 of October 6, 1987. Series A No. 9, para. 16.

academic speculation and is justified by its potential benefit for the international protection of human rights and for strengthening the universal juridical conscience¹⁸. When tackling the respective issue, the Court acts as a human rights tribunal, guided by the international instruments that regulate its advisory competence and makes a strictly juridical analysis of the questions submitted to it.

66. In view of the foregoing, the Court considers that it should examine the matters set out in the request and issue the corresponding opinion.

IV STRUCTURE OF THE OPINION

67. The Court is empowered to structure its rulings as it considers best suited to the interests of justice and the purposes of an advisory opinion. Accordingly, the Court takes into account the basic issues that underlie the questions posed in the request for an opinion and examines them in order to reach general conclusions that can, in turn, be extended to the specific points mentioned in the request itself and related issues¹⁹. On this occasion, the Court has decided to start by drawing up a glossary in order to define the conceptual scope of the words used in this Opinion. Once this conceptual framework has been established, the Court will proceed to examine the specific matters submitted to its consideration and, to this end, will reply to the questions it has been asked in the order it considers most appropriate, with a view to the coherence of the Opinion. Pursuant to the power inherent in all courts to give their rulings the logical structure they consider most adequate to the interest of justice,²⁰ the Court will consider the questions raised as follows:

- a) Obligation to respect and guarantee the human rights and fundamental nature of the principle of equality and non-discrimination (Questions 2(1) and 4);
- b) Application of the principle of equality and non-discrimination to migrants (Question 2(1));
- c) Rights of undocumented migrant workers (Questions 2(2) and 1); and
- d) State obligations in the determination of migratory policies in light of the international instruments for the protection of human rights (Question 3).

68. The Court will now consider each of the points mentioned above in the sequence indicated.

V GLOSSARY

69. For the purposes of this Advisory Opinion, the Court will use the following words with the meaning indicated:

- a) to emigrate or migrate** or To leave a State in order to transfer to another and establish oneself there.

¹⁸ Cf. *Legal Status and Human Rights of the Child*, *supra* note 1, para. 35; *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 49; and *Reports of the Inter-American Commission on Human Rights*, *supra* note 1, para. 32.

¹⁹ Cf. *Legal Status and Human Rights of the Child*, *supra* note 1, para. 37.

²⁰ *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law*, *supra* note 1, para. 66.

- b) emigrant** A person who leaves a State in order to transfer to another and establish himself there.
- c) to immigrate** To enter another State in order to reside there.
- d) immigrant** A person who enters another State in order to reside there.
- e) migrant** A generic word that covers both emigrants and immigrants.
- f) migratory status** Legal status of a migrant, in accordance with the domestic legislation of the State of employment.
- g) worker** A person who is to be engaged, is engaged or has been engaged in a remunerated activity.
- h) migrant worker** A person who is to be engaged, is engaged or has been engaged in a remunerated activity in a State of which he is not a national.²¹
- i) documented migrant worker or migrant worker in a regular situation** A person who is authorized to enter, stay and engage in a remunerated activity in the State of employment, pursuant to the law of the State and international agreements to which that State is a party.²²
- j) undocumented migrant worker or migrant worker in an irregular situation** A person who is not authorized to enter, stay and engage in a remunerated activity in the State of employment, pursuant to the law of the State and international agreements to which that State is a party and who, despite this, engages in the said activity.²³
- k) State of origin** State of which the migrant worker is a national.²⁴
- l) State of employment** State in which the migrant worker is to be engaged, is

²¹ Cf. ILO, Convention No. 97 concerning Migrant Workers (revised) of 1949 and Convention No. 143 concerning Migrant Workers (Supplementary Provisions) of 1975, Article 11 of which defines a migrant worker as "a person who migrates or has migrated from one country to another with a view to being employed otherwise than on his own account and includes any person regularly admitted as a migrant worker."

²² Cf. U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990. Article 5 indicates that migrant workers and their families "are considered as documented or in regular situation if they are authorized to enter, to stay and to engage in a remunerated activity in the State of employment, pursuant to the law of the State and international agreements to which that State is a party."

²³ Cf. U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990. Article 5 indicates that migrant workers and their families "are considered non-documented or in an irregular situation if they do not comply with the conditions provided for in subparagraph (a) of the present article."

²⁴ Cf. U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990. Article 6(a) indicates that "[t]he term 'State of origin' means the State of which the person concerned is a national."

or recipient State engaged or has been engaged in a remunerated activity.²⁵

VI
OBLIGATION TO RESPECT AND GUARANTEE HUMAN RIGHTS
AND THE FUNDAMENTAL NATURE OF THE PRINCIPLE OF
EQUALITY AND NON-DISCRIMINATION

70. With regard to the general obligation to respect and guarantee human rights, the following norms are cited in the request:

- a) Article 1 of the American Convention, which states that:
 - 1. The States Parties to this Convention undertake to respect the rights and freedoms recognized herein and to ensure to all persons subject to their jurisdiction the free and full exercise of those rights and freedoms, without any discrimination for reasons of race, color, sex, language, religion, political or other opinion, national or social origin, economic status, birth, or any other social condition.
 - 2. For the purposes of this Convention, "person" means every human being.
- b) Article 2 of the International Covenant on Civil and Political Rights, which stipulates that:
 - 1. Each State Party to the present Covenant undertakes to respect and to ensure to all individuals within its territory and subject to its jurisdiction the rights recognized in the present Covenant, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.
 - 2. Where not already provided for by existing legislative or other measures, each State Party to the present Covenant undertakes to take the necessary steps, in accordance with its constitutional processes and with the provisions of the present Covenant, to adopt such legislative or other measures as may be necessary to give effect to the rights recognized in the present Covenant.
 - 3. Each State Party to the present Covenant undertakes:
 - a) To ensure that any person whose rights or freedoms as herein recognized are violated shall have an effective remedy, notwithstanding that the violation has been committed by persons acting in an official capacity;
 - b) To ensure that any persons claiming such a remedy shall have his right thereto determined by competent judicial, administrative or legislative authorities, or by any other competent authority, provided for by the legal system of the State, and to develop the possibilities of judicial remedy;
 - c) To ensure that the competent authorities shall enforce such remedies when granted.

71. With regard to the principle of equality and non-discrimination, the norms mentioned in the request are:

- a) Articles 3(l) and 17 of the OAS Charter, which indicate that:

²⁵ Cf. U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990. Article 6(b) indicates that "[t]he term 'State of employment' means a State where the migrant worker is to be engaged, is engaged or has been engaged in a remunerated activity, as the case may be."

The American States proclaim the fundamental rights of the individual without distinction as to race, nationality, creed, or sex.

Each State has the right to develop its cultural, political, and economic life freely and naturally. In this free development, the State shall respect the rights of the individual and the principles of universal morality.

- b) Article 24 of the American Convention, which determines that:

All persons are equal before the law. Consequently, they are entitled, without discrimination, to equal protection of the law.

- c) Article II of the American Declaration, which states that:

All persons are equal before the law and have the rights and duties established in this Declaration, without distinction as to race, sex, language, creed or any other factor.

- d) Article 26 of the International Covenant on Civil and Political Rights, which stipulates that:

All persons are equal before the law and are entitled without any discrimination to the equal protection of the law. In this respect, the law shall prohibit any discrimination and guarantee to all persons equal and effective protection against discrimination on any ground such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.

- e) Article 2(1) of the Universal Declaration, which indicates that:

Everyone is entitled to all the rights and freedoms set forth in this Declaration, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.

*
* * *

Obligation to Respect and Guarantee Human Rights

72. The Court now considers it pertinent to refer to the general State obligation to respect and guarantee human rights, which is of the highest importance, and will then examine the principle of equality and non-discrimination.

73. Human rights must be respected and guaranteed by all States. All persons have attributes inherent to their human dignity that may not be harmed; these attributes make them possessors of fundamental rights that may not be disregarded and which are, consequently, superior to the power of the State, whatever its political structure.

74. The general obligation to respect and ensure human rights is enshrined in various international instruments²⁶.

²⁶ Some of these international instruments are: American Convention on Human Rights (Articles 1 and 2), Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights "Protocol of San Salvador" (Article 1), Charter of the United Nations (Article 55(c)), Universal Declaration of Human Rights (Preamble), International Covenant on Civil and Political Rights (Article 2(1) and 2(2)), International Covenant on Economic, Social and Cultural Rights (Article 2(2)), International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families (Article 7), International Convention on the Elimination of All Forms of Racial Discrimination (Preamble), European Convention for the Protection of the Human Rights and Fundamental Freedoms (Article 1), European Social Charter (Preamble), African Charter of Human and People's Rights "Banjul Charter" (Article 1), and the Arab Charter of Human Rights (Article 2).

75. The supervisory bodies of the American Convention and the International Covenant on Civil and Political Rights, the instruments indicated by Mexico in the questions of the request for an advisory opinion examined in this chapter, have ruled on the said obligation.

76. In this respect, the Inter-American Court has indicated that:

Article 1(1) is essential in determining whether a violation of the human rights recognized by the Convention can be imputed to a State Party. In effect, that article charges the States Parties with the fundamental duty to respect and guarantee, the rights recognized in the Convention. Any impairment of those rights which can be attributed to the action or omission of any public authority constitutes an act imputable to the State, which assumes responsibility in the terms provided by the Convention.

According to Article 1(1), any exercise of public power that violates the rights recognized by the Convention, is illegal. Whenever a State organ, official or public entity violates one of those rights, this constitutes a failure of the duty to respect the rights and freedoms set forth in the Convention.

This conclusion is independent of whether the organ or official has contravened provisions of domestic law or overstepped the limits of his authority. Under international law, a State is responsible for the acts of its agents undertaken in their official capacity and for their omissions, even when those agents act outside the sphere of their authority or violate domestic law.²⁷

77. The Inter-American Court has also stated that:

In international law, a customary norm establishes that a State which has ratified a human rights treaty must introduce the necessary modifications to its domestic law to ensure the proper compliance with the obligations it has assumed. This law is universally accepted, and is supported by jurisprudence. The American Convention establishes the general obligation of each State Party to adapt its domestic law to the provisions of this Convention, in order to guarantee the rights that it embodies. This general obligation of the State Party implies that the measures of domestic law must be effective (the principle of *effet utile*). This means that the State must adopt all measures so that the provisions of the Convention are effectively fulfilled in its domestic legal system, as Article 2 of the Convention requires. Such measures are only effective when the State adjusts its actions to the Convention's rules on protection.²⁸

78. Likewise, the Court has declared that:

[t]he general duty set forth in Article 2 of the American Convention implies the adoption of measures on two fronts. On the one hand, the suppression of rules and practices of any kind that entail the violation of the guarantees set forth in the Convention. On the other had, the issuance of rules and the development of practices leading to the effective observation of the said guarantees²⁹.

²⁷ "Five Pensioners" case. Judgment of February 28, 2003. Series C No. 98, para. 163; and *cf. The case of the Mayagna (Sumo) Awas Tingni Community*. Judgment of August 31, 2001. Series C No. 79, para. 154; and *Baena Ricardo et al. case*. Judgment of February 2, 2001. Series C No. 72, para. 178.

²⁸ "Five Pensioners" case, *supra* note 27, para. 164; and *cf. Cantos case*. Judgment of November 28, 2002. Series C No. 97, para. 59; and *Hilaire, Constantine and Benjamin et al. case*. Judgment of June 21, 2002. Series C No. 94, para. 213; and *cf. also "principe allant de soi"; Exchange of Greek and Turkish populations*, Advisory Opinion, 1925, P.I.C.J., Collection of Advisory Opinions. Series B. No. 10.

²⁹ *Cf. "Five Pensioners" case, supra* note 27, para. 165; *Baena Ricardo et al. case, supra* note 27, para. 180; and *Cantoral Benavides case*. Judgment of August 18, 2000. Series C No. 69, para. 178.

79. With regard to the provisions of Article 2 of the International Covenant on Civil and Political Rights, the Human Rights Committee has observed that:

[...] article 2 of the Covenant generally leaves it to the States parties concerned to choose their method of implementation in their territories within the framework set out in that article. It recognizes, in particular, that the implementation does not depend solely on constitutional or legislative enactments, which in themselves are often not per se sufficient. The Committee considers it necessary to draw the attention of States parties to the fact that the obligation under the Covenant is not confined to the respect of human rights, but that States parties have also undertaken to ensure the enjoyment of these rights to all individuals under their jurisdiction. This aspect calls for specific activities by the States parties to enable individuals to enjoy their rights. [...]

In this connection, it is very important that individuals should know what their rights under the Covenant (and the Optional Protocol, as the case may be) are and also that all administrative and judicial authorities should be aware of the obligations which the State party has assumed under the Covenant³⁰.

80. Likewise, the European Court of Human Rights has indicated that:

The Convention does not merely oblige the higher authorities of the Contracting States to respect for their own part the rights and freedoms it embodies; as is shown by Article 14 (art. 14) and the English text of Article 1 (art. 1) ("shall secure"), the Convention also has the consequence that, in order to secure the enjoyment of those rights and freedoms, those authorities must prevent or remedy any breach at subordinate levels.³¹

81. As can be seen from the above, both the international instruments and the respective international case law establish clearly that States have the general obligation to respect and ensure the fundamental rights. To this end, they should take affirmative action, avoid taking measures that restrict or infringe a fundamental right, and eliminate measures and practices that restrict or violate a fundamental right.

*
* * *

The principle of equality and non-discrimination

82. Having established the State obligation to respect and guarantee human rights, the Court will now refer to the elements of the principle of equality and non-discrimination.

83. Non-discrimination, together with equality before the law and equal protection of the law, are elements of a general basic principle related to the protection of human rights. The element of equality is difficult to separate from non-discrimination. Indeed, when referring to equality before the law, the instruments cited above (*supra* para. 71) indicate that this principle must be guaranteed with no discrimination. This Court has indicated that "[r]ecognizing equality before the law, [...] prohibits all discriminatory treatment."³²

³⁰ U.N., Human Rights Committee, General Comment 3, Application of the International Covenant on Civil and Political Rights at the National Level (Article 2), 29 July 1981, CCPR/C/13, paras. 1 and 2.

³¹ *Eur. Court H.R., Case of Ireland v. the United Kingdom, Judgment of 18 January 1978, Series A No 25, para. 239.*

³² *Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica. Advisory Opinion OC-4/84 of January 19, 1984. Series A No. 4, para. 54.*

84. This Advisory Opinion will differentiate by using the terms distinction and discrimination. The term distinction will be used to indicate what is admissible, because it is reasonable, proportionate and objective. Discrimination will be used to refer to what is inadmissible, because it violates human rights. Therefore, the term "discrimination" will be used to refer to any exclusion, restriction or privilege that is not objective and reasonable, and which adversely affects human rights.

85. There is an inseparable connection between the obligation to respect and guarantee human rights and the principle of equality and non-discrimination. States are obliged to respect and guarantee the full and free exercise of rights and freedoms without any discrimination. Non-compliance by the State with the general obligation to respect and guarantee human rights, owing to any discriminatory treatment, gives rise to its international responsibility.

86. The principle of the equal and effective protection of the law and of non-discrimination is embodied in many international instruments.³³ The fact that the principle of equality and non-discrimination is regulated in so many international instruments is evidence that there is a universal obligation to respect and guarantee the human rights arising from that general basic principle.

87. The principle of equality before the law and non-discrimination has been developed in international case law and legal writings. The Inter-American Court has understood that:

[t]he notion of equality springs directly from the oneness of the human family and is linked to the essential dignity of the individual. That principle cannot be reconciled with

³³ Some of these international instruments are: OAS Charter (Article 3(1)); American Convention on Human Rights (Articles 1 and 24); American Declaration on the Rights and Duties of Man (Article 2); Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights "Protocol of San Salvador" (Article 3); Charter of the United Nations (Article 1(3)); Universal Declaration of Human Rights (Articles 2 and 7); International Covenant on Economic, Social and Cultural Rights (Articles 2(2) and 3); International Covenant on Civil and Political Rights (Articles 2 and 26); International Convention on the Elimination of All Forms of Racial Discrimination (Article 2); Convention on the Rights of the Child (Article 2); Declaration on the Rights of the Child (Principle 1); International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families (Articles 1, 7, 18(1), 25, 27, 28, 43, 45(1), 48, 55 and 70); Convention on the Elimination of All Forms of Discrimination against Women (Articles 2, 3, 5 to 16); Declaration on the Elimination of All Forms of Intolerance and Discrimination Based on Religion or Beliefs (Articles 2 and 4); Declaration of the International Labor Organization (ILO) concerning the Fundamental Principles and Rights in Work and their Monitoring (2(d)); Convention No. 97 of the International Labor Organization (ILO) concerning Migrant Workers (revised) (Article 6); Convention No. 111 of the International Labor Organization (ILO) concerning Discrimination with regard to Employment and Occupation (Articles 1 to 3); Convention No. 143 of the International Labor Organization (ILO) concerning Migrant Workers (supplementary provisions) (Articles 8 and 10); Convention No. 168 of the International Labor Organization (ILO) concerning Promotion of Employment and Protection against Unemployment (Article 6); Proclamation of Teheran, the Teheran International Conference on Human Rights, May 13, 1968 (paras. 1, 2, 5, 8 and 11); Vienna Declaration and Programme of Action, World Conference on Human Rights, 14 to 25 June 1993 (I.15; I.19; I.27; I.30; II.B.1, Articles 19 to 24; II.B.2, Articles 25 to 27); Declaration on the Rights of Persons Belonging to National or Ethnic, Religious and Linguistic Minorities (Articles 2, 3, 4(1) and 5); World Conference against Racism, Racial Discrimination, Xenophobia and Related Forms of Intolerance, Programme of Action (paragraphs 1, 2, 7, 9, 10, 16, 25, 38, 47, 48, 51, 66 and 104 of the Declaration); Convention against Discrimination in Education (Article 3); Declaration on Race and Racial Prejudice (Articles 1, 2, 3, 4, 5, 6, 7, 8 and 9); Declaration on the Human Rights of Individuals Who are not Nationals of the Country in which They Live (Article 5(1)(b) and 5(1)(c)); Charter of the Fundamental Rights of the European Union (Articles 20 and 21); European Convention for the Protection of Human Rights and Fundamental Freedoms (Articles 1 and 14); European Social Charter (Article 19(4), 19(5) and 19(7)); Protocol No.12 to the European Convention for the Protection of Human Rights and Fundamental Freedoms (Article 1); African Charter of Human and People's Rights "Banjul Charter" (Articles 2 and 3); Arab Charter of Human Rights (Article 2); and Cairo Declaration of Human Rights in Islam (Article 1).

the notion that a given group has the right to privileged treatment because of its perceived superiority. It is equally irreconcilable with that notion to characterize a group as inferior and treat it with hostility or otherwise subject it to discrimination in the enjoyment of rights that are accorded to others not so classified. It is impermissible to subject human beings to differences in treatment that are inconsistent with their unique and congenerous character.³⁴

88. The principle of equality and non-discrimination is fundamental for the safeguard of human rights in both international and domestic law. Consequently, States have the obligation to combat discriminatory practices and not to introduce discriminatory regulations into their laws.

89. Nevertheless, when examining the implications of the differentiated treatment that some norms may give to the persons they affect, it is important to refer to the words of this Court declaring that "not all differences in treatment are in themselves offensive to human dignity."³⁵ In the same way, the European Court of Human Rights, following "the principles which may be extracted from the legal practice of a large number of democratic States," has held that a difference in treatment is only discriminatory when "it has no objective and reasonable justification."³⁶ Distinctions based on *de facto* inequalities may be established; such distinctions constitute an instrument for the protection of those who should be protected, considering their situation of greater or lesser weakness or helplessness.³⁷ For example, the fact that minors who are detained in a prison may not be imprisoned together with adults who are also detained is an inequality permitted by law. Another example of these inequalities is the limitation to the exercise of specific political rights owing to nationality or citizenship.

90. In this respect, the European Court has also indicated that:

"It is important, then, to look for the criteria which enable a determination to be made as to whether or not a given difference in treatment, concerning of course the exercise of one of the rights and freedoms set forth, contravenes Article 14 (art. 14). On this question the Court, following the principles which may be extracted from the legal practice of a large number of democratic States, holds that the principle of equality of treatment is violated if the distinction has no objective and reasonable justification. The existence of such a justification must be assessed in relation to the aim and effects of the measure under consideration, regard being had to the principles which normally prevail in democratic societies. A difference of treatment in the exercise of a right laid down in the Convention must not only pursue a legitimate aim: Article 14 (art. 14) is likewise violated when it is clearly established that there is no reasonable relationship of proportionality between the means employed and the aim sought to be realised.

In attempting to find out in a given case, whether or not there has been an arbitrary distinction, the Court cannot disregard those legal and factual features which characterise the life of the society in the State which, as a Contracting Party, has to

³⁴ *Legal Status and Human Rights of the Child*, *supra* note 1, para. 45; and *Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica.*, *supra* note 32, para. 55.

³⁵ *Legal Status and Human Rights of the Child*, *supra* note 1, para. 46; and *Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica.*, *supra* note 32, para. 56.

³⁶ Cf. *Eur. Court H.R., Case of Willis v. The United Kingdom*, *Judgement of 11 June 2002*, para. 39; *Eur. Court H.R., Case of Wessels-Bergervoet v. The Netherlands*, *Judgement of 4 June 2002*, para. 46; *Eur. Court H.R., Case of Petrovic v. Austria*, *Judgment of 27 March 1998*, *Reports 1998-II*, para. 30; *Eur. Court H.R., Case "relating to certain aspects of the laws on the use of languages in education in Belgium" v. Belgium*, *Judgment of 23 July 1968*, *Series A 1968*, para. 10.

³⁷ *Legal Status and Human Rights of the Child*, *supra* note 1, para. 46.

answer for the measure in dispute. In so doing it cannot assume the rôle of the competent national authorities, for it would thereby lose sight of the subsidiary nature of the international machinery of collective enforcement established by the Convention. The national authorities remain free to choose the measures which they consider appropriate in those matters which are governed by the Convention. Review by the Court concerns only the conformity of these measures with the requirements of the Convention."³⁸

91. Likewise, the Inter-American Court has established that:

[n]o discrimination exists if the difference in treatment has a legitimate purpose and if it does not lead to situations which are contrary to justice, to reason or to the nature of things. It follows that there would be no discrimination in differences in treatment of individuals by a state when the classifications selected are based on substantial factual differences and there exists a reasonable relationship of proportionality between these differences and the aims of the legal rule under review. These aims may not be unjust or unreasonable, that is, they may not be arbitrary, capricious, despotic or in conflict with the essential oneness and dignity of humankind.³⁹

92. The United Nations Committee on Human Rights has defined discrimination as:

[...] any distinction, exclusion, restriction or preference which is based on any ground such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status, and which has the purpose or effect of nullifying or impairing the recognition, enjoyment or exercise by all persons, on an equal footing, of all rights and freedoms.⁴⁰

93. Likewise, this Committee has indicated that:

[...] the enjoyment of rights and freedoms on an equal footing, however, does not mean identical treatment in every instance.⁴¹

94. The Human Rights Committee has also stated that:

[...] each State party must ensure the rights in the Covenant to "all individuals within its territory and subject to its jurisdiction" [...]. In general, the rights set forth in the Covenant apply to everyone, irrespective of reciprocity, and irrespective of his or her nationality or statelessness. [...]

Thus, the general rule is that each one of the rights of the Covenant must be guaranteed without discrimination between citizens and aliens. Aliens receive the benefit of the general requirement of non-discrimination in respect of the rights guaranteed in the Covenant, as provided for in article 2 thereof. This guarantee applies to aliens and citizens alike. Exceptionally, some of the rights recognized in the Covenant are expressly applicable only to citizens (art. 25), while article 13 applies only to aliens. However, the Committee's experience in examining reports shows that in a number of countries other rights that aliens should enjoy under the Covenant are denied to them or are subject to limitations that cannot always be justified under the Covenant. [...]

³⁸ *Eur. Court H.R., Case "relating to certain aspects of the laws on the use of languages in education in Belgium" v. Belgium, Judgment of 23 July 1968, Series A 1968, para. 10.*

³⁹ *Legal Status and Human Rights of the Child, supra note 1, para. 47; and Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica, supra note 32, para. 57.*

⁴⁰ U.N., Human Rights Committee, General Comment 18, Non-discrimination, 10/11/89, CCPR/C/37, para. 7.

⁴¹ U.N., Human Rights Committee, General Comment 18, Non-discrimination, 10/11/89, CCPR/C/37, para. 8.

The Covenant gives aliens all the protection regarding rights guaranteed therein, and its requirements should be observed by States parties in their legislation and in practice as appropriate. [...]

Aliens are entitled to equal protection by the law. There shall be no discrimination between aliens and citizens in the application of these rights. These rights of aliens may be qualified only by such limitations as may be lawfully imposed under the Covenant.⁴²

95. With regard to the principle of equality and non-discrimination, the African Commission of Human and Peoples' Rights has established that this:

[m]eans that citizens should expect to be treated fairly and justly within the legal system and be assured of equal treatment before the law and equal enjoyment of the rights available to all other citizens. The right to equality is important for a second reason. Equality or lack of it affects the capacity of one to enjoy many other rights.⁴³

96. In accordance with the foregoing, States must respect and ensure human rights in light of the general basic principle of equality and non-discrimination. Any discriminatory treatment with regard to the protection and exercise of human rights entails the international responsibility of the State.

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The fundamental nature of the principle of equality and non-discrimination

97. The Court now proceeds to consider whether this is a *jus cogens* principle.

98. Originally, the concept of *jus cogens* was linked specifically to the law of treaties. As *jus cogens* is formulated in Article 53 of the Vienna Convention on the Law of Treaties, "[a] treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law." Likewise, Article 64 of the Convention refers to *jus cogens superviniente*, when it indicates that "[i]f a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and terminates." *Jus cogens* has been developed by international case law and legal writings.⁴⁴

99. In its development and by its definition, *jus cogens* is not limited to treaty law. The sphere of *jus cogens* has expanded to encompass general international law, including all legal acts. *Jus cogens* has also emerged in the law of the international responsibility of States and, finally, has had an influence on the basic principles of the international legal order.

⁴² U.N., Human Rights Committee, General Comment 15, The situation of aliens in accordance with the Covenant, 11/04/86, CCPR/C/27, paras. 1, 2, 4, 7, 8 and 9.

⁴³ *African Commission of Human and Peoples' Rights, Communication No: 211/98 - Legal Resources Foundation v. Zambia, decision taken at the 29th Ordinary Session held in Tripoli, Libya, from 23 April to 7 May 2001, para. 63.*

⁴⁴ *Cf. I.C.T.Y., Trial Chamber II: Prosecutor v. Anto Furundzija, Judgment of 10 December 1998, Case No. IT-95-17/1-T, paras. 137-146, 153-157; Application of the Convention on the Prevention and Punishment of the Crime of Genocide, Preliminary Objections, Judgment, I.C.J. Reports 1996, p. 595; Barcelona Traction, Light and Power Company, Limited, Judgment, I.C.J. Reports 1970, p. 3, and Reservations to the Convention on Genocide, Advisory Opinion: I.C.J. Reports 1951, p. 15.*

100. In particular, when referring to the obligation to respect and ensure human rights, regardless of which of those rights are recognized by each State in domestic or international norms, the Court considers it clear that all States, as members of the international community, must comply with these obligations without any discrimination; this is intrinsically related to the right to equal protection before the law, which, in turn, derives "directly from the oneness of the human family and is linked to the essential dignity of the individual."⁴⁵ The principle of equality before the law and non-discrimination permeates every act of the powers of the State, in all their manifestations, related to respecting and ensuring human rights. Indeed, this principle may be considered peremptory under general international law, inasmuch as it applies to all States, whether or not they are party to a specific international treaty, and gives rise to effects with regard to third parties, including individuals. This implies that the State, both internationally and in its domestic legal system, and by means of the acts of any of its powers or of third parties who act under its tolerance, acquiescence or negligence, cannot behave in a way that is contrary to the principle of equality and non-discrimination, to the detriment of a determined group of persons.

101. Accordingly, this Court considers that the principle of equality before the law, equal protection before the law and non-discrimination belongs to *jus cogens*, because the whole legal structure of national and international public order rests on it and it is a fundamental principle that permeates all laws. Nowadays, no legal act that is in conflict with this fundamental principle is acceptable, and discriminatory treatment of any person, owing to gender, race, color, language, religion or belief, political or other opinion, national, ethnic or social origin, nationality, age, economic situation, property, civil status, birth or any other status is unacceptable. This principle (equality and non-discrimination) forms part of general international law. At the existing stage of the development of international law, the fundamental principle of equality and non-discrimination has entered the realm of *jus cogens*.

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* *

Effects of the principle of equality and non-discrimination

102. This general obligation to respect and guarantee human rights, without any discrimination and on an equal footing, has various consequences and effects that are defined in specific obligations. The Court will now refer to the effects derived from this obligation.

103. In compliance with this obligation, States must abstain from carrying out any action that, in any way, directly or indirectly, is aimed at creating situations of *de jure* or *de facto* discrimination. This translates, for example, into the prohibition to enact laws, in the broadest sense, formulate civil, administrative or any other measures, or encourage acts or practices of their officials, in implementation or interpretation of the law that discriminate against a specific group of persons because of their race, gender, color or other reasons.

104. In addition, States are obliged to take affirmative action to reverse or change discriminatory situations that exist in their societies to the detriment of a specific

⁴⁵ *Legal Status and Human Rights of the Child*, supra note 1, para. 45; *Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica*, supra note 32, para. 55.

group of persons. This implies the special obligation to protect that the State must exercise with regard to acts and practices of third parties who, with its tolerance or acquiescence, create, maintain or promote discriminatory situations.

105. Because of the effects derived from this general obligation, States may only establish objective and reasonable distinctions when these are made with due respect for human rights and in accordance with the principle of applying the norm that grants protection to the individual.

106. Non-compliance with these obligations gives rise to the international responsibility of the State, and this is exacerbated insofar as non-compliance violates peremptory norms of international human rights law. Hence, the general obligation to respect and ensure human rights binds States, regardless of any circumstance or consideration, including a person's migratory status.

107. One of the results of the foregoing is that, in their domestic laws, States must ensure that all persons have access, without any restriction, to a simple and effective recourse that protects them in determining their rights, irrespective of their migratory status.

108. In this respect, the Inter-American Court has indicated that:

[...] the absence of an effective remedy to violations of the rights recognized by the Convention is itself a violation of the Convention by the State Party in which the remedy is lacking. In that sense, it should be emphasized that, for such a remedy to exist, it is not sufficient that it be provided for by the Constitution or by law or that it be formally recognized, but rather it must be truly effective in establishing whether there has been a violation of human rights and in providing redress. A remedy which proves illusory because of the general conditions prevailing in the country, or even in the particular circumstances of a given case, cannot be considered effective. That could be the case, for example, when practice has shown its ineffectiveness: when the Judicial Power lacks the necessary independence to render impartial decisions or the means to carry out its judgments; or in any other situation that constitutes a denial of justice, as when there is an unjustified delay in the decision; or when, for any reason, the alleged victim is denied access to a judicial remedy⁴⁶.

109. This general obligation to respect and ensure the exercise of rights has an *erga omnes* character. The obligation is imposed on States to benefit the persons under their respective jurisdictions, irrespective of the migratory status of the protected persons. This obligation encompasses all the rights included in the American Convention and the International Covenant on Civil and Political Rights, including the right to judicial guarantees. In this way, the right of access to justice for all persons is preserved, understood as the right to effective jurisdictional protection.

110. Finally, as regards the second part of the fourth question of the request for an advisory opinion (*supra* para. 4), the contents of the preceding paragraphs are applicable to all the OAS Member States. The effects of the fundamental principle of equality and non-discrimination encompass all States, precisely because this principle, which belongs to the realm of *jus cogens* and is of a peremptory character,

⁴⁶ "Five Pensioners" case, *supra* note 27, para. 136; and *cf.* The case of the Mayagna (Sumo) Awajitjngni Community, *supra* note 27, para. 113; *Ivcher Bronstein case*. Judgment of February 6, 2001. Series C No. 74, paras. 136 and 137; and *Judicial Guarantees in States of Emergency*, *supra* note 17, para. 24.

entails obligations *erga omnes* of protection that bind all States and give rise to effects with regard to third parties, including individuals.

VII APPLICATION OF THE PRINCIPLE OF EQUALITY AND NON-DISCRIMINATION TO MIGRANTS

111. Now that the *jus cogens* character of the principle of equality and non-discrimination and the effects that derive from the obligation of States to respect and guarantee this principle have been established, the Court will refer to migration in general and to the application of this principle to undocumented migrants.

112. Migrants are generally in a vulnerable situation as subjects of human rights; they are in an individual situation of absence or difference of power with regard to non-migrants (nationals or residents). This situation of vulnerability has an ideological dimension and occurs in a historical context that is distinct for each State and is maintained by *de jure* (inequalities between nationals and aliens in the laws) and *de facto* (structural inequalities) situations. This leads to the establishment of differences in their access to the public resources administered by the State.

113. Cultural prejudices about migrants also exist that lead to reproduction of the situation of vulnerability; these include ethnic prejudices, xenophobia and racism, which make it difficult for migrants to integrate into society and lead to their human rights being violated with impunity.

114. In this respect, the resolution on "Protection of migrants" of the General Assembly of the United Nations is pertinent, when it indicates that it is necessary to recall "the situation of vulnerability in which migrants frequently find themselves, owing, *inter alia*, to their absence from their State of origin and to the difficulties they encounter because of differences of language, custom and culture, as well as the economic and social difficulties and obstacles for the return to their States of origin of migrants who are non-documented or in an irregular situation."⁴⁷ The General Assembly also expressed its concern "at the manifestations of violence, racism, xenophobia and other forms of discrimination and inhuman and degrading treatment against migrants, especially women and children, in different parts of the world."⁴⁸ Based on these considerations, the General Assembly reiterated:

the need for all States to protect fully the universally recognized human rights of migrants, especially women and children, regardless of their legal status, and to provide humane treatment, particularly with regard to assistance and protection [...].⁴⁹

115. The Court is aware that, as the General Assembly of the United Nations also observed, "among other factors, the process of globalization and liberalization, including the widening economic and social gap between and among many countries and the marginalization of some countries in the global economy, has contributed to

⁴⁷ United Nations General Assembly, Resolution A/RES/54/166 on "Protection of migrants" of February 24, 2000.

⁴⁸ United Nations General Assembly, Resolution A/RES/54/166 on "Protection of migrants" of 24 February 2000.

⁴⁹ United Nations General Assembly, Resolution A/RES/54/166 on "Protection of migrants" of 24 February 2000.

large flows of peoples between and among countries and to the intensification of the complex phenomenon of international migration.”⁵⁰

116. With regard to the foregoing, the Programme of Action of the International Conference on Population and Development held in Cairo in 1994 indicated that:

International economic imbalances, poverty and environmental degradation, combined with the absence of peace and security, human rights violations and the varying degrees of development of judicial and democratic institutions are all factors affecting international migration. Although most international migration flows occur between neighbouring countries, interregional migration, particularly that directed to developed countries, has been growing.⁵¹

117. In accordance with the foregoing, the international community has recognized the need to adopt special measures to ensure the protection of the human rights of migrants.⁵²

118. We should mention that the regular situation of a person in a State is not a prerequisite for that State to respect and ensure the principle of equality and non-discrimination, because, as mentioned above, this principle is of a fundamental nature and all States must guarantee it to their citizens and to all aliens who are in their territory. This does not mean that they cannot take any action against migrants who do not comply with national laws. However, it is important that, when taking the corresponding measures, States should respect human rights and ensure their exercise and enjoyment to all persons who are in their territory, without any discrimination owing to their regular or irregular residence, or their nationality, race, gender or any other reason.

119. Consequently, States may not discriminate or tolerate discriminatory situations that prejudice migrants. However, the State may grant a distinct treatment to documented migrants with respect to undocumented migrants, or between migrants and nationals, provided that this differential treatment is reasonable, objective, proportionate and does not harm human rights. For example, distinctions may be made between migrants and nationals regarding ownership of some political rights. States may also establish mechanisms to control the entry into and departure from their territory of undocumented migrants, which must always be applied with strict regard for the guarantees of due process and respect for human dignity. In this respect, the African Commission on Human and Peoples’ Rights has indicated that it:

does not wish to call into question nor is it calling into question the right of any State to take legal action against illegal immigrants and deport them to their countries of origin, if the competent courts so decide. It is however of the view that it is unacceptable to

⁵⁰ United Nations General Assembly, Resolution A/RES/54/212 on “International migration and development” of 1 February 2000.

⁵¹ United Nations, A/CONF.171/13, 18 October 1994, Report on the International Conference on Population and Development held in Cairo from 5 to 13 September 1994, Programme of Action, Chapter X.A.10.1.

⁵² Cf. United Nations, World Summit on Social Development held in Copenhagen in March 1995, Programme of Action, paras. 63, 77 and 78; United Nations, A/CONF.171/13, 18 October 1994, Report on the International Conference on Population and Development held in Cairo from 5 to 13 September 1994, Programme of Action, Chapter X.A.10(2) to 10(20); United Nations General Assembly, A/CONF. 157/23, 12 July 1993, World Conference on Human Rights held in Vienna, Austria, from 14 to 25 June 1993, Declaration and Programme of Action, I.24 and II.33-35.

deport individuals without giving them the possibility to plead their case before the competent national courts as this is contrary to the spirit and letter of the Charter [the African Charter of Human and Peoples' Rights] and international law.⁵³

120. When dealing with the principle of equality and non-discrimination, the continuing development of international law should be borne in mind. In this respect, the Inter-American Court has indicated, in its Advisory Opinion OC-16/99 on *The Right to Information on Consular Assistance within the Framework of the Guarantees of Due Process of Law*, that:

The *corpus juris* of international human rights law comprises a set of international instruments of varied content and juridical effects (treaties, conventions, resolutions and declarations). Its dynamic evolution has had a positive impact on international law in affirming and building up the latter's faculty for regulating relations between States and the human beings within their respective jurisdictions. This Court, therefore, must adopt the proper approach to consider this question in the context of the evolution of the fundamental rights of the human person in contemporary international law.⁵⁴

121. Due process of law is a right that must be ensured to all persons, irrespective of their migratory status. In this respect, in the above-mentioned Advisory Opinion on *The Right to Information on Consular Assistance within the Framework of the Guarantees of Due Process of Law*, this Court indicated that:

[...] for "the due process of law" a defendant must be able to exercise his rights and defend his interests effectively and in full procedural equality with other defendants. It is important to recall that the judicial process is a means to ensure, insofar as possible, an equitable resolution of a difference. The body of procedures, of diverse character and generally grouped under the heading of the due process, is all calculated to serve that end. To protect the individual and see justice done, the historical development of the judicial process has introduced new procedural rights. An example of the evolutive nature of judicial process are the rights not to incriminate oneself and to have an attorney present when one speaks. These two rights are already part of the laws and jurisprudence of the more advanced legal systems. And so, the body of judicial guarantees given in Article 14 of the International Covenant on Civil and Political Rights has evolved gradually. It is a body of judicial guarantees to which others of the same character, conferred by various instruments of international law, can and should be added.

and that:

To accomplish its objectives, the judicial process must recognize and correct any real disadvantages that those brought before the bar might have, thus observing the principle of equality before the law and the courts and the corollary principle prohibiting discrimination. The presence of real disadvantages necessitates countervailing measures that help to reduce or eliminate the obstacles and deficiencies that impair or diminish an effective defense of one's interests. Absent those countervailing measures, widely recognized in various stages of the proceeding, one could hardly say that those who have the disadvantages enjoy a true opportunity for justice and the benefit of the due process of law equal to those who do not have those disadvantages.⁵⁵

⁵³ *African Commission of Human and Peoples' Rights, Communication No: 159/96 - Union Inter-Africaine des Droits de l'Homme, Federation Internationale des Ligues des Droits de l'Homme, Rencontre Africaine des Droits de l'Homme, Organisation Nationale des Droits de l'Homme au Sénégal and Association Malienne des Droits de l'Homme au Angola, decision of 11 November, 1997, para. 20.*

⁵⁴ *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law, supra note 1, para. 115.*

⁵⁵ *The Right to Information on Consular Assistance in the Framework of the Guarantees of Due Process of Law, supra note 1, para. 117 and 119; and cf. Legal Status and Human Rights of the Child, supra note 1, paras. 97 and 115; and Hilaire, Constantine and Benjamin et al. case, supra note 28, para. 146.*

122. The Court considers that the right to due process of law should be recognized within the framework of the minimum guarantees that should be provided to all migrants, irrespective of their migratory status. The broad scope of the preservation of due process applies not only *ratione materiae* but also *ratione personae*, without any discrimination.

123. As this Court has already indicated, due legal process refers to the:

all the requirement that must be observed in the procedural stages in order for an individual to be able to defend his rights adequately vis-à-vis any [...] act of the State that could affect them. That it to say, due process of law must be respected in any act or omission on the part of the State bodies in a proceeding, whether of an administrative, punitive or jurisdictional nature.⁵⁶

124. Likewise, the Court has observed⁵⁷ that the list of minimum guarantees of due legal process applies when determining rights and obligations of "civil, labor, fiscal or any other nature."⁵⁸ This shows that due process affects all these areas and not only criminal matters.

125. In addition, it is important to establish, as the Court has already done, that "[i]t is a human right to obtain all the guarantees which make it possible to arrive at fair decisions, and the administration is not exempt from its duty to comply with this obligation. The minimum guarantees must be observed in administrative processes whose decision may affect the rights of persons."⁵⁹

126. The right to judicial protection and judicial guarantees is violated for several reasons: owing to the risk a person runs, when he resorts to the administrative or judicial instances, of being deported, expelled or deprived of his freedom, and by the negative to provide him with a free public legal aid service, which prevents him from asserting the rights in question. In this respect, the State must guarantee that access to justice is genuine and not merely formal. The rights derived from the employment relation subsist, despite the measures adopted.

127. Now that the Court has established what is applicable for all migrants, it will examine the rights of migrant workers, in particular those who are undocumented.

VIII RIGHTS OF UNDOCUMENTED MIGRANT WORKERS

128. As established in the glossary (*supra* para. 69), a migrant worker is any persons who is to be engaged, is engaged or has been engaged in a remunerated activity in a State of which he or she is not a national. This definition is embodied in the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families (Article 2(1)).

⁵⁶ *Baena Ricardo et al. case, supra* note 27, para. 124; and *cf. Ivcher Bronstein case, supra* note 46, para. 102; *the Constitutional Court case*. Judgment of January 31, 2001. Series C No. 71, para. 69; and *Judicial Guarantees in States of Emergency, supra* note 17, para. 27.

⁵⁷ *Cf. Ivcher Bronstein case, supra* note 46, para. 103; *Baena Ricardo et al. case, supra* note 27, para. 125; and *the Constitutional Court case, supra* note 56, para. 70.

⁵⁸ *Cf.* Article 8.1 of the American Convention on Human Rights.

⁵⁹ *Cf. Baena Ricardo et al. case, supra* note 27, para. 127.

129. Migrant workers who are documented or in a regular situation are those who have been "authorized to enter, stay and engage in a remunerated activity in the State of employment"⁶⁰ pursuant to the law of the State and to international agreements to which that State is a party."⁶¹ Workers who are undocumented or in an irregular situation do not comply with the conditions that documented workers do; in other words, they are not authorized to enter, stay and engage in a remunerated activity in a State of which they are not nationals.

130. In continuation, the Court will rule on undocumented migrant workers and their rights.

131. The vulnerability of migrant workers as compared to national workers must be underscored. In this respect, the preamble to the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families refers to "the situation of vulnerability in which migrant workers and members of their families frequently find themselves owing, among other things, to their absence from their State of origin and to the difficulties they may encounter arising from their presence in the State of employment."

132. Nowadays, the rights of migrant workers "have not been sufficiently recognized everywhere"⁶² and, furthermore, undocumented workers "are frequently employed under less favorable conditions of work than other workers and [...] certain employers find this an inducement to seek such labor in order to reap the benefits of unfair competition."⁶³

133. Labor rights necessarily arise from the circumstance of being a worker, understood in the broadest sense. A person who is to be engaged, is engaged or has been engaged in a remunerated activity, immediately becomes a worker and, consequently, acquires the rights inherent in that condition. The right to work, whether regulated at the national or international level, is a protective system for workers; that is, it regulates the rights and obligations of the employee and the employer, regardless of any other consideration of an economic and social nature. A person who enters a State and assumes an employment relationship, acquires his labor human rights in the State of employment, irrespective of his migratory status, because respect and guarantee of the enjoyment and exercise of those rights must be made without any discrimination.

134. In this way, the migratory status of a person can never be a justification for depriving him of the enjoyment and exercise of his human rights, including those related to employment. On assuming an employment relationship, the migrant acquires rights as a worker, which must be recognized and guaranteed, irrespective

⁶⁰ U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990, Article 6(b), according to which, the employer State is "a State where the migrant worker is to be engaged, is engaged or has been engaged in a remunerated activity [...]."

⁶¹ U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990, Article 5(a).

⁶² U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990, Preamble.

⁶³ U.N., International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families of 18 December 1990, Preamble.

of his regular or irregular status in the State of employment. These rights are a consequence of the employment relationship.

135. It is important to clarify that the State and the individuals in a State are not obliged to offer employment to undocumented migrants. The States and individuals, such as employers, can abstain from establishing an employment relationship with migrants in an irregular situation.

136. However, if undocumented migrants are engaged, they immediately become possessors of the labor rights corresponding to workers and may not be discriminated against because of their irregular situation. This is very important, because one of the principal problems that occurs in the context of immigration is that migrant workers who lack permission to work are engaged in unfavorable conditions compared to other workers.

137. It is not enough merely to refer to the obligations to respect and ensure the labor human rights of all migrant workers, but it should be noted that these obligations have different scopes and effects for States and third parties.

138. Employment relationships are established under both public law and private law and, in both spheres, the State plays an important part.

139. In the context of an employment relationship in which the State is the employer, the latter must evidently guarantee and respect the labor human rights of all its public officials, whether nationals or migrants, documented or undocumented, because non-observance of this obligation gives rise to State responsibility at the national and the international level.

140. In an employment relationship regulated by private law, the obligation to respect human rights between individuals should be taken into consideration. That is, the positive obligation of the State to ensure the effectiveness of the protected human rights gives rise to effects in relation to third parties (*erga omnes*). This obligation has been developed in legal writings, and particularly by the *Drittwirkung* theory, according to which fundamental rights must be respected by both the public authorities and by individuals with regard to other individuals.

141. As of the first contentious cases on which it ruled, the Inter-American Court has outlined the application of the effects of the American Convention in relation to third parties (*erga omnes*), having indicated that:

Thus, in principle, any violation of rights recognized by the Convention carried out by an act of public authority or by persons who use their position of authority is imputable to the State. However, this does not define all the circumstances in which a State is obligated to prevent, investigate and punish human rights violations, or all the cases in which the State might be found responsible for an infringement of those rights. An illegal act which violates human rights and which is initially not directly imputable to a State (for example, because it is the act of a private person or because the person responsible has not been identified) can lead to international responsibility of the State, not because of the act itself, but because of the lack of due diligence to prevent the violation or to respond to it as required by the Convention.⁶⁴

⁶⁴ *Velásquez Rodríguez case*. Judgment of July 29, 1988. Series C No. 4, para. 172; and *cf. Godínez Cruz case*. Judgment of January 20, 1989. Series C No. 5, paras. 181, 182 and 187.

142. Likewise, by means of provisional measures, this Court has ordered the protection of members of communities and persons that provide services to them, from threats of death and harm to personal safety allegedly caused by the State and third parties.⁶⁵ Likewise, on another occasion, it ordered the protection of persons detained in prison, owing to deaths and threats in that prison, many of which were allegedly perpetrated by the prisoners themselves.⁶⁶

143. The European Court of Human Rights recognized the applicability of the European Convention for the Protection of Human Rights and Fundamental Freedoms to relationships between individuals, when it declared that the State had violated this Convention because it had restricted freedom of association, by establishing that membership in determined trade unions was a necessary condition for the petitioners in the case to be able to continue their employment in a company, since the restriction imposed was not "necessary in a democratic society."⁶⁷ In another case, the European Court considered that, although the object of Article 8 of this Convention (the right to respect of private and family life) was essentially that of protecting the individual against arbitrary interference by the public authorities, the State must abstain from such interference; in addition to this obligation to abstain, there are positive obligations inherent in effective respect for private or family life that may involve the adoption of measures designed to secure respect for private life even in the sphere of the relations of individuals among themselves. In this case, the European Court found that the State had violated the right to private and family life of a young mentally disabled woman who had been sexually assaulted, because she could not file criminal proceedings against her aggressor due to a vacuum in the criminal legislation.⁶⁸

144. The United Nations Committee on Human Rights has considered that the right to freedom and personal safety, embodied in article 9 of the International Covenant on Civil and Political Rights, imposes on the State the obligation to take adequate steps to ensure the protection of an individual threatened with death. In other words, an interpretation of this article that authorized States parties to ignore threats against the life of persons subject to their jurisdiction, even though they have not been detained or arrested by State agents, would deprive the guarantees established in the Covenant of any effectiveness.⁶⁹ The Committee also considered that the State has the obligation to protect the rights of members of minorities against attacks by individuals. Likewise, in its General Comments Nos. 18 and 20 on non-discrimination and article 7 of the said Covenant, the Committee has indicated that States parties must punish public officials, other persons acting in the name of the State, and individuals, who carry out torture and cruel, inhuman or degrading

⁶⁵ Cf. *Case of the Peace Community of San José de Apartadó*, Provisional Measures. Order of the Inter-American Court of June 18, 2002. Series E No. 3; and *Case of the Communities of the Jiguamiandó and the Curbaradó*, Provisional Measures. Order of the Inter-American Court of March 6, 2003.

⁶⁶ *Urso Branco Prison case*, Provisional Measures. Order of the Inter-American Court of June 18, 2002.

⁶⁷ *Eur. Court H.R., Case of Young, James and Webster v. The United Kingdom, (Merits) Judgement of 13 August 1981, Series A no. 44, paras. 48 to 65.*

⁶⁸ *Eur. Court H.R., Case of X and Y v. The Netherlands, (Merits) Judgement of 26 March 1985, Series A no. 91, para. 23.*

⁶⁹ Cf. U.N., Human Rights Committee. *Delgado Páez v. Colombia*. Decision of 12 July 1990. No. 195/85, para. 5.5.

treatment or punishment, and should also "take affirmative action in order to diminish or eliminate conditions which cause or help to perpetuate discrimination prohibited by the Covenant."

145. In addition, in a decision on the obligation to investigate acts of racial discrimination and violence against persons of another color or ethnic origin committed by individuals, the Committee for the Elimination of Racial Discrimination indicated that "when threats of racial violence are made, and especially when they are made in public and by a group, it is incumbent upon the State to investigate with due diligence and expedition."⁷⁰

146. In this way, the obligation to respect and ensure human rights, which normally has effects on the relations between the State and the individuals subject to its jurisdiction, also has effects on relations between individuals. As regards this Advisory Opinion, the said effects of the obligation to respect human rights in relations between individuals is defined in the context of the private employment relationship, under which the employer must respect the human rights of his workers.

147. The obligation to respect and guarantee the human rights of third parties is also based on the fact that it is the State that determines the laws that regulate the relations between individuals and, thus, private law; hence, it must also ensure that human rights are respected in these private relationships between third parties; to the contrary, the State may be responsible for the violation of those rights.

148. The State is obliged to respect and ensure the labor human rights of all workers, irrespective of their status as nationals or aliens, and not to tolerate situations of discrimination that prejudice the latter in the employment relationships established between individuals (employer-worker). The State should not allow private employers to violate the rights of workers, or the contractual relationship to violate minimum international standards.

149. This State obligation arises from legislation that protects workers – legislation based on the unequal relationship between both parties – which therefore protects the workers as the more vulnerable party. In this way, States must ensure strict compliance with the labor legislation that provides the best protection for workers, irrespective of their nationality, social, ethnic or racial origin, and their migratory status; therefore they have the obligation to take any necessary administrative, legislative or judicial measures to correct *de jure* discriminatory situations and to eradicate discriminatory practices against migrant workers by a specific employer or group of employers at the local, regional, national or international level.

150. On many occasions migrant workers must resort to State mechanisms for the protection of their rights. Thus, for example, workers in private companies have recourse to the Judiciary to claim the payment of wages, compensation, etc. Also, these workers often use State health services or contribute to the State pension system. In all these cases, the State is involved in the relationship between

⁷⁰ Cf. U.N., Committee on the Elimination of Racial Discrimination, Communication No. 4/1991, *L.K. v. The Netherlands*, paras. 6.3 and 6.6; and also *cf., inter. alia*, International Convention on the Elimination of All Forms of Racial Discrimination; Convention on the Elimination of All Forms of Discrimination against Women; Convention No. 111 concerning Discrimination in respect of Employment and Occupation of the International Labor Organization (ILO).

individuals as a guarantor of fundamental rights, because it is required to provide a specific service.

151. In labor relations, employers must protect and respect the rights of workers, whether these relations occur in the public or private sector. The obligation to respect the human rights of migrant workers has a direct effect on any type of employment relationship, when the State is the employer, when the employer is a third party, and when the employer is a natural or legal person.

152. The State is thus responsible for itself, when it acts as an employer, and for the acts of third parties who act with its tolerance, acquiescence or negligence, or with the support of some State policy or directive that encourages the creation or maintenance of situations of discrimination.

153. In summary, employment relationships between migrant workers and third party employers may give rise to the international responsibility of the State in different ways. First, States are obliged to ensure that, within their territory, all the labor rights stipulated in its laws – rights deriving from international instruments or domestic legislation – are recognized and applied. Likewise, States are internationally responsible when they tolerate actions and practices of third parties that prejudice migrant workers, either because they do not recognize the same rights to them as to national workers or because they recognize the same rights to them but with some type of discrimination.

154. Furthermore, there are cases in which it is the State that violates the human rights of the workers directly. For example, when it denies the right to a pension to a migrant worker who has made the necessary contributions and fulfilled all the conditions that were legally required of workers, or when a worker resorts to the corresponding judicial body to claim his rights and this body does not provide him with due judicial protection or guarantees.

155. The Court observes that labor rights are the rights recognized to workers by national and international legislation. In other words, the State of employment must respect and guarantee to every worker the rights embodied in the Constitution, labor legislation, collective agreements, agreements established by law (*convenios-ley*), decrees and even specific and local practices, at the national level; and, at the international level, in any international treaty to which the State is a party.

156. This Court notes that, since there are many legal instruments that regulate labor rights at the domestic and the international level, these regulations must be interpreted according to the principle of the application of the norm that best protects the individual, in this case, the worker. This is of great importance, because there is not always agreement either between the different norms or between the norms and their application, and this could prejudice the worker. Thus, if a domestic practice or norm is more favorable to the worker than an international norm, domestic law should be applied. To the contrary, if an international instrument benefits the worker, granting him rights that are not guaranteed or recognized by the State, such rights should be respected and guaranteed to him.

157. In the case of migrant workers, there are certain rights that assume a fundamental importance and yet are frequently violated, such as: the prohibition of obligatory or forced labor; the prohibition and abolition of child labor; special care for women workers, and the rights corresponding to: freedom of association and to

organize and join a trade union, collective negotiation, fair wages for work performed, social security, judicial and administrative guarantees, a working day of reasonable length with adequate working conditions (safety and health), rest and compensation. The safeguard of these rights for migrants has great importance based on the principle of the inalienable nature of such rights, which all workers possess, irrespective of their migratory status, and also the fundamental principle of human dignity embodied in Article 1 of the Universal Declaration, according to which "[a]ll human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood."

158. This Court considers that the exercise of these fundamental labor rights guarantees the enjoyment of a dignified life to the worker and to the members of his family. Workers have the right to engage in a work activity under decent, fair conditions and to receive a remuneration that allows them and the members of their family to enjoy a decent standard of living in return for their labor. Likewise, work should be a means of realization and an opportunity for the worker to develop his aptitudes, capacities and potential, and to realize his ambitions, in order to develop fully as a human being.

159. On many occasions, undocumented migrant workers are not recognized the said labor rights. For example, many employers engage them to provide a specific service for less than the regular remuneration, dismiss them because they join unions, and threaten to deport them. Likewise, at times, undocumented migrant workers cannot even resort to the courts of justice to claim their rights owing to their irregular situation. This should not occur; because, even though an undocumented migrant worker could face deportation, he should always have the right to be represented before a competent body so that he is recognized all the labor rights he has acquired as a worker.

160. The Court considers that undocumented migrant workers, who are in a situation of vulnerability and discrimination with regard to national workers, possess the same labor rights as those that correspond to other workers of the State of employment, and the latter must take all necessary measures to ensure that such rights are recognized and guaranteed in practice. Workers, as possessors of labor rights, must have the appropriate means of exercising them.

IX STATE OBLIGATIONS WHEN DETERMINING MIGRATORY POLICIES IN LIGHT OF THE INTERNATIONAL INSTRUMENTS FOR THE PROTECTION OF HUMAN RIGHTS

161. The Court will now refer to State obligations when determining migratory policies solely in light of international instruments for the protection of human rights.

162. In this section of the Advisory Opinion, the Court will consider whether the fact that the American States subordinate and condition the observance of human rights to their migratory policies is compatible with international human rights law; it will do so in light of the international obligations arising from the International Covenant on Civil and Political Rights and other obligations of an *erga omnes* nature.

163. The migratory policy of a State includes any institutional act, measure or omission (laws, decrees, resolutions, directives, administrative acts, etc.) that refers to the entry, departure or residence of national or foreign persons in its territory.

164. In this respect, the Durban Declaration and Programme of Action adopted by the World Conference against Racism, Racial Discrimination, Xenophobia and Related Intolerance urged all States to “[t]o review and, where necessary, revise their immigration laws, policies and procedures with a view to eliminating any element of racial discrimination and make them consistent with State obligations by virtue of international human rights instruments.”⁷¹ Likewise, in paragraph 9 of the Commission on Human Rights resolution 2001/5 on racism, racial discrimination, xenophobia and related intolerance, “States were asked to review and, where necessary, revise any immigration policies which are inconsistent with international human rights instruments, with a view to eliminating all discriminatory policies and practices against migrants.”

165. This Court considers it essential to mention the provisions of Article 27 of the Vienna Convention on the Law of Treaties, which, when referring to domestic law and the observance of treaties, provides that: “[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.”

166. In other words, when ratifying or acceding to an international treaty, States manifest their commitment in good faith to guarantee and respect the rights recognized therein. In addition, the States must adapt their domestic law to the applicable international law.

167. In this regard, the Inter-American Court has indicated that the general obligation set forth in Article 2 of the American Convention implies the adoption of measures to eliminate norms and practices of any nature that entail the violation of the guarantees set forth in the Convention, and the issuance of norms and the development of practices leading to the effective observance of the said guarantees.⁷² In this respect, the Court has indicated that:

Under the law of nations, a customary rule prescribes that a State that has concluded an international agreement must introduce in its domestic laws whatever changes are needed to ensure execution of the obligations it has undertaken. This principle has been accepted universally, and is supported by case law. The American Convention establishes the general obligation of each State Party to adapt its domestic laws to the provisions of the said Convention, so as to guarantee the rights embodied therein. This general obligation of the State Party implies that measures of domestic law must be effective (the “*effet utile*” principle). This means that the State must adopt all necessary measures to ensure that the provisions of the Convention are complied with effectively in its domestic laws, as required by Article 2 of the Convention. Such measures are only effective when the State adapts its actions to the protective norms of the Convention.⁷³

⁷¹ Cf. Declaration and Programme of Action of the World Conference against Racism, Racial Discrimination, Xenophobia and Related Forms of Intolerance, held in Durban South African, from August 31 to September 8, 2001, paras. 38 y 30.b), respectively.

⁷² Cf. “*Five Pensioners*” case, *supra* note 27, para. 165; *Baena Ricardo et al. case*, *supra* note 27, para. 180; and *Cantoral Benavides case*, *supra* note 29, para. 178.

⁷³ “*Five Pensioners*” case, *supra* note 27, para. 164; and cf. “*The Last Temptation of Christ*” case (*Olmedo Bustos et al.*). Judgment of February 5, 2001. Series C No. 73, para. 87; *Baena Ricardo et al. case*, *supra* note 27, para. 179; *Durand and Ugarte case*. Judgment of August 16, 2000. Series C No. 68, para. 136; and cf. also “*principe allant de soi*”; *Exchange of Greek and Turkish populations*. Advisory Opinion. 1925, P.I.C.J., Collection of Advisory Opinions. Series B. No. 10.

168. The goals of migratory policies should take into account respect for human rights. Likewise, migratory policies should be implemented respecting and guaranteeing human rights. As indicated above (*supra* paras. 84, 89, 105 and 119), the distinctions that the States establish must be objective, proportionate and reasonable.

169. Considering that this Opinion applies to questions related to the legal aspects of migration, the Court deems it appropriate to indicate that, in the exercise of their power to establish migratory policies, it is licit for States to establish measures relating to the entry, residence or departure of migrants who will be engaged as workers in a specific productive sector of the State, provided this is in accordance with measures to protect the human rights of all persons and, in particular, the human rights of the workers. In order to comply with this requirement, States may take different measures, such as granting or denying general work permits or permits for certain specific work, but they must establish mechanisms to ensure that this is done without any discrimination, taking into account only the characteristics of the productive activity and the individual capability of the workers. In this way, the migrant worker is guaranteed a decent life, he is protected from the situation of vulnerability and uncertainty in which he usually finds himself, and the local or national productive process is organized efficiently and adequately.

170. Therefore, it is not admissible for a State of employment to protect its national production, in one or several sectors by encouraging or tolerating the employment of undocumented migrant workers in order to exploit them, taking advantage of their condition of vulnerability in relation to the employer in the State or considering them an offer of cheaper labor, either by paying them lower wages, denying or limiting their enjoyment or exercise of one or more of their labor rights, or denying them the possibility of filing a complaint about the violation of their rights before the competent authority.

171. The Inter-American Court has established the obligation of States to comply with every international instrument applicable to them. However, when referring to this State obligation, it is important to note that this Court considers that not only should all domestic legislation be adapted to the respective treaty, but also State practice regarding its application should be adapted to international law. In other words, it is not enough that domestic laws are adapted to international law, but the organs or officials of all State powers, whether the Executive, the Legislature or the Judiciary, must exercise their functions and issue or implement acts, resolutions and judgments in a way that is genuinely in accordance with the applicable international law.

172. The Court considers that the State may not subordinate or condition the observance of the principle of equality before the law and non-discrimination to achieving the goals of its public policies, whatever these may be, including those of a migratory nature. This general principle must be respected and guaranteed always. Any act or omission to the contrary is inconsistent with the international human rights instruments.

X OPINION

173. For the foregoing reasons,

THE COURT,**DECIDES**

unanimously,

that it is competent to issue this Advisory Opinion.

AND IS OF THE OPINION

unanimously,

1. That States have the general obligation to respect and ensure the fundamental rights. To this end, they must take affirmative action, avoid taking measures that limit or infringe a fundamental right, and eliminate measures and practices that restrict or violate a fundamental right.
2. That non-compliance by the State with the general obligation to respect and ensure human rights, owing to any discriminatory treatment, gives rise to international responsibility.
3. That the principle of equality and non-discrimination is fundamental for the safeguard of human rights in both international law and domestic law.
4. That the fundamental principle of equality and non-discrimination forms part of general international law, because it is applicable to all States, regardless of whether or not they are a party to a specific international treaty. At the current stage of the development of international law, the fundamental principle of equality and non-discrimination has entered the domain of *jus cogens*.
5. That the fundamental principle of equality and non-discrimination, which is of a peremptory nature, entails obligations *erga omnes* of protection that bind all States and generate effects with regard to third parties, including individuals.
6. That the general obligation to respect and guarantee human rights binds States, regardless of any circumstance or consideration, including the migratory status of a person.
7. That the right to due process of law must be recognized as one of the minimum guarantees that should be offered to any migrant, irrespective of his migratory status. The broad scope of the preservation of due process encompasses all matters and all persons, without any discrimination.
8. That the migratory status of a person cannot constitute a justification to deprive him of the enjoyment and exercise of human rights, including those of a labor-related nature. When assuming an employment relationship, the migrant acquires rights that must be recognized and ensured because he is an employee, irrespective of his regular or irregular status in the State where he is employed. These rights are a result of the employment relationship.
9. That the State has the obligation to respect and guarantee the labor human rights of all workers, irrespective of their status as nationals or aliens, and not to

tolerate situations of discrimination that are harmful to the latter in the employment relationships established between private individuals (employer-worker). The State must not allow private employers to violate the rights of workers, or the contractual relationship to violate minimum international standards.

10. That workers, being possessors of labor rights, must have all the appropriate means to exercise them. Undocumented migrant workers possess the same labor rights as other workers in the State where they are employed, and the latter must take the necessary measures to ensure that this is recognized and complied with in practice.

11. That States may not subordinate or condition observance of the principle of equality before the law and non-discrimination to achieving their public policy goals, whatever these may be, including those of a migratory character.

Judges Cañado Trindade, García Ramírez, Salgado Pesantes and Abreu Burelli informed the Court of their Concurring Opinions, which accompany this Advisory Opinion.

Done at San José, Costa Rica, on September 17, 2003, in the Spanish and the English language, the Spanish text being authentic.

Antônio A. Cañado Trindade
President

Sergio García-Ramírez

Hernán Salgado-Pesantes

Oliver Jackman

Alirio Abreu-Burelli

Carlos Vicente de Roux-Rengifo

Manuel E. Ventura-Robles
Secretary

So ordered,

Antônio A. Cañado Trindade
President

Manuel E. Ventura-Robles
Secretary

CONCURRING OPINION OF JUDGE A.A. CANÇADO TRINDADE

1. I vote in favour of the adoption of the present Advisory Opinion of the Inter-American Court of Human Rights, which in my view constitutes a significant contribution to the evolution of the International Law of Human Rights. Four years ago, the Inter-American Court delivered the historical Advisory Opinion n. 16, on *The Right to Information on Consular Assistance in the Framework of the Guarantees of the Due Process of Law* (of 01.10.1999), truly pioneering, which has served as inspiration for the international case-law *in statu nascendi* on the matter⁷⁴. Today, in the same line of reasoning oriented to the needs and imperatives of protection of the human person, and at the end of an advisory procedure which has generated the greatest mobilization of all its history⁷⁵, the Inter-American Court adopts another Advisory Opinion, of great transcendence and again pioneering, on *The Juridical Condition and the Rights of the Undocumented Migrants*, becoming the first international tribunal to pronounce on this matter as a central theme.

2. Even more significant is the fact that the matter dealt with in the present Advisory Opinion, requested by Mexico and adopted by the Court by unanimity, is of direct interest of wide segments of the population in distinct latitudes, - in reality, of millions of human beings⁷⁶, - and constitutes in our days a legitimate preoccupation of the whole international community, and - I would not hesitate to add, - of the humanity as a whole. Given the transcendental importance of the points examined by the Inter-American Court in the present Advisory Opinion, I feel obliged to leave on the records, as the juridical foundation of my position on the matter, the reflections which I allow myself to develop in this Concurring Opinion, particularly in relation with the aspects which appear to me to deserve special attention.

3. Such aspects correspond to those which I see it fit to name as follows: a) the *civitas maxima gentium* and the universality of the human kind; b) the disparities of the contemporary world and the vulnerability of the migrants; c) the reaction of the

⁷⁴. The Inter-American Court, by means of its Advisory Opinion n. 16 referred to, - delivered at the end of an advisory procedure which generated a wide mobilization (with eight intervening States, besides the Inter-American Commission of Human Rights and several non-governmental organizations and individuals), - was in fact the first international tribunal to warn that non-compliance with Article 36(1)(b) of the Vienna Convention on Consular Relations of 1963 took place to the detriment not only of a State Party to such Convention but also to the affected human beings.

⁷⁵. Besides a considerable volume of written documents, such procedure counted on two public hearings, the first one having taken place at the headquarters of the Inter-American Court in San José of Costa Rica, in February 2003, and the second one having been held for the first time in its history outside its headquarters, in Santiago of Chile, in June 2003. The procedure counted on the participation of twelve accredited States (among which five intervening States in the public hearings), the Inter-American Commission of Human Rights, one agency of the United Nations (the United Nations High Commissioner for Refugees - UNHCR), and nine entities of civil society and of the Academy of several countries in the region, besides the Central American Council of Attorneys-General (*Procuradores*) of Human Rights.

⁷⁶. According to the International Organization for Migrations (I.O.M.), from 1965 to 2000 the total of migrants in the world more than doubled, raising from 75 millions to 175 millions of persons; and the projections for the future are in the sense that this total will increase even much further in the following years; I.O.M., *World Migration 2003 - Managing Migration: Challenges and Responses for People on the Move*, Geneva, I.O.M., 2003, pp. 4-5; and cf. also, in general, P. Stalker, *Workers without Frontiers*, Geneva/London, International Labour Organization (I.L.O.)/L. Rienner Pubs., 2000, pp. 26-33.

universal juridical conscience; d) the construction of the individual subjective right of asylum; e) the position and the role of the general principles of Law; f) the fundamental principles as *substratum* of the legal order itself; g) the principle of equality and non-discrimination in the International Law of Human Rights; h) the emergence, the content and the scope of the *jus cogens*; e i) the emergence and the scope of the obligations *erga omnes* of protection (their horizontal and vertical dimensions). I proceed to present my reflections on each of those aspects.

I. The *Civitas Maxima Gentium* and the Universality of the Human Kind.

4. The consideration of a question such as the one with which the present Advisory Opinion is concerned cannot make abstraction of the teachings of the so-called founding fathers of International Law, in whose thinking one can find reflections which remain remarkably up-to-date, and are of importance to the legal settlement also of contemporary problems. Francisco de Vitoria, for example, in his pioneering and decisive contribution to the notion of prevalence of the *rule of law*, upheld, in his acclaimed *Relecciones Teológicas* (1538-1539), that the legal order binds everyone - both the rulers as well as the ruled ones, and that the international community (*totus orbis*) has primacy over the will of each individual State⁷⁷. In the conception of Vitoria, the great preacher of Salamanca, the *droit des gens* rules an international community constituted of human beings organized socially in States and coextensive with humanity itself⁷⁸; the reparation of the violations of (human) rights reflects an international necessity fulfilled by the *droit des gens*, with the same principles of justice applying both to the States and to the individuals or peoples who form them⁷⁹.

5. In the outlook of Francisco Suárez (author of the treatise *De Legibus ac Deo Legislatore*, 1612), the *droit des gens* reveals the unity and universality of the human kind; the States have necessity of a legal system which regulates their relations, as members of the universal society⁸⁰. To Suárez, the *droit des gens* comprised, besides the nations and the peoples, the human kind as a whole, and the law fulfilled the needs of regulation of all the peoples and human beings. Both Suárez and Vitoria formulated the bases of the international duties of the States *vis-à-vis* also the foreigners, in the framework of the general principle of the freedom of circulation and of communications, in the light of the *universality of the human kind*⁸¹. The human sociability and solidarity

⁷⁷. Cf. Francisco de Vitoria, *Relecciones - del Estado, de los Indios, y del Derecho de la Guerra*, México, Porrúa, 1985, pp. 1-101; A. Gómez Robledo, *op. cit. infra* n. (15), pp. 30-39; W.G. Grewe, *The Epochs of International Law*, Berlin, W. de Gruyter, 2000, pp. 189-190.

⁷⁸. Cf., in particular, Francisco de Vitoria, *De Indis - Relectio Prior* (1538-1539), in: *Obras de Francisco de Vitoria - Relecciones Teológicas* (ed. T. Urdanoz), Madrid, BAC, 1960, p. 675.

⁷⁹. A.A. Cançado Trindade, "Co-existence and Co-ordination of Mechanisms of International Protection of Human Rights (At Global and Regional Levels)", 202 *Recueil des Cours de l'Académie de Droit International de La Haye* (1987) p. 411; J. Brown Scott, *The Spanish Origin of International Law - Francisco de Vitoria and his Law of Nations*, Oxford/London, Clarendon Press/H. Milford - Carnegie Endowment for International Peace, 1934, pp. 282-283, 140, 150, 163-165 and 172.

⁸⁰. Cf. Association Internationale Vitoria-Suarez, *Vitoria et Suarez - Contribution des Théologiens au Droit International Moderne*, Paris, Pédone, 1939, pp. 169-170.

⁸¹. Cf. *ibid.*, pp. 40-46, and cf. pp. 5-6 and 11-12.

were present in the whole doctrinal construction and the contribution of the Spanish theologians to the formation of the *droit des gens*.

6. In its turn, the conception of the *jus gentium* of Hugo Grotius - whose work, above all the *De Jure Belli ac Pacis* (1625), lies in the origins of the international law, as the discipline came to be known, - was always attentive to the role of civil society. To Grotius, the State is not an end in itself, but rather a means to secure the social order in conformity with human intelligence, so as to improve the "common society which embraces all mankind"⁸². In Grotian thinking, every legal norm - whether of domestic law or of the law of nations - creates rights and obligations for the persons to whom they are directed; the forerunning work of Grotius, already in the first half of the XVIIth century, thus admits the possibility of the international protection of human rights against the State itself⁸³.

7. Pursuant to the Grotian outlook, the human being and his welfare occupy a central position in the system of international relations; the standards of justice apply *vis-à-vis* both the States and the individuals⁸⁴. To Grotius, natural law derives from human reason, is a "dictate of the *recta ratio*", and imposes limits to the "unrestricted conduct of the rulers of the States"⁸⁵. The States are subjected to Law, and International Law has "an objective, independent foundation, and above the will of the States"⁸⁶. The considerations of justice thus permeate the legal rules and foster their evolution⁸⁷.

8. Even before Grotius, Alberico Gentili (author of *De Jure Belli*, 1598) sustained, by the end of the XVIth century, that it is Law that governs the relationship among the members of the universal *societas gentium*⁸⁸. Samuel Pufendorf (author of *De Jure*

⁸². P.P. Remec, *The Position of the Individual in International Law according to Grotius and Vattel*, The Hague, Nijhoff, 1960, pp. 216 and 203. The subjects have rights *vis-à-vis* the sovereign State, which cannot demand obedience from its citizens in an absolute way (imperative of the common good); thus, in the vision of Grotius, the *raison d'État* has limits, and the absolute conception of this latter becomes applicable in the international as well as internal relations of the State. *Ibid.*, pp. 219-220 and 217.

⁸³. *Ibid.*, pp. 243 and 221. One has, thus, to bear always in mind the true legacy of the Grotian tradition of international law. The international community cannot pretend to base itself on the *voluntas* of each State individually. In face of the historical necessity to regulate the relations of the emerging States, Grotius sustained that international relations are subject to legal norms, and not to the "*raison d'État*", which is incompatible with the very existence of the international community: this latter cannot do without Law. (Cf., in this respect, the classical study by Hersch Lauterpacht, "The Grotian Tradition in International Law", 23 *British Year Book of International Law* (1946) pp. 1-53).

⁸⁴. Hersch Lauterpacht, "The Law of Nations, the Law of Nature and the Rights of Man", 29 *Transactions of the Grotius Society* (1943) pp. 7 and 21-31.

⁸⁵. E. Jiménez de Aréchaga, "El Legado de Grocio y el Concepto de un Orden Internacional Justo", in *Pensamiento Jurídico y Sociedad Internacional - Libro-Homenaje al Profesor A. Truyol y Serra*, vol. I, Madrid, Universidad Complutense de Madrid, 1986, pp. 608 and 612-613.

⁸⁶. *Ibid.*, p. 617.

⁸⁷. *Ibid.*, pp. 619-621.

⁸⁸. A. Gómez Robledo, *Fundadores del Derecho Internacional*, Mexico, UNAM, 1989, pp. 48-55.

Naturae et Gentium, 1672), in his turn, defended "the subjection of the legislator to the higher law of human nature and of reason"⁸⁹. On his part, Christian Wolff (author of *Jus Gentium Methodo Scientifica Pertractatum*, 1749), pondered that just as the individuals ought, in their association in the State, promote the common good, in its turn the State has the correlative duty to seek its perfection⁹⁰.

9. Regrettably, the reflections and the vision of the so-called founding fathers of international law, which conceived it as a truly universal system⁹¹, were to be overtaken by the emergence of legal positivism, which, above all as from the XIXth century, personified the State conferring upon it a "will of its own", reducing the rights of the human beings to those that the State "granted" to them. The consent or the "will" of the States (voluntarist positivism) became the criterion predominant in international law, denying *jus standi* to the individuals, to the human beings⁹². This rendered difficult the understanding of the international society, and debilitated the International Law itself, reducing it to an inter-State law, no more *above* but *between* sovereign States⁹³. The disastrous consequences of this distortion are widely known.

10. The great legacy of the juridical thinking of the second half of the XXth century, in my view, has been, by means of the emergence and evolution of the International Law of Human Rights, the rescue of the human being as subject of both domestic and international law, endowed with international juridical capacity⁹⁴. But this advance comes together with new needs of protection, to require new answers on the part of the *corpus juris* of protection itself. This is the case, in our days, of the persons affected by the problems raised in the present advisory procedure before the Inter-American Court of Human Rights.

11. To face these problems, one has, in my understanding, to keep in mind the most valuable legacy of the founding fathers of International Law. Already in the epoch of the elaboration and dissemination of the classic works by F. Vitoria and F. Suárez (*supra*), the *jus gentium* had liberated itself from its origins of private law (of Roman law), so as to apply universally to all human beings: the *societas gentium* was expression of the fundamental unity of the human kind, forming a true *societas ac communicatio*, as no

⁸⁹. *Ibid.*, p. 26.

⁹⁰. César Sepúlveda, *Derecho Internacional*, 13th. ed., Mexico, Ed. Porrúa, 1983, pp. 28-29. Wolff beheld the nation-States as members of a *civitas maxima*, a concept which Emmerich de Vattel (author of *Le Droit des Gens*, 1758), subsequently, invoking the necessity of "realism", intended to replace by a "society of nations" (a less advanced concept); cf. F.S. Ruddy, *International Law in the Enlightenment - The Background of Emmerich de Vattel's Le Droit des Gens*, Dobbs Ferry/N.Y., Oceana, 1975, p. 95; for a criticism to this step backwards (incapable of providing the foundation of the principle of *obligation* in international law), cf. J.L. Briery, *The Law of Nations*, 6th. ed., Oxford, Clarendon Press, pp. 38-40.

⁹¹. C. Wilfred Jenks, *The Common Law of Mankind*, London, Stevens, 1958, pp. 66-69; and cf. also René-Jean Dupuy, *La communauté internationale entre le mythe et l'histoire*, Paris, Economica/UNESCO, 1986, pp. 164-165.

⁹². P.P. Remec, *The Position of the Individual...*, *op. cit. supra* n. (9), pp. 36-37.

⁹³. *Ibid.*, p. 37.

⁹⁴. A.A. Cançado Trindade, *Tratado de Direito Internacional dos Direitos Humanos*, vol. III, Porto Alegre/Brazil, S.A. Fabris Ed., 2003, pp. 447-497.

State was self-sufficient⁹⁵. The new *jus gentium*, thus conceived also to fulfil human needs, paved the way to the conception of a universal international law⁹⁶.

12. The belief came to prevail - expressed in the work of H. Grotius - that it was possible to capture the content of this law by means of reason: natural law, from which the law of nations derived, was a dictate of reason⁹⁷. In the framework of the new universalist conception the *jus communicationis* was affirmed, as from F. Vitoria, erecting the freedom of movement and of commercial exchange as one of the pillars of the international community itself⁹⁸. The controls of the ingress of aliens were to become manifest only in a much more recent historical epoch (cf. par. 35, *infra*), *pari passu* with the great migratory fluxes and the development of the law of refugees and displaced persons⁹⁹.

II. The Disparities of the So-Called "Globalized" World, the Forced Displacements and the Vulnerability of the Migrants.

13. Nowadays, in an era of great migrations, an increasingly greater distance from the universalist ideal of the *societas gentium* of the founding fathers of International Law can regrettably be found. The migrations and the forced displacements, intensified in the decade of the nineties¹⁰⁰, have been characterized particularly by the disparities in the conditions of living between the place of origin and that of destiny of the migrants. Their causes are multiple: economic collapse and unemployment, collapse in the public services (education, health, among others), natural disasters, armed conflicts, repression and persecution, systematic violations of human rights, ethnic rivalries and xenophobia, violence of distinct forms, personal insecurity¹⁰¹.

14. The migrations and forced displacements, with the consequent uprootedness of so many human beings, bring about traumas: suffering of the abandonment of home (at times with family separation or disruption), loss of the profession and of personal goods, arbitrarinesses and humiliations imposed by frontier authorities and security officers, loss of the mother tongue and of the cultural roots, cultural shock and

⁹⁵. P. Guggenheim, "Contribution à l'histoire des sources du droit des gens", 94 *Recueil des Cours de l'Académie de Droit International de La Haye* (1958) pp. 21-22.

⁹⁶. J. Moreau-Reibel, "Le droit de société interhumaine et le *jus gentium* - Essai sur les origines et le développement des notions jusqu'à Grotius", 77 *Recueil des Cours de l'Académie de Droit International de La Haye* (1950) pp. 506-510.

⁹⁷. G. Fourlanos, *Sovereignty and the Ingress of Aliens*, Stockholm, Almqvist & Wiksell, 1986, p. 17.

⁹⁸. *Ibid.*, pp. 19-23, and cf. pp. 79-81.

⁹⁹. Cf. *ibid.*, pp. 160-161 and 174-175.

¹⁰⁰. The forced displacements of the nineties (after the so-called end of the cold war) encompassed roughly nine million persons; UNHCR, *The State of the World's Refugees - Fifty Years of Humanitarian Action*, Oxford, UNHCR/Oxford University Press, 2000, p. 9.

¹⁰¹. N. Van Hear, *New Diasporas - The Mass Exodus, Dispersal and Regrouping of Migrant Communities*, London, UCL Press, 1998, pp. 19-20, 29, 109-110, 141, 143 y 151-252, and cf. p. 260; F.M. Deng, *Protecting the Dispossessed - A Challenge for the International Community*, Washington D.C., Brookings Institution, 1993, pp. 3-20.

permanent feeling of injustice¹⁰². The so-called "globalization" of the economy has been accompanied by the persistence (and in various parts of the world of the aggravation) of the disparities within nations and in the relations among them, it being found, e.g., a remarkable contrast between the poverty of the countries of origin of the migrations (at times clandestine ones) and the incomparably greater resources of the countries sought by the migrants.

15. Migrants, - particularly the undocumented ones, - as pointed out by the Inter-American Court in the present Advisory Opinion n. 18 (pars. 112-113 and 131-132), - are often in a situation of great vulnerability, in face of the risk of precarious employment (in the so-called "informal economy"), of labour exploitation, of unemployment itself and the perpetuation in poverty (also in the receiving country)¹⁰³. The "administrative fault" of indocumentation has been "criminalized" in intolerant and repressive societies, aggravating even further the social problems which they suffer. The drama of the refugees and the undocumented migrants can only be effectively dealt with amidst a spirit of true human solidarity towards the victimized¹⁰⁴. Definitively, only the firm determination of the reconstruction of the international community on the basis of human solidarity can lead to the overcoming of all those traumas.

16. In times of the so-called "globalization" (the misleading and false neologism which is *en vogue* in our days), the frontiers have been opened to the capitals, goods and services, but have sadly closed themselves to human beings. The neologism which suggests the existence of a process which would comprise everyone and in which everyone would participate, in reality hides the fragmentation of the contemporary world, and the social exclusion and marginalization of increasingly greater segments of the population. The material progress of some has been accompanied by the contemporary (and clandestine) forms of labour exploitation of many (the exploitation of undocumented migrants, forced prostitution, traffic of children, forced and slave labour), amidst the proven increase of poverty and social exclusion and marginalization¹⁰⁵.

17. As aggravating circumstances, the State abdicates from its ineluctable social function, and irresponsibly handles to the "market" the essential public services (education and health, among others), transforming them in merchandises to which the access becomes increasingly more difficult for the majority of the individuals. These latter come to be regarded as mere agents of economic production¹⁰⁶, amidst the sad

¹⁰². As Simone Weil warned already in the mid-XXth century, "to be rooted is perhaps the most important and least recognized need of the human soul. It is one of the hardest to define"; S. Weil, *The Need for Roots*, London/N.Y., Routledge, 1952 (reprint 1995), p. 41; and cf. also the considerations by H. Arendt, *La tradition cachée*, Paris, Ch. Bourgeois Éd., 1987 (ed. orig. 1946), pp. 58-59 and 125-127.

¹⁰³. H. Domenach and M. Picouet, *Les migrations*, Paris, PUF, 1995, pp. 58-61, 66 and 111, and cf. pp. 48 and 82-85.

¹⁰⁴. J. Ruiz de Santiago, "Derechos Humanos, Migraciones y Refugiados: Desafíos en los Inicios del Nuevo Milenio", *Memoria del III Encuentro de Movilidad Humana: Migrante y Refugiado*, San José of Costa Rica, ACNUR/IIDH, 2001, pp. 37-72.

¹⁰⁵. Cf., e.g., M. Lengellé-Tardy, *L'esclavage moderne*, Paris, PUF, 1999, pp. 8-13, 21-32 and 73-98.

¹⁰⁶. Already in the mid-XXth century, distinct trends of the philosophical thinking of the time rebelled themselves against the dehumanization of social relations and the depersonalization of the human being,

mercantilization of human relations. Moreover, one detects today, together with an aggravation of the intolerance and xenophobia, a regrettable erosion of the right of asylum¹⁰⁷ (cf. *infra*, pars. 36-42). All these dangerous developments point towards a new world without values, which adheres to, without further reflection, to an unsustainable model.

18. Within the Inter-American Court of Human Rights, in my Concurring Opinion in the case of the *Haitians and Dominicans of Haitian Origin in the Dominican Republic* (Provisional Measures of Protection, Resolution of 18.08.2000) I pointed out that, in this beginning of the XXIst century, "the human being has been placed by himself in a scale of priority inferior to that attributed to the capitals and goods, - in spite of all the struggles of the past, and of all the sacrifices of the previous generations" (par. 4). With the uprootedness, - I proceeded, - one loses his spontaneous means of expression and of communication with the outside world, as well as the possibility of developing a *project of life*: "it is, thus, a problem which concerns the whole human kind, which encompasses the totality of human rights, and, above all, which has a spiritual dimension which cannot be forgotten, with all more reason in the dehumanized world of our days" (par. 6).

19. And, on this first aspect of the problem, I concluded that "the problem of uprootedness ought to be considered in a framework of action oriented towards the eradication of social exclusion and extreme poverty, - if one indeed wishes to reach its causes and not only to fight its symptoms. One ought to develop responses to the new needs of protection, even if they are not literally contemplated in the international instruments in force of protection of the human being" (par. 7). I added my understanding to the effect that "the question of the uprootedness ought to be dealt with not in the light of State sovereignty, but rather as a problem of a truly *global* dimension that it is (requiring a concert at universal level), bearing in mind the obligations *erga omnes* of protection" (par. 10).

20. In spite of the uprootedness being "a problem which affects the whole *international community*", - I kept on warning, -

"continues to be treated in an atomized way by the States, with the outlook of a legal order of a purely inter-State character, without apparently realizing that the Westphalian model of such international order is, already for a long time, definitively exhausted. It is precisely for this reason that the States cannot exempt themselves from responsibility in view of the global character of the uprootedness, since they continue to apply to this latter their own criteria of domestic legal order. (...) The State ought, thus, to respond for the consequences of the practical application of the norms and public policies that it adopts in the matter of migration, and in particular of the procedures of deportations and expulsions" (pars. 11-12).

III. The Reaction of the *Universal Juridical Conscience (Opinio Juris Communis)*.

generated by the technocratic society, which treats the individual as a simple agent of material production; cf., e.g., *inter alia*, Roger Garaudy, *Perspectivas do Homem*, 3rd. ed., Rio de Janeiro, Ed. Civilização Brasileira, 1968, pp. 141-143 and 163-165.

¹⁰⁷. Cf., e.g., F. Crepeau, *Droit d'asile - de l'hospitalité aux contrôles migratoires*, Bruxelles, Bruylant/Éd. Univ. de Bruxelles, 1995, pp. 17-353; Ph. Ségur, *La crise du droit d'asile*, Paris, PUF, 1998, pp. 5-171; A.A. Cançado Trindade and J. Ruiz de Santiago, *La Nueva Dimensión de las Necesidades de Protección del Ser Humano en el Inicio del Siglo XXI*, 2nd. ed., San José of Costa Rica, UNHCR, 2003, pp. 23-123.

21. On this last point, it may be recalled that, in 1986, the International Law Association adopted (in its 62nd. session, in Seoul), by consensus, the Declaration of Principles of International Law on Mass Expulsion, in which, *inter alia*, it expressed its "deep concern" with "the vulnerabilidad and precarious position of many minorities", including migrant workers (preamble). It sustained that the principle of *non-refoulement*, as the "cornerstone of the protection of refugees", is applicable, even if these latter have been legally admitted in the receiving State, and independently of having arrived individually or massively (principle 12). And it urged the States to put an end to any expulsion of a massive character and to establish systems of "early warning" (principle 19)¹⁰⁸. Four years later, the International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families (1990) came to prohibit measures of collective expulsion, and to determine that each case of expulsion should be "examined and decided individually", in accordance with the law (Article 22).

22. Moreover, one ought to underline that the common denominator of the cycle of the World Conferences of the United Nations of the end of the XXth century¹⁰⁹ has been precisely the special attention dedicated to the *conditions of living* of the population (particularly of the vulnerable groups, in special necessity of protection, which certainly include the undocumented migrants), it resulting therefrom the universal recognition of the necessity to place human beings, definitively, in the centre of all process of development¹¹⁰. In the present Advisory Opinion n. 18, the Inter-American Court has taken into account the final documents of two of those Conferences (pars. 116 and 164), namely, the Programme of Action of the International Conference on Population and Development (Cairo, 1994), and the Declaration and Programme of Action of the World Conference against Racism, Racial Discrimination, Xenophobia and Related Intolerance (Durban, 2001).

23. The final documents of the recent World Conferences of the United Nations (held in the period from 1992 until 2001) reflect the reaction of the universal juridical conscience to the attempts against, and affronts to, the dignity of the human person all over the world. In reality, the aforementioned cycle of World Conferences has consolidated the recognition of "the legitimacy of the concern of the whole international community with the violations of human rights everywhere and at any moment"¹¹¹. As I saw it fit to point out in my Concurring Opinion in the Advisory Opinion n. 16 of the Inter-American Court of Human Rights on *The Right to Information on Consular Assistance in the Framework of the Guarantees of the Due Process of Law* (1999),

¹⁰⁸. The Declaration referred to was to relate mass expulsion in given circumstances to the concept of "international crime" (principle 9).

¹⁰⁹. United Nations Conference on Environment and Development, Rio de Janeiro, 1992; II World Conference on Human Rights, Vienna, 1993; International Conference on Population and Development, Cairo, 1994; World Summit for Social Development, Copenhagen, 1995; IV World Conference on Women, Beijing, 1995; II United Nations Conference on Human Settlements, Habitat-II, Istanbul, 1996. To these followed, more recently, the Rome Conference on the Statute of the International Criminal Court, 1998; and the World Conference against Racism, Racial Discrimination, Xenophobia and Related Intolerance, Durban, 2001.

¹¹⁰. A.A. Cançado Trindade, "Desarrollo Humano y Derechos Humanos en la Agenda Internacional del Siglo XXI", in *Memoria - Foro Desarrollo Humano y Derechos Humanos* (August 2000), San José of Costa Rica, UNDP/Inter-American Court of Human Rights, 2001, pp. 25-42.

¹¹¹. A.A. Cançado Trindade, *El Derecho Internacional de los Derechos Humanos en el Siglo XXI*, Santiago, Editorial Jurídica de Chile, 2001, p. 413, and cf. p. 88.

"the very emergence and consolidation of the *corpus juris* of the International Law of Human Rights are due to the reaction of the *universal juridical conscience* to the recurrent abuses committed against human beings, often warranted by positive law: with that, the Law (*el Derecho*) came to the encounter of the human being, the ultimate addressee of its norms of protection" (pars. 3-4).

24. Further on, in the aforementioned Concurring Opinion in the Advisory Opinion n. 16, I mentioned the recognition, in our days, of the necessity to reconstitute to the human being the central position, "as *subject of domestic as well as international law*" (par. 12), and added:

- "With the demystification of the postulates of voluntarist positivism, it became evident that one can only find an answer to the problem of the foundations and the validity of general international law in the *universal juridical conscience*, starting with the assertion of the idea of an objective justice. As a manifestation of this latter, the rights of the human being have been affirmed, emanating directly from international law, and not subjected, thereby, to the vicissitudes of domestic law" (par. 14).

25. In fact, the atrocities and abuses which have victimized in the last decades millions of human beings everywhere, increasing the contingents of refugees, displaced persons and undocumented migrants in search of survival, have definitively awakened the *universal juridical conscience* for the pressing need to reconceptualize the very bases of the international legal order. But it is urgently necessary, in our days, to stimulate this awakening of the *universal juridical conscience* to intensify the process of humanization of contemporary international law¹¹². Also in the case *Bámaca Velásquez versus Guatemala* (Judgment as to the merits, of 25 November 2000), I saw it fit to insist on the point; in my Separate Opinion, I reaffirmed that:

"(..) the existence of a *universal juridical conscience* (corresponding to the *opinio juris comunis*) (...) constitutes, in my understanding, the *material source par excellence* (beyond the formal sources) of the whole law of nations (*droit des gens*), responsible for the advances of the human kind not only at the juridical level but also at the spiritual one" (par. 16, and cf. par. 28).

26. There is pressing need to seek, therefrom, the reconstruction of the law of nations, in this beginning of the XXIst century, on the basis of a new paradigm, no longer State-centered, but rather placing the human being in a central position¹¹³ and bearing in mind the problems which affect the humanity as a whole. The existence of the human person, which has its root in the spirit, was the point of departure, e.g., of the reflections of Jacques Maritain, to whom the true progress meant the *ascent of conscience*, of the equality and communion of all in human nature, thus accomplishing

¹¹². As I stressed in my already mentioned Concurring Opinion in the case of the *Haitians and Dominicans of Haitian Origin in the Dominican Republic* (Provisional Measures of Protection, 2000) before the Inter-American Court (par. 12).

¹¹³. It is a true reconstruction; more than half a century ago, Maurice Bourquin warned that "ni au point de vue de son objet, ni même au point de vue de sa structure, le droit des gens ne peut se définir comme un droit inter-étatique. (...) L'être humain (...) y occupe une place de plus en plus considérable"; M. Bourquin, "L'humanisation du droit des gens", in *La technique et les principes du Droit public - Études en l'honneur de Georges Scelle*, vol. I, Paris, LGDJ, 1950, pp. 53-54.

the common good and justice¹¹⁴. The conceptual evolution examined herein gradually moved, as from the sixties, from the *international* to the *universal* dimension, under the great influence of the development of the International Law of Human Rights itself. The recognition of certain fundamental *values*, on the basis of a sense of objective justice, has much contributed to the formation of the *opinio juris communis*¹¹⁵ in the last decades of the XXth century, which one ought to keep on developing in our days in order to face the new necessities of protection of the human being.

27. Despite the fact that the international legal order of this beginning of the XXIst century is, in fact, far too distant from the ideals of the founding fathers of the *droit des gens* (*supra*), instead of capitulating before this reality, one has rather to face it. It could be argued that the contemporary world is entirely distinct from that of the epoch of F. Vitoria, F. Suárez and H. Grotius, who supported a *civitas maxima* ruled by the *droit des gens*, the new *jus gentium* reconstructed by them. But even if one is before two different world scenarios (no one would deny it), the human aspiration is the same, that is, that of the construction of an international order applicable both to the States (and international organizations) and to human beings (the *droit des gentes*), in conformity with certain universal standards of justice, without whose observance there cannot be social peace. One has, thus, to endeavour in a true *return to the origins* of the law of nations, whereby the current historical process of *humanization* of International Law will be fostered.

28. If it is certain that the drama of the numerous refugees, displaced persons and undocumented migrants presents today an enormous challenge to the labour of international protection of the rights of the human person, it is also certain that the reactions to the violations of their fundamental rights are today immediate and forceful, by virtue precisely of the awakening of the universal juridical conscience for the necessity of prevalence of the dignity of the human person in any circumstances. The emergence and assertion of *jus cogens* in contemporary International Law (cf. *infra*) constitute, in my view, an unequivocal manifestation of this awakening of the universal juridical conscience.

29. In the course of the procedure before the Inter-American Court of Human Rights pertaining to the present Advisory Opinion, the requesting State, Mexico, singled out with pertinence the importance of the so-called *Martens clause* as an element of interpretation of Law (above all humanitarian), which could also provide support to the migrants. In this respect, I believe it possible to go even further: at least one trend of the contemporary legal doctrine has come to characterize the Martens clause as *source* of general international law itself¹¹⁶; and no one would dare today to deny that the

¹¹⁴. J. Maritain, *Los Derechos del Hombre y la Ley Natural*, Buenos Aires, Ed. Leviatan, 1982 (reprint), pp. 12, 18, 38, 43 and 94-96, and cf. p. 69. The liberation from material servitudes was necessary, for the development above all of the life of the spirit; in his vision, humankind only progresses when it advances towards human emancipation (*ibid.*, pp. 50 and 105-108). In affirming that "the human person transcends the State", as it has "a destiny superior to time", he added that "each human person has the right to decide by herself as to what concerns her personal destiny (...)" (*ibid.*, pp. 79-82, and cf. p. 104).

¹¹⁵. Maarten Bos, *A Methodology of International Law*, Amsterdam, North-Holland, 1984, p. 251, and cf. pp. 246 and 253-255.

¹¹⁶. F. Münch, "Le rôle du droit spontané", in *Pensamiento Jurídico y Sociedad Internacional - Libro-Homenaje al Profesor Dr. A. Truyol Serra*, vol. II, Madrid, Universidad Complutense, 1986, p. 836.

"laws of humanity" and the "dictates of the public conscience" invoked by the Martens clause belong to the domain of *jus cogens*¹¹⁷. The aforementioned clause, as a whole, has been conceived and reiteratedly affirmed, ultimately, to the benefit of the whole human kind, remaining thus quite up-to-date. It can be considered, - as I have affirmed in a recent work, - as expression of the *raison de l'humanité* imposing limits to the *raison d'État*¹¹⁸.

30. One of the significant contributions of the present Advisory Opinion n. 18 on *The Juridical Condition and the Rights of the Undocumented Migrants* lies in its determination of the wide scope of the due process of law (par. 124). In its earlier Advisory Opinion n. 16 on *The Rights to Information on Consular Assistance in the Framework of the Guarantees of the Due Process of Law*, the Inter-American Court underlined the historical evolution of the due process of law in the sense of its expansion *ratione materiae* (pars. 117 and 119), whilst, in the present Advisory Opinion n. 18, it examines such expansion *ratione personae*, and determines that "the right to the due process ought to be recognized in the framework of the minimal guarantees which ought to be granted to every migrant, irrespective of its migratory status" (par. 122). The correct conclusion of the Court, in the sense that "the wide scope of the intangibility of the due process comprises all matters and all persons, without any discrimination" (resolatory point n. 7), fulfills effectively the exigencies and the imperatives of the common good.

III. The Construction of the Individual Subjective Right to Asylum.

31. The very notion of the common good ought to be considered not in relation to a social *milieu in abstracto*, but rather to the totality of human beings who compose it, irrespectively of the political or migratory status of each one. Human rights much transcend the so-called "rights of the citizenship", "granted" by the State. The common good, as Jacques Maritain used to rightly sustain, is erected upon the *human person* herself (rather than individuals or citizens), and the concept of personality encompasses the deepest dimension of the being or of the spirit¹¹⁹. The common good is "common" because it projects and reflects itself in the *human persons*¹²⁰. If it were require of certain individuals to capitulate before the social whole, to deprive themselves of the rights which are inherent to them (as a result, e.g., of their political or migratory status), to entrust their destiny entirely to the artificial social whole, in such circumstances the very notion of common good would completely disappear¹²¹.

¹¹⁷. S. Miyazaki, "The Martens Clause and International Humanitarian Law", *Études et essais sur le Droit international humanitaire et sur les principes de la Croix-Rouge en l'honneur de J. Pictet* (ed. Christophe Swinarski), Genève/La Haye, ICRC/Nijhoff, 1984, pp. 438 and 440.

¹¹⁸. A.A. Cançado Trindade, *Tratado de Direito Internacional...*, *op. cit. supra* n. (21), vol. III, p. 509, and cf. pp. 497-509.

¹¹⁹. J. Maritain, *The Person and the Common Good*, Notre Dame, University of Notre Dame Press, 2002 [reprint], pp. 29-30, 40 and 105.

¹²⁰. *Ibid.*, pp. 49, 76 and 103-104. Any understanding to the contrary would most probably lead to abuses (proper of authoritarianism and of the repressive regimes) and violations of human rights; *ibid.*, p. 50, and cf. pp. 95-97.

¹²¹. Cf. *ibid.*, pp. 92-93.

32. In spite of the recognition nowadays of the right to *emigrate*, as a corollary of the right to freedom of movement, the States have not yet recognized the correlative right to *immigrate*, creating thus a situation which has generated incongruencies and arbitrarinesses, very often affecting negatively the due process of law¹²². In perpetuating, in this way, the uncertainties and inconsistencies, the States responsible for this situation have failed to act at the level of their responsibilities as subjects of International Law, the *droit des gens*. And have created more problems not only for numerous individuals directly affected but also, ultimately, for themselves, in contributing indirectly to the formation of the fluxes of "illegal" immigrants.

33. On the other hand, there are also the States which have sought solutions to the problem. The fact that 12 accredited States participated in the advisory procedure before the Inter-American Court which preceded the adoption of the present Advisory Opinion on *The Juridical Condition and the Rights of the Undocumented Migrants* is symptomatic of the common purpose of the search for such solutions. From the analysis of the arguments presented, throughout the procedure referred to, by Mexico, Honduras, Nicaragua, El Salvador, Costa Rica and Canada, one detects, in a reassuring way, as common denominator, the recognition that the States have the obligation to respect and to ensure respect for the human rights of all persons under their respective jurisdictions, in the light of the principle of equality and non-discrimination, irrespectively of whether such persons are nationals or foreigners.

34. Moreover, in the same procedure before the Inter-American Court pertaining to the present Advisory Opinion, the United Nations High Commissioner for Refugees (UNHCR), in emphasizing the situation of vulnerability of the migrants, referred to the existing link between migration and asylum, and added with lucidity that the nature and complexity of the contemporary displacements render it difficult to establish a clear line of distinction between refugees and migrants. This situation, encompassing millions of human beings¹²³, reveals a new dimension of the protection of the human being in certain circumstances, and underlines the capital importance of the fundamental principle of equality and non-discrimination, to which I shall refer further on (cf. pars. 58-63, *infra*).

35. It is, in reality, a great challenge to the safeguard of the rights of the human person in our days, at this beginning of the XXIst century. In this respect, it is not to pass unnoticed that, as already pointed out, the *jus communicationis* and the freedom of movement, proclaimed since the XVIth and XVIIth centuries, lasted for a long time, and only in a much more recent historical epoch restrictions to them began to manifest themselves (cf. par. 9, *supra*). In fact, only in the second half of the XIXth century, when *immigration* definitively penetrated in the sphere of *domestic* law, it came to suffer successive and systematic restrictions¹²⁴. Hence the growing importance of the prevalence of certain rights, as the right of access to justice (the right to justice *lato sensu*), the right to private and family life (comprising family unity), the right not to be subjected to cruel, inhuman and degrading treatment; this is a theme which transcends

¹²². A.A. Cançado Trindade, *Elementos para un Enfoque de Derechos Humanos del Fenómeno de los Flujos Migratorios Forzados*, *op. cit. infra* n. (105), pp. 15-16 and 18.

¹²³. Cf. notes (3) and (27), *supra*.

¹²⁴. F. Rigaux, "L'immigration: droit international et droits fondamentaux", in *Les droits de l'homme au seuil du troisième millénaire - Mélanges en hommage à P. Lambert*, Bruxelles, Bruylant, 2000, pp. 693-696.

the purely State or inter-State dimension¹²⁵, and that has to be approached in the light of the fundamental human rights of the migrant workers, including the undocumented ones.

36. Nor is it to pass unnoticed, in the present context, the more lucid doctrine which led, in the past, to the configuration of the institute of the territorial asylum. In fact, the *historia juris* of the institute of asylum has been marked by the tension between its characterization as a discretionary faculty of the State, or rather as a subjective individual right. It is not my purpose to begin to examine in depth this institute in the present Concurring Opinion, but rather to refer to a pertinent aspect of the matter object of the present Advisory Opinion of the Inter-American Court. In recent years, with the growing restrictions in the use by the States of the self-attributed faculty of migratory control, it is the first trend which seems *de facto* to prevail¹²⁶, to the detriment of the thesis of the subjective individual right.

37. One may recall that the frustrated Conference of the United Nations on Territorial Asylum, held in Geneva in 1977, did not succeed to obtain a universal consensus as to the asylum as an individual right, and, ever since, State unilateralism has become synonymous of the precariousness of asylum¹²⁷. The "protectionist" measures of the industrialized States (in relation to "undesirable" migratory fluxes) have moved away from the best legal doctrine and generated distortions in the practice relating to the institute of asylum¹²⁸.

38. Nevertheless, the International Law of Human Rights has reacted to respond to the new necessities of protection. And it is perfectly possible that we are witnessing the beginnings of formation of a true *human right to the humanitarian assistance*¹²⁹. We are before two distinct approaches to the international legal order, one centered in the State, the other (which I firmly sustain) centred in the human person. It would be in conformity with this latter the characterization of the right of asylum as a subjective individual right. The *corpus juris* of the International Law of Human Rights contains, in

¹²⁵. *Ibid.*, pp. 707-708, 710-713, 717-720 and 722.

¹²⁶. In this, as in other areas of the international legal order, an underlying and recurring tension has persisted between the conventional obligations in force, undertaken by the States and the insistence of these latter on keeping on searching for themselves the satisfaction of their own interests, as perceived by them. Cf., e.g., J.-G. Kim and J.M. Howell, *Conflict of International Obligations and State Interests*, The Hague, Nijhoff, 1972, pp. 68 and 112.

¹²⁷. Ph. Ségur, *La crise du droit d'asile*, *op. cit. supra* n. (34), pp. 107 and 140. - On the frustrated Conference on Territorial Asylum of 1977, cf. the report "Diplomatic Conference on Territorial Asylum", 18 *Review of the International Commission of Jurists* (June 1977) pp. 19-24; and cf. P. Weis, "The Present State of International Law on Territorial Asylum", 31 *Schweizerisches Jahrbuch für internationales Recht/Annuaire suisse de Droit international* (1975) pp. 71-96.

¹²⁸. F. Crepeau, *Droit d'asile - de l'hospitalité aux contrôles migratoires*, *op. cit. supra* n. (34), pp. 306-317, 324-330 and 335-339.

¹²⁹. Cf. Inter-American Court of Human Rights, case of the *Communities of the Jiguamiandó and of the Curbaradó*, Provisional Measures of Protection of 06.03.2003, Concurring Opinion of Judge A.A. Cançado Trindade, par. 6.

fact, elements which can lead to the construction (or rather the reconstruction) of a true individual right to asylum¹³⁰.

39. It ought to be kept in mind that the institute of asylum is much wider than the meaning attributed to asylum in the ambit of Refugee Law (i.e., amounting to refuge). Furthermore, the institute of asylum (general kind to which belongs the type of territorial asylum, in particular) precedes historically for a long time the *corpus juris* itself of Refugee Law. The *aggiornamento* and a more integral comprehension of territorial asylum, - which could be achieved as from Article 22 of the American Convention on Human Rights, - could come in aid of the undocumented migrant workers, putting an end to their clandestine and vulnerable situation. To that end, it would have to be (or again to become) recognized precisely as a subjective individual right¹³¹, and not as a discretionary faculty of the State.

40. Likewise, as to the refugees, one "recognizes", rather than "grants", their statute; it is not a simple "concession" on the part of the States. Nevertheless, the terminology nowadays commonly employed is a reflection of the steps backwards which we regrettably witness. For example, there are terms, like "temporary protection", which seem to imply a relativization of the integral protection granted in the past. Other terms (e.g., "refugees in orbit", "displaced persons in transit", "safe havens", "convention plus") seem to be endowed with a certain degree of surrealism, appearing frankly open to all sorts of interpretation (including the retrograde one), instead of attaching to that which is essentially juridical and to the conquests of law in the past. It is perhaps symptomatic of our days that one has to invoke the conquests of the past in order to stop or avoid even greater steps backwards in the present and in the future. At this moment - of shadows, rather than light - in which we live, one has at least to preserve the advances achieved by past generations in order to avoid a greater evil.

41. It is not to be forgotten, thus, that there have been doctrinal manifestations which sustain the process of gradual formation of the individual right of asylum, at the same time that they affirm the character of *jus cogens* of the principle of *non-refoulement*¹³². This posture appears in accordance with the thinking of the founding fathers of International Law: while Francisco de Vitoria sustained the *jus communicationis*, Francisco Suárez, in the same line of thinking, visualized a "subjective

¹³⁰. Cf., e.g., Universal Declaration of Human Rights, Article 14(1); American Convention on Human Rights, Article 22(7); OAU Convention (of 1969) Governing Specific Aspects of the Refugee Problems in Africa, Article II(1) and (2).

¹³¹. In the same year of the adoption of the Universal Declaration of Human Rights of 1948, whilst discussions within the *Institut de Droit International* were taking place as to whether asylum was a right of the State or of the individual (cf. *Annuaire de l'Institut de Droit International* (1948) pp. 199-201 and 204-205), in face of the uncertainties manifested G. Scelle commented that "asylum had become a question of universal *ordre public*" (*ibid.*, p. 202). Two years later, the theme was again discussed in the same *Institut* (in the debates of 07-08.09.1950): on the basis of the impact of human rights in International Law (cf. *Annuaire de l'Institut de Droit International* (1950)-II, p. 228), the possibility was raised of the establishment *de lege ferenda* of an obligation of the States to grant asylum. Despite a certain opposition to the idea, fortunately there were those jurists who supported the establishment of such State obligation, or at least who took it seriously; cf. *ibid.*, pp. 204 and 221 (F. Castberg), p. 200 (H. Lauterpacht), pp. 204-205 (P. Guggenheim), and p. 225 (A. de La Pradelle).

¹³². G. Furlanos, *Sovereignty and the Ingress of Aliens*, *op. cit. supra* n. (24), pp. 143-144, 146, 149 and 172-173.

natural right", proper of the *jus gentium*, in a sense comparable to that utilized in our days¹³³ in the conceptual universe of the International Law of Human Rights.

42. There will of course always be the "realists" who will object that the subjective individual right of asylum is an utopia. To them I would retort that the alternative to utopia is desperation. More than three decades ago (and the situation of the millions of uprooted persons has only aggravated ever since) L. Legaz y Lacambra warned that:

"The existence of 'proletarian peoples' amounts to a nonsense if the idea of an international community is affirmed; and, above all, it constitutes an injustice when there already are peoples who have achieved a phase of maximum development and economic, social and cultural level, which sharply contrasts with the situation of misery of so many others. [...There is an] obligation of the international community towards their more destitute and needed members who, in this dimension, embody also the idea of the humanity as subject of Law.

Thus, in the evolution of Law, a human - humanist and humanitarian (...) - sense becomes evident: it ceases to be a coercive order of the State and it incorporates more and more some forms of social life open to the growing communication between all men (...). All that, and only that, is what gives meaning to the juridical personalization and subjectivization of humankind"¹³⁴.

43. In his biography of Erasmus of Rotterdam (1467-1536), Stefan Zweig, one of the more lucid writers of the XXth century, singled out, in the precious legacy of the great humanist, the tolerance, to put and end, without violence, to the conflicts which divide the human beings and the peoples. Erasmus, pacifist and defender of the freedom of conscience, identified in the intolerance the hereditary evil of human society, which should be eradicated. Although the ideal of Erasmus has not been accomplished until now, it was not thereby devoid of value. In the penetrating words of S. Zweig,

"An idea which does not come to be materialized is, for that reason, invincible, since it is no longer possible to prove its falseness; that which is necessary, even though its realization is delayed, not therefore is less necessary; quite on the contrary, only the ideals which have not become worn-out and committed by the realization continue acting in each generation as an element of moral impulse. Only the ideas which have not been complied with return eternally. (...) What Erasmus, the disillusioned old man, and, notwithstanding, not excessively disillusioned, left to us as legacy (...) was not anything else but the renewed and dreamed of very old wish of all the religions and myths of a future and continued humanization of humanity and of a triumph of the reason (...). And even if the cautious and cold calculating persons can turn to demonstrate always the lack of future of erasmism, and even if the reality seems to give them each time the reason, those spirits will always be necessary who point out that which links among themselves the peoples beyond that which separates them and that renews faithfully, in the heart of humankind, the idea of a future age of a higher human feeling"¹³⁵.

¹³³. *Ibid.*, p. 23.

¹³⁴. L. Legaz y Lacambra, "La Humanidad, Sujeto de Derecho", in *Estudios de Derecho Internacional Público y Privado - Homenaje al Profesor L. Sela Sampil*, vol. II, Oviedo, University of Oviedo, 1970, pp. 558-559.

¹³⁵. S. Zweig, *Triunfo y Tragedia de Erasmo de Rotterdam*, 5th. ed., Barcelona, Ed. Juventud, 1986, pp.

IV. The Position and Role of the General Principles of Law.

44. Every legal system has fundamental principles, which inspire, inform and conform their norms. It is the principles (derived etymologically from the Latin *principium*) that, evoking the first causes, sources or origins of the norms and rules, confer cohesion, coherence and legitimacy upon the legal norms and the legal system as a whole. It is the general principles of law (*prima principia*) which confer to the legal order (both national and international) its ineluctable axiological dimension; it is they that reveal the values which inspire the whole legal order and which, ultimately, provide its foundations themselves. This is how I conceive the presence and the position of the principles in any legal order, and their role in the conceptual universe of Law.

45. The general principles of law entered into the legal culture, with historical roots which go back, e.g., to Roman law, and came to be linked to the very conception of the democratic State under the rule of law (*Estado democrático de Derecho*), above all as from the influence of the enlightenment thinking (*pensée illuministe*). Despite the apparent indifference with which they were treated by legal positivism (always seeking to demonstrate a "recognition" of such principles in the positive legal order), and despite the lesser attention dispensed to them by the shallow and reductionist legal doctrine of our days, nevertheless we will never be able to prescind from them.

46. From the *prima principia* the norms and rules emanate, which in them find their meaning. The principles are thus present in the origins of Law itself. The principles show us the legitimate ends to seek: the common good (of all human beings, and not of an abstract collectivity), the realization of justice (at both national and international levels), the necessary primacy of law over force, the preservation of peace. Contrary to those who attempt - in my view in vain - minimize them, I understand that, if there are no principles, nor is there truly a legal system. Without the principles, the "legal order" simply is not accomplished, and ceases to exist as such.

47. The identification of the basic principles has accompanied *pari passu* the emergence and consolidation of all the domains of Law, and all its branches (civil, civil procedural, criminal, criminal procedural, administrative, constitutional, and so forth). This is so with Public International Law¹³⁶, with the International Law of Human Rights, with International Humanitarian Law¹³⁷, with the International Law of Refugees¹³⁸, with International Criminal Law¹³⁹. However circumscribed or specialized a legal regime may

205-207; S. Zweig, *Érasme - Grandeur et décadence d'une idée*, Paris, Grasset, 2002 (reed.), pp. 183-185.

¹³⁶. E.g., principle of the prohibition of the use or threat of force, principle of the peaceful settlement of international disputes, principle of non-intervention in inter-State relations, principle of the juridical equality of the States, principle of the equality of rights and the self-determination of peoples, principle of good faith in the compliance with the international obligations, principle of international cooperation. Cf. A.A. Cançado Trindade, *O Direito Internacional em um Mundo em Transformação*, Rio de Janeiro, Edit. Renovar, 2002, pp. 91-140.

¹³⁷. Principle of humanity, principle of proportionality, principle of distinction (between combatants and the civil population), principle whereby the election of methods or means of combat is not illimited, principle which requires avoiding unnecessary sufferings or superfluous evils.

¹³⁸. Principle of *non-refoulement*, principle of humanity.

¹³⁹. Principle of legality (*nullum crimen sine lege, nulla poena sine lege*), principle of individual penal

be, its basic principles can there be found, as, e.g., in International Environmental Law¹⁴⁰, in the Law of the Sea¹⁴¹, in the Law of Outer Space¹⁴², among many others. As pointed out before the Inter-American Court of Human Rights during the procedure pertaining to the present Advisory Opinion on *The Legal Condition and the Rights of the Undocumented Migrants*, the International Labour Organization (ILO) itself has sought to identify the "fundamental principles and rights in work", by means of a Declaration adopted in June 1998.

48. Some of the basic principles are proper of certain areas of Law, others permeate all areas. The *corpus* of legal norms (national or international) operates moved by the principles, some of them ruling the relations themselves between human beings and the public power (as the principles of natural justice, of the rule of law [*Estado del Derecho*], of the rights of the defence, of the right to the natural judge, of the independence of justice, of the equality of all before the law, of the separation of powers, among others). The principles enlighten the path of the legality and the legitimacy. Hence the continuous and eternal "rebirth" of natural law, which has never disappeared.

49. It is no longer a return to the classic natural law, but rather the affirmation or restoration of a standard of justice, heralded by the general principles of law, whereby positive law is evaluated¹⁴³. In sustaining that *opinio juris* is above the will of the State, F. Castberg has correctly pondered that:

"the experiences of our own age, with its repellent cruelties and injustice under cover of positive law, have in fact confirmed the conviction that something - even though it is only certain fundamental norms - must be objectively valid. This may consist of principles which appear to be valid for every human community at any time (...). The law can and should itself move forward in the direction of greater expedience and justice, and to a higher level of humanity"¹⁴⁴.

responsibility, principle of the presumption of innocence, principle of non-retroactivity, principle of a fair trial.

¹⁴⁰. E.g., principle of precaution or due diligence, principle of prevention, principle of the common but differentiated responsibility, principle of intergenerational equity, polluter-pay principle.

¹⁴¹. E.g., principle of the common heritage of mankind (ocean floors), principle of the peaceful uses of the sea, principle of the equality of rights (in the high seas), principle of the peaceful settlement of disputes, principles of the freedom of navigation and of innocent passage, principles of equidistance and of special circumstances (delimitation of maritime spaces).

¹⁴². E.g., principle of non-appropriation, principle of the peaceful uses and ends, principle of the sharing of benefits in space exploration.

¹⁴³. C.J. Friedrich, *Perspectiva Histórica da Filosofia do Direito*, Rio de Janeiro, Zahar Ed., 1965, pp. 196-197, 200-201 and 207; and cf., in general, e.g., Y.R. Simon, *The Tradition of Natural Law - A Philosopher's Reflections* (ed. V. Kuic), N.Y., Fordham Univ. Press, 2000 [reprint], pp. 3-189; A.P. d'Entrèves, *Natural Law*, London, Hutchinson Univ. Library, 1972 [reprint], pp. 13-203.

¹⁴⁴. F. Castberg, "Natural Law and Human Rights", 1 *Revue des droits de l'homme / Human Rights Journal* (1968) p. 37, and cf. pp. 21-22.

This "eternal return" to jusnaturalism has been, thus, recognized by the jusinternationalists themselves¹⁴⁵, much contributing to the affirmation and consolidation of the primacy, in the order of the values, of the obligations pertaining to human rights, *vis-à-vis* the international community as a whole¹⁴⁶. What is certain is that there is no Law without principles, which inform and conform the legal norms and rules.

50. To the extent that a new *corpus juris* is formed, one ought to fulfill the pressing need of identification of its principles. Once identified, these principles ought to be observed, as otherwise the application of the norms would be replaced by a simple rhetoric of "justification" of the "reality" of the facts; if there is truly a legal system, it ought to operate on the basis of its fundamental principles, as otherwise we would be before a legal vacuum, before the simple absence of a legal system¹⁴⁷.

51. The general principles of law have contributed to the formation of normative systems of protection of the human being. The recourse to such principles has taken place, at the substantive level, as a response to the new necessities of protection of the human being. No one would dare to deny their relevance, e.g., in the historical formation of the International Law of Refugees, or, more recently, in the emergence, in recent years, of the international normative framework pertaining to the (internally) displaced persons¹⁴⁸. No one would dare to deny their incidence - to quote another example - in the legal regime applicable to foreigners. In this respect, it has been suggested that certain general principles of law apply specifically or predominantly to foreigners, e.g., the principle of the unity of the family, and the principle of the prohibition of extradition whenever this latter presents risks of violations of human rights¹⁴⁹.

¹⁴⁵. Cf., e.g., L. Le Fur, "La théorie du droit naturel depuis le XVIIe. siècle et la doctrine moderne", 18 *Recueil des Cours de l'Académie de Droit International de La Haye* (1927) pp. 297-399; A. Truyol y Serra, "Théorie du Droit international public - Cours général", 183 *Recueil des Cours de l'Académie de Droit International de La Haye* (1981) pp. 142-143; A. Truyol y Serra, *Fundamentos de Derecho Internacional Público*, 4th. rev. ed., Madrid, Tecnos, 1977, pp. 69 and 105; J. Puente Egido, "Natural Law", in *Encyclopedia of Public International Law* (ed. R. Bernhardt/Max Planck Institute), vol. 7, Amsterdam, North-Holland, 1984, pp. 344-349.

¹⁴⁶. J.A. Carrillo Salcedo, "Derechos Humanos y Derecho Internacional", 22 *Isegoría - Revista de Filosofía Moral y Política* - Madrid (2000) p. 75.

¹⁴⁷. G. Abi-Saab, "Cours général de Droit international public", 207 *Recueil des Cours de l'Académie de Droit International de La Haye* (1987) p. 378: "soit il existe un système normatif, et dans ce cas il doit être apte à remplir sa tâche, soit il n'y a pas de système de tout".

¹⁴⁸. Cf. W. Kälin, *Guiding Principles on Internal Displacement - Annotations*, Washington D.C., ASIL/Brookings Institution, 2000, pp. 6-74; and cf. F.M. Deng, *Protecting the Dispossessed - A Challenge for the International Community*, Washington D.C., Brookings Institution, 1993, pp. 1-148.

¹⁴⁹. C. Pierucci, "Les principes généraux du droit spécifiquement applicables aux étrangers", 10 *Revue trimestrielle des droits de l'homme* (1999) n. 37, pp. 8, 12, 15, 17, 21, 24 and 29-30. Among such principles, applicable to foreigners, there are those set forth initially at international level (e.g., in the framework of the law of extradition, and the law of asylum and or refuge) which have projected at the level of domestic law; cf. *ibid.*, pp. 7-32, esp. pp. 8, 15-21 and 30-32.

V. The Fundamental Principles as *Substratum* of the Legal Order Itself.

52. The general principles of law have thus inspired not only the interpretation and the application of the legal norms, but also the law-making process itself of its elaboration. They reflect the *opinio juris*, which, in its turn, lies on the basis of the formation of Law¹⁵⁰, and is decisive for the configuration of the *jus cogens*¹⁵¹ (cf. *infra*). Such principles mark presence at both national and international levels. If, in the framework of this latter, one has insisted, in the chapter of the (formal) "sources" of international law on the general principles "recognized" *in foro domestico*, this was due to an endeavour to proceed with juridical security¹⁵², as such principles are present in every and any legal system (cf. *supra*), at national or international levels. In sum, in every legal system (of domestic or international law) the general principles mark presence, assuring its coherence and disclosing its axiological dimension. When one moves away from the principles, one incurs into distortions, and grave violations of the legal order including the positive one.

53. There are general principles of law which appear truly *fundamental*, to the point of identifying themselves with the very foundations of the legal system¹⁵³. Such fundamental principles reveal the values and ultimate ends of the international legal order, guide it and protect it against the incongruencies of the practice of States, and fulfill the necessities of the international community¹⁵⁴. Such principles, as expression of the "idea of justice", have a universal scope; they do not emanate from the "will" of the States, but are endowed with an objective character which impose them to the observance of all the States¹⁵⁵. In this way, - as lucidly points out A. Favre, - they secure the unity of Law, as from the idea of justice, to the benefit of the whole humanity¹⁵⁶.

¹⁵⁰. On the wide scope of the *opinio juris* in the formation of contemporary International Law, cf. A.A. Cançado Trindade, "A Formação do Direito Internacional Contemporâneo: Reavaliação Crítica da Teoria Clássica de Suas `Fontes'", 29 *Curso de Derecho Internacional Organizado por el Comité Jurídico Interamericano* (2002) pp. 54-57, and cf. pp. 51-65.

¹⁵¹. B. Simma, "International Human Rights and General International Law: A Comparative Analysis", 4 *Collected Courses of the Academy of European Law - Florence* (1993)-II, pp. 226-229.

¹⁵². *Ibid.*, p. 224.

¹⁵³. G. Cohen-Jonathan, "Le rôle des principes généraux dans l'interprétation et l'application de la Convention Européenne des Droits de l'Homme", in *Mélanges en hommage à L.E. Pettiti*, Bruxelles, Bruylant, 1998, pp. 192-193; F. Sudre, "Existe t-il un ordre public européen?", in *Quelle Europe pour les droits de l'homme?*, Bruxelles, Bruylant, 1996, pp. 57-59.

¹⁵⁴. M. Koskenniemi, "General Principles: Reflexions on Constructivist Thinking in International Law", in *Sources of International Law* (ed. M. Koskenniemi), Aldershot, Ashgate/Dartmouth, 2000, pp. 360-365, 377, 381, 387, 390 and 395-398.

¹⁵⁵. A. Favre, "Les principes généraux du droit, fonds commun du Droit des gens", in *Recueil d'études de Droit international en hommage à Paul Guggenheim*, Genève, IUHEI, 1968, pp. 374-374, and cf. p. 369.

¹⁵⁶. *Ibid.*, pp. 375-376, and cf. p. 379.

54. It is evident that these principles of law do not depend on the "will", nor on the "agreement", nor on the consent, of the subjects of law; the fundamental rights of the human person being the "necessary foundation of every legal order", which knows no frontiers, the human being is *titulaire* of inalienable rights, which do not depend on his statute of citizenship or any other circumstance¹⁵⁷. In the domain of the International Law of Human Rights, an example of general principles of law lies in the *principle of the dignity of the human being*; another lies in that of the *inalienability of the rights inherent to the human being*. In the present Advisory Opinion on *The Juridical Condition and the Rights of the Undocumented Migrants*, the Inter-American Court has expressly referred to both principles (par. 157).

55. Moreover, in its *jurisprudence constante*, the Inter-American Court, in interpreting and applying the American Convention, has also always resorted to the general principles of law¹⁵⁸. Among these principles, those which are endowed with a truly fundamental character, which I here refer to, in reality form the *substratum* of the legal order itself, revealing the *right to the Law* of which are *titulaires* all human beings¹⁵⁹, independently of their statute of citizenship or any other circumstance. And it could not be otherwise, as human rights are universal and inherent to all human beings, while the rights of citizenship vary from country to country and encompass only those which the positive law of the State considers citizens, not protecting, thus, the undocumented migrants. As vehemently proclaimed, in a rare moment of enlightenment, the Universal Declaration of Human Rights of 1948 (Article 1),

- "All human beings are born free and equal in dignity and rights. They are endowed with reason and conscience and should act towards one another in a spirit of brotherhood".

56. The safeguard and prevalence of the principle of respect of the dignity of the human person human are identified with the end itself of Law, of the legal order both national and international. By virtue of this fundamental principle, every person ought to be respected by the simple fact of belonging to the human kind, independently of her condition, of her statute of citizenship, or any other circumstance¹⁶⁰. The principle of the inalienability of the rights inherent to the human being, in its turn, is identified with a basic premise of the construction of the whole *corpus juris* of the International Law of Human Rights.

¹⁵⁷. *Ibid.*, pp. 376-380, 383, 386 and 389-390.

¹⁵⁸. Cf. Inter-American Court of Human Rights (IACtHR), case of the *Five Pensioners versus Peru* (Judgment of 28.02.2003), par. 156; IACtHR, case *Cantos versus Argentina* (Prel. Obj., Judgment of 07.09.2001), par. 37; IACtHR, case *Baena Ricardo and Others versus Panama* (Judgment of 02.02.2001), par. 98; IACtHR, case *Neira Alegría versus Peru* (Prel. Obj., Judgment of 11.12.1991), par. 29; IACtHR, case *Velásquez Rodríguez versus Honduras* (Judgment of 29.07.1988), par. 184; and cf. also IACtHR, Advisory Opinion n. 17, on the *Juridical Condition and Human Rights of the Child* (of 28.08.2002), pars. 66 and 87; IACtHR, Advisory Opinion n. 16, on *The Right to Information on Consular Assistance in the Framework of the Guarantees of the Due Process of Law* (of 01.10.1999), pars. 58, 113 and 128; IACtHR, Advisory Opinion n. 14, on the *International Responsibility for the Promulgation and Enforcement of Laws in Violation of the American Convention on Human Rights* (of 09.12.1994), par. 35.

¹⁵⁹. A.A. Cançado Trindade, *Tratado de Direito Internacional dos Direitos Humanos*, op. cit. supra n. (21), vol. III, pp. 524-525.

¹⁶⁰. B. Maurer, *Le principe de respect de la dignité humaine et la Convention Européenne des Droits de l'Homme*, Paris, CERIC/Univ. d'Aix-Marseille, 1999, p. 18.

57. There can be no doubts as to the extent of the fundamental principles referred to, and, if by chance there were doubts, it is the function of the jurist to clarify them and not to perpetuate them, so that Law may accomplish its fundamental function of giving justice¹⁶¹. It is here that the ineluctable recourse to the general principles of Law can help to dispel any doubt which may be raised as to the scope of the individual rights. It is certain that the norms are the ones juridically binding, but when they move away from the principles, their application leads to breaches of individual rights and to serious injustices (e.g., the discrimination *de jure*).

58. In reality, when we recognize the fundamental principles which conform the *substratum* of the legal order itself, we enter into the domain of the *jus cogens*, of the peremptory law (cf. *infra*). In fact, it is perfectly possible to visualize the peremptory law (the *jus cogens*) as identified with the general principles of law of material order which are guarantors of the legal order itself, of its unity, integrity and cohesion¹⁶². Such principles are indispensable (the *jus necessarium*), are prior and superior to the will; in expressing an "idea of objective justice" (the natural law), they are consubstantial to the international legal order itself¹⁶³.

VI. The Principle of Equality and Non-Discrimination in the International Law of Human Rights.

59. In the ambit of the International Law of Human Rights, another of the fundamental principles, although not sufficiently developed by doctrine to date, but which permeates its whole *corpus juris*, is precisely the principle of equality and non-discrimination. Such principle, set forth, as recalled by the Inter-American Court in the present Advisory Opinion (par. 86), in numerous international instruments of human rights, assumes special importance in relation with the protection of the rights of the migrants in general, and of the undocumented migrant workers in particular. Besides the constitutive element of equality, - essential to the rule of law (*Estado de Derecho*) itself¹⁶⁴, - the other constitutive element, that of non-discrimination, set forth in so many international instruments¹⁶⁵, assumes capital importance in the exercise of the protected rights. The discrimination is defined, in the sectorial Conventions aiming at its

¹⁶¹. M. Chemillier-Gendreau, "Principe d'égalité et libertés fondamentales en Droit international", in *Liber Amicorum Judge Mohammed Bedjaoui* (eds. E. Yakpo and T. Boumedra), The Hague, Kluwer, 1999, pp. 659-669.

¹⁶². R. Kolb, *Théorie du jus cogens international*, Paris, PUF, 2001, p. 98.

¹⁶³. *Ibid.*, pp. 104-105 and 110-112.

¹⁶⁴. G. Pellissier, *Le principe d'égalité en droit public*, Paris, LGDJ, 1996, p. 17.

¹⁶⁵. Universal Declaration of Human Rights, Article 2; Covenant on Civil and Political Rights, Articles 2(1) and 26; Covenant on Economic, Social and Cultural Rights, Article 2; European Convention of Human Rights, Article 14; American Convention on Human Rights, Article 1(1); African Charter on Human and Peoples Rights, Article 2; International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, Articles 1(1) and 7; besides the *corpus juris* of the Convention on the Elimination of All Forms of Racial Discrimination, of the Convention on the Elimination of All Forms of Discrimination against Women, of the ILO Convention on Discrimination in Matter of Employment and Occupation (1958), of the UNESCO Convention against Discrimination in Education (1960), as well as of the Declaration of the United Nations on the Elimination of All Forms of Intolerance and Discrimination Based on Religion or Beliefs (1981).

elimination, essentially as any distinction, exclusion, restriction or limitation, or privilege, to the detriment of the human rights enshrined therein¹⁶⁶. The prohibition of discrimination comprises both the totality of those rights, at substantive level, as well as the conditions of their exercise, at procedural level.

60. On this point the contemporary doctrine is settled, in considering the principle of equality and non-discrimination as one of the pillars of the International Law of Human Rights¹⁶⁷, and also as an element integrating general or customary international law¹⁶⁸. Ultimately, the *corpus juris* of International Law, "must, by definition, be the same for all subjects of the international community"¹⁶⁹. It is not my intention to dwell into greater depth, in this Concurring Opinion, upon the international case-law on the matter, as it is already analyzed in details in one of my works¹⁷⁰. I here limit myself, thus, to point out, in sum, that the case-law of the organs of international supervision of human rights has oriented itself, in a general way, - like the present Advisory Opinion n. 18 of the Inter-American Court (pars. 84 and 168), - in the sense of considering discriminatory any distinction which does not have a legitimate purpose, or an objective and reasonable justification, and which does not keep a relation of proportionality between its purpose and the means employed.

61. Under the Covenant on Civil and Political Rights of the United Nations, the Human Rights Committee has effectively pointed out the wide scope of Article 26 of the Covenant, which sets forth the basic principle of equality and non-discrimination: in its *general comment n. 18* (of 1989), the Committee sustained, on that principle, the understanding in the sense Article 26 of the Covenant provides for an "autonomous right", and the application of that principle contained in it is not limited to the rights stipulated in the Covenant¹⁷¹. This posture advanced by the Human Rights Committee,

¹⁶⁶. Cf., e.g., Convention on the Elimination of All Forms of Racial Discrimination, Article 1(1); Convention on the Elimination of All Forms of Discrimination against Women, Article 1; International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, Article 7; Inter-American Convention on the Elimination of All Forms of Discrimination against Persons with Disabilities (of 1999), Article 1(2); among others.

¹⁶⁷. A. Eide and T. Opsahl, *Equality and Non-Discrimination*, Oslo, Norwegian Institute of Human Rights (publ. n. 1), 1990, p. 4, and cf. pp. 1-44 (study reproduced in T. Opsahl, *Law and Equality - Selected Articles on Human Rights*, Oslo, Notam Gyldendal, 1996, pp. 165-206). And, for a general study, cf. M. Bossuyt, *L'interdiction de la discrimination dans le droit international des droits de l'homme*, Bruxelles, Bruylant, 1976, pp. 1-240.

¹⁶⁸. Y. Dinstein, "Discrimination and International Human Rights", 15 *Israel Yearbook on Human Rights* (1985) pp. 11 and 27.

¹⁶⁹. H. Mosler, "To What Extent Does the Variety of Legal Systems of the World Influence the Application of the General Principles of Law within the Meaning of Article 38(1)(c) of the Statute of the International Court of Justice?", in *International Law and the Grotian Heritage* (Hague Commemorative Colloquium of 1983 on the Occasion of the Fourth Centenary of the Birth of Hugo Grotius), The Hague, T.M.C. Asser Instituut, 1985, p. 184.

¹⁷⁰. A.A. Cançado Trindade, *Tratado de Direito Internacional dos Direitos Humanos*, vol. II, Porto Alegre/Brazil, S.A. Fabris Ed., 1999, pp. 76-82.

¹⁷¹. Paragraph 12 of the *general comment general n. 18*; the Committee underlined the fundamental character of that principle (pars. 1 and 3); cf. text reproduced in: United Nations, *Compilation of General*

added to the determination by the European Court of Human Rights of a violation of Article 14 of the European Convention on Human Rights in the *Gaygusuz versus Austria* case (1996), as well as the requisites established in the legal doctrine that the "distinctions" ought to be reasonable and in accordance with justice (so as not to incur into discriminations), have led to the suggestion to the emergence and evolution of a true *right to equality*¹⁷².

62. But despite the search, by international doctrine and case-law, of the identification of illegitimate bases of discrimination, this does not appear sufficient to me; one ought to go beyond that, as discrimination hardly occurs on the basis of a sole element (e.g., race, national or social origin, religion, sex, among others), being rather a complex mixture of several of them (and there also being cases of discrimination *de jure*). Moreover, when the clauses of non-discrimination of the international instruments of human rights contain a list illegitimate bases referred to, what they really aim at thereby is to eliminate a *whole discriminatory social structure*, having in mind the distinct component elements¹⁷³.

63. It is perfectly possible, besides being desirable, to turn the attentions to all the areas of discriminatory human behaviour, including those which have so far been ignored or neglected at international level (e.g., *inter alia*, social status, income, medical state, age, sexual orientation, among others)¹⁷⁴. In reality, the causes of forced migrations (in search of survival, work and better conditions of living - cf. *supra*) are not fundamentally distinct from those of population displacement, and it is not merely casual that the basic principle of equality and non-discrimination occupies a central position in the document adopted by the United Nations in 1998 containing the *Guiding Principles on Internal Displacement*¹⁷⁵.

64. The basic idea of the whole document is in the sense that the internally displaced persons do not lose the rights which are inherent to them as human beings as a result of their displacement, and are protected by the norms of the International Law of Human Rights and of International Humanitarian Law¹⁷⁶. In the same line of reasoning, the basic idea underlying the International Convention on the Protection of

Comments and General Recommendations Adopted by Human Rights Treaty Bodies, U.N. doc. HRI/GEN/1/Rev.3, of 1997, pp. 26-29.

¹⁷². Cf. A.H.E. Morawa, "The Evolving Human Right to Equality", 1 *European Yearbook of Minority Issues* (2001-2002) pp. 163, 168, 190 and 203.

¹⁷³. E.W. Vierdag, *The Concept of Discrimination in International Law with Special Reference to Human Rights*, The Hague, Nijhoff, 1973, pp. 129-130.

¹⁷⁴. D. Türk (special *rapporteur* of the U.N. Sub-Commission on Prevention of Discrimination and Protection of Minorities), *The Realization of Economic, Social and Cultural Rights - Final Report*, U.N. doc. E/CN.4/Sub.2/1992/16, of 03.07.1992, p. 48, and cf. p. 55; and cf. also, e.g., T. Clark and J. Niessen, "Equality Rights and Non-Citizens in Europe and America; The Promise, the Practice and Some Remaining Issues", 14 *Netherlands Quarterly of Human Rights* (1996) pp. 245-275.

¹⁷⁵. Cf. ONU, document E/CN.4/1998/L.98, of 14.04.1998, p. 5; cf. principles 1(1), 4(1), 22 and 24(1). Principle 3(2), in its turn, affirms the right of the internally displaced persons to *humanitarian assistance*.

¹⁷⁶. R. Cohen and F. Deng, *Masses in Flight: The Global Crisis of Internal Displacement*, Washington D.C., Brookings Institution, 1998, p. 74.

the Rights of All Migrant Workers and Members of Their Families (1990) is in the sense that all the workers qualified as migrants under their provisions ought to enjoy their human rights irrespectively of their juridical situation; hence the central position occupied, also in this context, by the principle of non-discrimination¹⁷⁷. In sum, the migrant workers, including the undocumented ones, are *titulaires* of the fundamental human rights, which are not conditioned by their legal situation (irregular or not)¹⁷⁸. In conclusion on this point, to the fundamental principle of equality and non-discrimination is reserved, from the Universal Declaration of 1948, a truly central position in the ambit of the International Law of Human Rights.

VII. Emergence, Content and Scope of the *Jus Cogens*.

65. In the present Advisory Opinion on *The Juridical Condition and the Rights of the Undocumented Migrants*, the Inter-American Court has significantly recognized that the aforementioned fundamental principle of equality and non-discrimination, in the present stage of evolution of International Law, "has entered into the domain of the *jus cogens*"; on such principle, which "permeates every legal order", - has correctly added the Court, - "rests the whole juridical structure of the national and international public order" (par. 101, and cf. resolatory points ns. 2 and 4). The Court, moreover, has not abstained itself from referring to the evolution of the concept of *jus cogens*, transcending the ambit of both the law of treaties and of the law of the international responsibility of the States, so as to reach general international law and the very foundations of the international legal order (pars. 98-99). In support of this important pronouncement of the Court I see it fit to add some reflections.

66. The emergence and assertion of *jus cogens* in contemporary International Law fulfill the necessity of a minimum of verticalization in the international legal order, erected upon pillars in which the juridical and the ethical are merged. The *jus cogens* was definitively incorporated to the conceptual universe of contemporary international law as from the inclusion, among the bases of invalidity and termination of treaties, of the peremptory norms of general international law, in Articles 53 and 64 of the Vienna Convention of 1969 on the Law of Treaties¹⁷⁹. The Convention set forth the concept of *jus cogens*, without thereby adopting the thesis - defended in the past by A. McNair¹⁸⁰ - that a treaty could generate a regime of objective character *erga omnes* in derogation

¹⁷⁷. Such as enunciated in its Article 7.

¹⁷⁸. A.A. Cançado Trindade, *Elementos para un Enfoque de Derechos Humanos del Fenómeno de los Flujos Migratorios Forzados*, Guatemala City, OIM/IIDH (Cuadernos de Trabajo sobre Migración n. 5), 2001, pp. 13 and 18.

¹⁷⁹. More than three decades earlier, the expression "*jus cogens*" was utilized by Judge Schücking, in his well-known Separate Opinion in the *Oscar Chinn* case (United Kingdom versus Belgium); Permanent Court of International Justice (PCIJ), Series A/B, n. 63, 1934, pp. 148-150, esp. p. 149. One year later, in his course at the Hague Academy of International Law, Alfred Verdross also utilized the expression "*jus cogens*", and referred himself to the aforementioned Separate Opinion of Judge Schücking; cf. A. Verdross, "Les principes généraux du Droit dans la jurisprudence internationale", 52 *Recueil des Cours de l'Académie de Droit International de La Haye* (1935) pp. 206 and 243.

¹⁸⁰. Cf. A.D. McNair, «Treaties Producing Effects `Erga Omnes'», *Scritti di Diritto Internazionale in Onore di T. Perassi*, vol. II. Milano, Giuffrè, 1957, pp. 23-36.

of the classic principle *pacta tertiis nec nocent nec prosunt*¹⁸¹. The concept seems to have been recognized by the Vienna Convention of 1969 as a whole; if this latter did not adopt the notion of treaties establishing "legal regimes of objective character", on the other hand it set forth the concept of *jus cogens*¹⁸², i.e., of peremptory norms of general international law¹⁸³. The provisions on *jus cogens* became the object of analysis of a wide specialized bibliography¹⁸⁴.

67. One and a half decades later, the concept of *jus cogens* was again set forth in the Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations (1986); in my intervention in the United Nations Conference which adopted it, I saw it fit to warn for the manifest incompatibility with the concept of *jus cogens* of the voluntarist conception of

¹⁸¹. S. Rosenne, «Bilateralism and Community Interest in the Codified Law of Treaties», *Transnational Law in a Changing Society - Essays in Honour of Ph. C. Jessup* (ed. W. Friedmann, L. Henkin, and O. Lissitzyn), N.Y./London, Columbia University Press, 1972, p. 207; and cf. Ph. Cahier, «Le problème des effets des traités à l'égard des États tiers», 143 *Recueil des Cours de l'Académie de Droit International de La Haye* (1974) pp. 589-736. - During the *travaux préparatoires* of the Convention undertaken by the International Law Commission of the United Nations, the notion of «community interest» was made present: at first utilized by J.-M. Yepes in 1950, the idea was later to appear in the 1st. report by J.L. Brierly (the first *rapporteur* on the subject), in the 1st. report by H. Lauterpacht (the second *rapporteur*), becoming absent from the reports by G. Fitzmaurice (the third *rapporteur*), and reappeared at last in the 2nd. report by H. Waldock (the fourth and last *rapporteur* on the matter); S. Rosenne, *op. cit. supra*, pp. 212-219.

¹⁸². For a historical account of the concept, going back to the old Roman law, but reappearing mainly as from the XIXth century, cf. Jerzy Sztucki, *Jus Cogens and the Vienna Convention on the Law of Treaties - A Critical Appraisal*, Viena, Springer-Verlag, 1974, pp. 6-11 and 97-108.

¹⁸³. The term, as such, appeared for the first time in the 3rd. report by G. Fitzmaurice, and was again to appear in the 2nd. report by H. Waldock; J. Sztucki, *op. cit. supra* n. (98), pp. 104-105 and 108. - In the preparatory work - of the debates of 1963 and 1966 of the VI Commission of the General Assembly of the United Nations, the necessity was pointed out of the establishment of criteria for the determination of the rules of International Law which could constitute *jus cogens*. Cf. I.M. Sinclair, «Vienna Conference on the Law of Treaties», 19 *International and Comparative Law Quarterly* (1970) pp. 66-69; I.M. Sinclair, *The Vienna Convention on the Law of Treaties*, Manchester, University Press/Oceana, 1973, pp. 124-129, and cf. pp. 129-131.

¹⁸⁴. Cf., e.g., Ch.L. Rozakis, *The Concept of Jus Cogens in the Law of Treaties*, Amsterdam, North Holland Publ. Co., 1976, pp. 1ss.; Ch. de Visscher "Positivism et *jus cogens*", 75 *Revue générale de Droit international public* (1971) pp. 5-11; M. Virally, «Réflexions sur le *jus cogens*», 12 *Annuaire français de Droit international* (1966) pp. 5-29; A. Verdross, "*Jus dispositivum* and *Jus Cogens* in International Law", 60 *American Journal of International Law* (1966) pp. 55-63; J.A. Barberis, "La liberté de traiter des États et le *jus cogens*", 30 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht [Z.f.a.o.R.u.V.]* (1970) pp. 19-45; U. Scheuner, "Conflict of Treaty Provisions with a Peremptory Norm of International Law", 27 and 29 *Z.f.a.o.R.u.V.* (1967 y 1969) pp. 520-532 and 28-38, respectively; H. Mosler, "*Ius cogens* im Völkerrecht", 25 *Schweizerisches Jahrbuch für internationales Recht* (1968) pp. 1-40; K. Marek, "Contribution à l'étude du *jus cogens* en Droit international", *Recueil d'études de Droit International en hommage à P. Guggenheim*, Geneva, I.U.H.E.I., 1968, pp. 426-459; M. Schweitzer, "*Ius cogens* im Völkerrecht", 15 *Archiv des Völkerrechts* (1971) pp. 197-223; G. Gaja, "*Jus Cogens* beyond the Vienna Convention", 172 *Recueil des Cours de l'Académie de Droit International de La Haye* (1981) pp. 279-313; L. Alexidze, "Legal Nature of *Jus Cogens* in Contemporary International Law", in *ibid.*, pp. 227-268; and other sources referred to in notes (109), (115), (123), (124), (125) and (131).

International Law¹⁸⁵, which appeared incapable to explain even the formation of rules of general international law and the incidence in the process of formation and evolution of contemporary International Law of elements independent of the free will of the States¹⁸⁶. With the assertion of *jus cogens* in the two Vienna Conventions on the Law of Treaties (1969 and 1986), the next step consisted in determining its incidence beyond the law of treaties.

68. On my part, I have always sustained that it is an ineluctable consequence of the affirmation and the very existence of *peremptory* norms of International Law their not being limited to the conventional norms, to the law of treaties, and their being extended to every and any juridical act¹⁸⁷. Recent developments point out in the same sense, that is, that the domain of the *jus cogens*, beyond the law of treaties, encompasses likewise general international law¹⁸⁸. Moreover, the *jus cogens*, in my understanding, is an open category, which expands itself to the extent that the universal juridical conscience (material source of all Law) awakens for the necessity to protect the rights inherent to each human being in every and any situation.

69. The evolution of the International Law of Human Rights has emphasized the absolute character of the *non-derogable* fundamental rights. The absolute prohibition of the practices of torture, of forced disappearance of persons, and of summary and extra-legal executions, leads us decidedly into the *terra nova* of the international *jus cogens*¹⁸⁹. In the case *A. Furundzija* (Judgment of 10.12.1998), the *ad hoc* International Criminal Tribunal for the Former Yugoslavia (*Trial Chamber*) sustained that the prohibition of torture, established in an absolute way by International Law, both conventional (under certain human rights treaties) as well as customary, had the character of a norm of *jus cogens* (pars. 137-139, 144 and 160)¹⁹⁰. This occurred by virtue of the importance of the protected values (par. 153). Such absolute prohibition of

¹⁸⁵. Cf. U.N., *United Nations Conference on the Law of Treaties between States and International Organizations or between International Organizations* (Vienna, 1986) - *Official Records*, vol. I, N.Y., U.N., 1995, pp. 187-188 (intervention by A.A. Cançado Trindade).

¹⁸⁶. A.A. Cançado Trindade, "The Voluntarist Conception of International Law: A Re-Assessment", 59 *Revue de droit international de sciences diplomatiques et politiques* - Geneva (1981) pp. 201-240.

¹⁸⁷. Cf. A.A. Cançado Trindade, *Tratado de Direito Internacional...*, *op. cit. supra* n. (97), vol. II, pp. 415-416.

¹⁸⁸. For the extension of *jus cogens* to all possible juridical acts, cf., e.g., E. Suy, «The Concept of *Jus Cogens* in Public International Law», in *Papers and Proceedings of the Conference on International Law* (Langonissi, Greece, 03-08.04.1966), Geneva, C.E.I.P., 1967, pp. 17-77.

¹⁸⁹. A.A. Cançado Trindade, *Tratado de Direito Internacional...*, *op. cit. supra* n. (97), vol. II, p. 415.

¹⁹⁰. The Tribunal added that such prohibition was so absolute that it had incidence not only on actual, but also potential, violations (above all as from the Judgment of the European Court of Human Rights in the case *Soering versus United Kingdom*, 1989), thus impeding the expulsion, the return or the extradition of a person to another State in which he could run the risk of being subjected to torture; *ibid.*, pars. 144 and 148. - In this respect, on the practice under the Covenant on Civil and Political Rights of the United Nations, cf. F. Pocar, "Patto Internazionale sui Diritti Civili e Politici ed Estradizione", in *Diritti dell'Uomo, Estradizione ed Espulsione - Atti del Convegno di Ferrara (1999) per Salutare G. Battaglini* (ed. F. Salerno), Padova, Cedam, 2003, pp. 89-90.

torture, - added the Tribunal, - imposes on the States obligations *erga omnes* (par. 151); the *jus cogens* nature of this prohibition renders it "one of the most fundamental standards of the international community", incorporating "an absolute value from which no one should divert himself" (par. 154).

70. The concept of *jus cogens* in fact is not limited to the law of treaties, and is likewise proper to the law of the international responsibility of the States. The Articles on the Responsibility of the States, adopted by the International Law Commission of the United Nations in 2001, bear witness of this fact. Among the passages of such Articles and their comments which refer expressly to *jus cogens*, there is one in which it is affirmed that "various tribunals, national and international, have affirmed the idea of peremptory norms in contexts not limited to the validity of treaties"¹⁹¹. In my understanding, it is in this central chapter of International Law, that of the international responsibility (perhaps more than in the chapter on the law of treaties), that the *jus cogens* reveals its real, wide and profound dimension, encompassing all juridical acts (including the unilateral ones), and having an incidence (including beyond the domain of State responsibility) on the very *foundations* of an international law truly universal.

71. To the international *objective* responsibility of the States corresponds necessarily the notion of *objective illegality*¹⁹² (one of the elements underlying the concept of *jus cogens*). In our days, no one would dare to deny the objective illegality of acts of genocide¹⁹³, of systematic practices of torture, of summary and extra-legal executions, and of forced disappearance of persons, - practices which represent crimes against humanity, - condemned by the universal juridical conscience¹⁹⁴, parallel to the application of treaties. Already in its Advisory Opinion of 1951 on the *Reservations to the Convention against Genocide*, the International Court of Justice pointed out that the humanitarian principles underlying that Convention were recognizedly "binding on States, even without any conventional obligation"¹⁹⁵.

72. Just as, in the ambit of the International Law of Refugees, the basic principle of *non-refoulement* was recognized as being of *jus cogens*¹⁹⁶, in the domain of the International Law of Human Rights the character of *jus cogens* of the fundamental principle of equality and non-discrimination was likewise recognized (cf. *supra*). The objective illegality is not limited to the aforementioned acts and practices. As the *jus cogens* is not a closed category (*supra*), I understand that no one either would dare to

¹⁹¹. J. Crawford, *The International Law Commission's Articles on State Responsibility - Introduction, Text and Commentaries*, Cambridge, University Press, 2002, p. 188, and cf. pp. 246 and 127-128.

¹⁹². In its Advisory Opinion of 21.06.1971 on *Namibia*, the International Court of Justice in fact referred itself to a situation which it characterized as "illegal *erga omnes*"; *ICJ Reports* (1971) p. 56, par. 126.

¹⁹³. In its Judgment of 11 July 1996, in the case concerning the *Application of the Convention against Genocide*, the International Court of Justice affirmed that the rights and obligations set forth in that Convention were "rights and duties *erga omnes*"; *ICJ Reports* (1996) p. 616, par. 31.

¹⁹⁴. Inter-American Court of Human Rights, case *Blake versus Guatemala* (Merits), Judgment of 24.01.1998, Separate Opinion of Judge A.A. Cançado Trindade, par. 25, and cf. pars. 23-24.

¹⁹⁵. ICJ, Advisory Opinion of 28 May 1951, *ICJ Reports* (1951) p. 23.

¹⁹⁶. Cf. J. Allain, "The *Jus Cogens* Nature of *Non-Refoulement*", 13 *International Journal of Refugee Law* (2002) pp. 538-558.

deny that the slave work, and the persistent denial of the most elementary guarantees of the due process of law would likewise affront the universal juridical conscience, and effectively collide with the peremptory norms of the *jus cogens*. This is particularly significant for the safeguard of the rights of the undocumented migrant workers. All this doctrinal evolution points to the direction of the crystallization of the obligations *erga omnes* of protection (cf. *infra*). Without the consolidation of such obligations one will advance very little in the struggle against the violations of human rights.

73. The manifestations of international *jus cogens* mark presence in the very manner whereby human rights treaties have been interpreted and applied: the restrictions, foreseen in them, to the human rights they set forth, are restrictively interpreted, safeguarding the *État de Droit* (*Estado de Derecho*), and demonstrating that human rights do not belong to the domain of *jus dispositivum*, and cannot be considered as simply "negotiable"¹⁹⁷; on the contrary, they permeate the (national and international) legal order itself. In sum and conclusion on the point under examination, the emergence and assertion of *jus cogens* evoke the notions of international public order and of a hierarchy of legal norms, as well as the prevalence of the *jus necessarium* over the *jus voluntarium*; *jus cogens* presents itself as the juridical expression of the very international community as a whole, which, at last, takes conscience of itself, and of the fundamental principles and values which guide it¹⁹⁸.

VIII. Emergence and Scope of the Obligations *Erga Omnes* of Protection: Their Horizontal and Vertical Dimensions.

74. In the present Advisory Opinion on *The Juridical Condition and the Rights of the Undocumented Migrants*, the Inter-American Court has pointed out that the fundamental principle of equality and non-discrimination, for belonging to the domain of *jus cogens*, "brings about obligations *erga omnes* of protection which bind all States and generate effects with regard to third parties, including individuals (private persons)" (par. 110, and cf. resolutive point n. 5)¹⁹⁹. Also on this particular point I see it fit to present some reflections, in support of what was determined by the Inter-American Court. It is widely recognized, in our days, that the peremptory norms of *jus cogens* effectively bring about obligations *erga omnes*.

75. In a well-known *obiter dictum* in its Judgment in the case of the *Barcelona Traction* (Second Phase, 1970), the International Court of Justice determined that there are certain international obligations *erga omnes*, obligations of a State *vis-à-vis* the international community as a whole, which are of the interest of all the States; "such obligations derive, for example, in contemporary International Law, from the outlawing

¹⁹⁷. J.A. Pastor Ridruejo, "La Convención Europea de los Derechos del Hombre y el 'Jus Cogens' Internacional", in *Estudios de Derecho Internacional - Homenaje al Profesor Miaja de la Muela*, tomo I, Madrid, Ed. Tecnos, 1979, pp. 581-590. - On the possibility of the incidence of *jus cogens* in the elaboration itself of drafts of international instruments, cf. discussion in G.M. Danilenko, "International *Jus Cogens*: Issues of Law-Making", 2 *European Journal of International Law* (1991) pp. 48-49 and 59-65.

¹⁹⁸. A. Gómez Robledo, *El Jus Cogens Internacional (Estudio Histórico Crítico)*, Mexico, UNAM, 1982, pp. 20-21, 222-223 and 226, and cf. p. 140; and cf. also R.St.J. Macdonald, "Fundamental Norms in Contemporary International Law", 25 *Annuaire canadien de Droit international* (1987) pp. 133-134, 140-142 and 148.

¹⁹⁹. And cf. also par. 146.

of acts of aggression, and of genocide, and also from the principles and rules concerning the basic rights of the human person, including protection from slavery and racial discrimination. Some of the corresponding rights of protection *have entered into the body of general international law (...)*; others are conferred by international instruments of a universal or quasi-universal character²⁰⁰. The prohibitions mentioned in this *obiter dictum* are not exhaustive: to them new prohibitions are added, such as the ones referred to in paragraphs 71-72 of the present Concurring Opinion, precisely for not being the *jus cogens* a closed category (*supra*).

76. In the construction of the international legal order of the new century, we witness, with the gradual erosion of reciprocity, the emergence *pari passu* of superior considerations of *ordre public*, reflected in the conceptions of the peremptory norms of general international law (the *jus cogens*) and of the obligations *erga omnes* of protection (owed to everyone, and to the international community as a whole). The *jus cogens*, in bringing about obligations *erga omnes*, characterizes them as being endowed with a necessarily objective character, and thereby encompassing all the addressees of the legal norms (*omnes*), both those who integrate the organs of the public power as well as the individuals.

77. In my view, we can consider such obligations *erga omnes* from *two dimensions, one horizontal and the other vertical*, which complement each other. Thus, the obligations *erga omnes* of protection, in a horizontal dimension, are obligations pertaining to the protection of the human beings due to the international community as a whole²⁰¹. In the framework of conventional international law, they bind all the States Parties to human rights treaties (obligations *erga omnes partes*), and, in the ambit of general international law, they bind all the States which compose the organized international community, whether or not they are Parties to those treaties (obligations *erga omnes lato sensu*). In a vertical dimension, the obligations *erga omnes* of protection bind both the organs and agents of (State) public power, and the individuals themselves (in the inter-individual relations).

78. For the conformation of this vertical dimension have decisively contributed the advent and the evolution of the International Law of Human Rights. But it is surprising that, until now, these horizontal and vertical dimensions of the obligations *erga omnes* of protection have passed entirely unnoticed from contemporary legal doctrine. Nevertheless, I see them clearly shaped in the legal regime itself of the American Convention on Human Rights. Thus, for example, as to the vertical dimension, the general obligation, set forth in Article 1(1) of the American Convention, to respect and to ensure respect for the free exercise of the rights protected by it, generates effects

²⁰⁰. ICJ, Judgment of 05 February 1970, *ICJ Reports* (1970) p. 32, pars. 33-34 (emphasis added). - The same Court had a unique opportunity to develop these considerations years later, in the *East Timor* case, but wasted it: in the Judgment of 30.06.1995, in which it reaffirmed the existence of the obligations *erga omnes* (in relation to the right of self-determination of peoples), it nevertheless related such obligations which something which is its antithesis, the consent of a third State (Indonesia); from a bilateralist and voluntarist perspective, it thus failed, unfortunately, to extract the consequences of the existence of such obligations *erga omnes*; cf. ICJ, *East Timor* case (Portugal versus Australia), *ICJ Reports* (1995) pp. 90-106.

²⁰¹. IACtHR, case *Blake versus Guatemala* (Merits), Judgment of 24.01.1998, Separate Opinion of Judge A.A. Cançado Trindade, par. 26, and cf. pars. 27-30.

erga omnes, encompassing the relations of the individual both with the public (State) power as well as with other individuals (*particuliers*)²⁰².

79. In their turn, the obligations *erga omnes partes*, in their horizontal dimension, find expression also in Article 45 of the American Convention, which foresees the mechanism (not yet utilized in the practice of the inter-American system of human rights), of inter-State complaints or petitions. This mechanism, - as I pointed out in my Concurring Opinion (par. 3) in the case of the *Community of Peace of San José of Apartadó* (Provisional Measures of Protection of 18.06.2002), - constitutes not only a mechanism *par excellence* of action of collective guarantee, but also a true embryo *actio popularis* in International Law, in the framework of the American Convention. In any case, these dimensions, both horizontal and vertical, reveal the wide scope of the obligations *erga omnes* of protection.

80. The crystallization of the obligations *erga omnes* of protection of the human person represents, in reality, the overcoming of a pattern of conduct erected on the alleged autonomy of the will of the State, from which International Law itself sought gradually to liberate itself in giving expression to the concept of *jus cogens*²⁰³. By definition, all the norms of *jus cogens* generate necessarily obligations *erga omnes*. While *jus cogens* is a concept of material law, the obligations *erga omnes* refer to the structure of their performance on the part of all the entities and all the individuals bound by them. In their turn, not all the obligations *erga omnes* necessarily refer to norms of *jus cogens*.

81. One ought to secure a follow-up to the endeavours of greater doctrinal and jurisprudential development of the peremptory norms of international law (*jus cogens*) and of the corresponding obligations *erga omnes* of protection of the human being²⁰⁴, moved above all by the *opinio juris* as a manifestation of the universal juridical conscience, to the benefit of all human beings²⁰⁵. By means of this conceptual development one will advance in the overcoming of the obstacles of the dogmas of the past and in the creation of a true international *ordre public* based upon the respect for,

²⁰². Cf., in this respect, in general, the resolution adopted by the *Institut de Droit International* (I.D.I.) at the session of Santiago de Compostela of 1989 (Article 1), in: I.D.I., 63 *Annuaire de l'Institut de Droit International* (1989)-II, pp. 286 and 288-289.

²⁰³. Cf. A.A. Cançado Trindade, "The International Law of Human Rights at the Dawn of the XXIst Century", 3 *Cursos Euromediterráneos Bancaja de Derecho Internacional* - Castellón (1999) pp. 207-215.

²⁰⁴. On the relationship between *jus cogens* and *erga omnes* obligations of protection, cf.: M. Ragazzi, *The Concept of International Obligations Erga Omnes*, Oxford, Clarendon Press, 1997, pp. 135, 201-202 and 213; Y. Dinstein, "The *Erga Omnes* Applicability of Human Rights", 30 *Archiv des Völkerrechts* (1992) pp. 16-37; A.J.J. de Hoogh, "The Relationship between *Jus Cogens*, Obligations *Erga Omnes* and International Crimes: Peremptory Norms in Perspective", 42 *Austrian Journal of Public and International Law* (1991) pp. 183-214; C. Annacker, "The Legal Regime of *Erga Omnes* Obligations in International Law", 46 *Austrian Journal of Public and International Law* (1994) pp. 131-166; M. Byers, "Conceptualising the Relationship between *Jus Cogens* and *Erga Omnes* Rules", 66 *Nordic Journal of International Law* (1997) pp. 211-239; J. Juste Ruiz, "Las Obligaciones 'Erga Omnes' en Derecho Internacional Público", in *Estudios de Derecho Internacional - Homenaje al Profesor Miaja de la Muela*, vol. I, Madrid, Tecnos, 1979, p. 228.

²⁰⁵. IACtHR, case *Blake versus Guatemala* (Merits), Judgment of 24.01.1998, Series C, n. 36, Separate Opinion of Judge A.A. Cançado Trindade, par. 28; IACtHR, case *Blake versus Guatemala* (Reparations), Judgment of 22.01.1999, Series C, n. 48, Separate Opinion of Judge A.A. Cançado Trindade, par. 40.

and observance of, human rights. Such development will contribute, thus, to a greater cohesion of the organized international community (the *civitas maxima gentium*), centred on the human person.

82. As I saw it fit to point out in my Separate Opinion in the case *Las Palmeras* (Preliminary Objections, 2000, pars. 13-14) and in my Concurring Opinions in the case of the *Community of Peace of San José of Apartadó* (Provisional Measures of Protection, 18.06.2002, pars. 2-9) and in the case of the *Communities of the Jiguamiandó and of the Curbaradó* (Provisional Measures of Protection, 06.03.2003, pars. 4-6), at a more circumscribed level, the American Convention on Human Rights itself contains mechanisms for application of the conventional obligations of protection *erga omnes partes*. This is endowed with particular relevance at both conceptual and operative levels. The general obligation, set forth in Article 1(1) of the American Convention, to respect and to ensure respect for the free exercise of the rights protected by it, has a character *erga omnes*²⁰⁶.

83. In my understanding, the obligations *erga omnes partes* are not to be minimized, nor at the conceptual level, as, by means of the exercise of collective guarantee, such obligations can serve as guide, or pave the way, for the crystallization, in the future, of the obligations *erga omnes lato sensu*, due to the international community as a whole. And, at the operative level, the obligations *erga omnes partes* under a human rights treaty such as the American Convention also assume special importance, in face of the current diversification of the sources of violations of the rights enshrined into the Convention, which requires the clear recognition of the effects of the conventional obligations *vis-à-vis* third parties (the *Drittwirkung*), including individuals (e.g., in labour relations).

84. A minimum of conventional protection can thereby be promptly secured, for example, to the undocumented migrant workers, in their relations not only with the public power but also with other individuals, in particular their employers. One can, thus, sustain that migrant workers, including the undocumented ones, are *titulaires* of fundamental rights *erga omnes*. Ultimately, the State has the obligation to take positive measures to impede the unscrupulous labour exploitation, and to put an end to it. The State has the duty to secure the prevalence of the fundamental principle of equality and non-discrimination, which, as rightly establishes the present Advisory Opinion of the Inter-American Court, is a principle of *jus cogens* (par. 101, and resolutive point n. 4). To have clarified this basic point constitutes a valuable contribution of the present Advisory Opinion n. 18 of the Court.

85. The State is bound by the *corpus juris* of the international protection of human rights, which protects every human person *erga omnes*, independently of her statute of citizenship, or of migration, or any other condition or circumstance. The fundamental rights of the migrant workers, including the undocumented ones, are opposable to the public power and likewise to the private persons or individuals (e.g., employers), in the inter-individual relations. The State cannot prevail itself of the fact of not being a Party to a given treaty of human rights to evade the obligation to respect the fundamental principle of equality and non-discrimination, for being this latter a principle of general

²⁰⁶ Cf., in this sense, the resolution adopted by the *Institut de Droit International* (I.D.I.) at the session of Santiago de Compostela of 1989 (Article 1), in: I.D.I., 63 *Annuaire de l'Institut de Droit International* (1989)-II, pp. 286 and 288-289.

international law, and of *jus cogens*, which thus transcends the domain of the law of treaties.

IX. Epilogue.

86. The fact that the concepts both of the *jus cogens* and of the obligations (and rights) *erga omnes* already integrate the conceptual universe of International Law discloses the reassuring and necessary opening of this latter, in the last decades, to certain superior and fundamental values. This significant evolution of the recognition and assertion of norms of *jus cogens* and *erga omnes* obligations of protection ought to be fostered, seeking to secure its full practical application, to the benefit of all human beings. Only thus shall we rescue the universalist vision of the founding fathers of the *droit des gens*, and shall we move closer to the plenitude of the international protection of the rights inherent to the human person. These new conceptions impose themselves in our days, and, of their faithful observance, in my view, will depend in great part the future evolution of the present domain of protection of the human person, as well as, ultimately, of the International Law itself as a whole.

87. It is not function of the jurist simply to take note of what the States do, particularly the most powerful ones, which do not hesitate to seek formulas to impose their "will", including in relation to the treatment to be dispensed to the persons under its jurisdiction. The function of the jurist is to show and to tell what the Law is. In the present Advisory Opinion n. 18 on *The Juridical Condition and the Rights of the Undocumented Migrants*, the Inter-American Court of Human Rights has determined, firmly and with clarity, what the Law is. This latter does not emanate from the inscrutable "will" of the States, but rather from human conscience. General or customary international law emanates not so much from the practice of States (not devoid of ambiguities and contradictions), but rather from the *opinio juris communis* of all the subjects of International Law (the States, the international organizations, and the human beings). Above the will is the conscience.

88. The fact that, despite all the sufferings of past generations, persist in our days new forms of exploitation of man by man, - such as the exploitation of the labour force of the undocumented migrants, forced prostitution, the traffic of children, forced and slave labour, amidst a proved increase of poverty and social exclusion and marginalization, the uprootedness and family disruption, - does not mean that "regulation is lacking" or that Law does not exist. It rather means that Law is being ostensibly and flagrantly violated, from day to day, to the detriment of millions of human beings, among whom the undocumented migrants all over the world. In reacting against these generalized violations of the rights of the undocumented migrants, which affront the juridical conscience of humankind, the present Advisory Opinion of the Inter-American Court contributes to the current process of the necessary *humanization* of International Law.

89. In so doing, the Inter-American Court bears in mind the universality and unity of the human kind, which inspired, more than four and a half centuries ago, the historical process of formation of the *droit des gens*. In rescuing, in the present Advisory Opinion, the universalist vision which marked the origins of the best doctrine of International Law, the Inter-American Court contributes to the construction of the new *jus gentium* of the XXIst century, oriented by the general principles of law (among which the fundamental principle of equality and non-discrimination), characterized by the intangibility of the due process of law in its wide scope, crystallized in the recognition of *jus cogens* and instrumentalized by the consequent obligations *erga omnes* of

protection, and erected, ultimately, on the full respect for, and guarantee of, the rights inherent to the human person.

Antônio Augusto Cançado Trindade
Judge

Manuel E. Ventura-Robles
Secretary

**REASONED CONCURRING OPINION OF
JUDGE SERGIO GARCÍA RAMÍREZ
IN RELATION TO ADVISORY OPINION OC-18/03 ON
"LEGAL STATUS AND RIGHTS OF UNDOCUMENTED MIGRANTS"
OF SEPTEMBER 17, 2003
ISSUED BY THE INTER-AMERICAN COURT OF HUMAN RIGHTS**

1. The Inter-American Court rendered *Advisory Opinion OC-18/03* on September 17, 2003, under the heading "*Legal Status and Rights of Undocumented Migrants.*" Consequently, it covers a wide spectrum of situations regarding undocumented migrants in general; that is, those persons who leave a State to migrate to another State and stay there, but who do not have authorization to do so from the State in which they seek to reside. This description is clear from the "Glossary" in Chapter V of the *Advisory Opinion* (para. 69). Many individuals are in this situation, regardless of the motive for their move, their particular conditions, and the activity they perform or wish to perform.

2. One specific category within this spectrum corresponds to undocumented migrant *workers*; that is, persons who are not authorized to enter the State of employment and engage in a remunerated activity there, according to the laws of the State and the international agreements to which that State is a party, but who, nevertheless, engage in that activity, as the 1990 International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families has understood, and as is recognized in the "Glossary" cited in the preceding paragraph. It is with regard to the latter, working in urban and rural areas, that the request submitted by the United Mexican States to the Inter-American Court of Human Rights refers principally – although not exclusively. It is necessary to examine the rights of millions of human beings, women and men, who have migrated or who migrate in all parts of the world – and especially in the countries of the Americas – moved by different factors, but all driven by the same expectation: to earn their living outside the country in which they were born.

3. This issue is extremely important and, consequently, has merited prominent mention in the request for the opinion and in the briefs of the States and individuals who intervened in the consultation process – the latter as *amici curiae*. It is also underscored in the answers of the Inter-American Court, which could have been grouped under another heading emphasizing the universe that concerns the requesting State and the participants and is being examined by the Inter-American Court: "*Legal status and rights of undocumented migrant workers*".

4. The issue to which this *Advisory Opinion* refers is of fundamental importance today. The increasing interrelation between nations, the process of globalization that has an impact in diverse areas, and the different conditions of the national, regional and global economies have been determining factors in the appearance and growth of migratory flows that have particular characteristics and require coherent solutions. In its resolution on "*International migration and development*" (A/RES/54/212, of 1 February 2000) – mentioned in *OC-18*, the General Assembly of the United Nations indicated that "among other factors, the process of globalization and liberalization, including the widening economic and social gap between and among many countries and the marginalization of some countries in the global economy, has contributed to large flows of peoples between and among countries and to the intensification of the complex phenomenon of international migration."

5. In a recent publication, it is recalled that “most individuals migrate in order to improve their living conditions, seek new opportunities or escape poverty”; although we should not overlook other reasons, such as: family reunion, war and other conflicts, human rights violations, expulsion, and discrimination. At the “end of the 20th century, there were an estimated 175 million international migrants, nearly 3% of the world’s people and twice the number in 1975. Some 60% of the international migrants, about 104 million, are in developing countries” (Commission on Human Security, *Human Security*, New York, 2003, p. 41).

6. The new migratory flows, which are the focal point of *Advisory Opinion OC-18/2003*, reflect the situation of the economy in the countries of origin and destination of migrants. In the latter there is a factor of attraction that requires the contribution of the labor of those workers, who play a role in wealth creation and – as those who study these processes have acknowledged – make a very significant contribution to the welfare and development of the receiving countries. A study on this issue by the International Labour Office (ILO) – cited in the brief submitted by the Center for Justice and International Law (CEJIL) – mentions, with regard to a universe of 152 countries, that between 1970 and 1990 the number of countries classified as major recipients of immigrants seeking work increased from 39 to 67, while the number of those considered major originators of migrants increased from 29 to 55. The conditions in which some of these processes occur and their results produce a form of subsidy for the most developed economies, in addition to their importance as a source of income for the migrants who provide their services in those economies and for their families who reside in their countries of origin.

7. These processes cannot – or rather, should not – be exempt from scrupulous respect for the human rights of migrants. This is the central thesis of *Advisory Opinion OC-18/2003*, which extends to the different areas it covers. It is a thesis that corresponds to the best expressions of the guiding principle of contemporary national and international law, to legal writings and practice of the rule of law in a democratic society, and to the principles that govern international human rights law and the implementation of its norms by the States that compose the legal community and the corresponding international jurisdictions.

8. Evidently, it is not possible to reduce a phenomenon of this nature to a question of border policy, or approach it from the simple perspective of the legal or illegal, regular or irregular status of the residence of aliens in a specific territory. This viewpoint does not permit us to understand and regulate rationally and constructively the offer of licit and creative work and the demand that keeps the economic processes operating, to the benefit of those who provide their services and to those who employ them. The phenomenon goes beyond these reductionist perspectives, which often lead to the adoption of inadmissible and harmful measures for migrant workers, and even for the economy in which they are established. Moreover, this limited and flawed vision frequently entails problems in relations with neighboring countries.

9. Those who form part of these migratory flows are very often almost totally helpless, owing to their lack of social, economic and cultural knowledge of the country in which they work, and to the lack of instruments to protect their rights. In these circumstances, they constitute an extremely vulnerable sector that has suffered the consequences of this vulnerability by the implementation of laws, the adoption and execution of policies, and the proliferation of discriminatory and abusive practices in their labor relations with the employers who use their services

and the authorities of the country where they reside. This vulnerability is structural in character. Its cultural aspect, of an endogenous nature, is associated – as the *amicus curiae* brief presented by an academic of the Juridical Research Institute of the Universidad Nacional Autónoma de México states – with “conditions that are sufficient to result in extreme impunity for those who violate the human rights of aliens/ immigrants.”

10. It is well known that there have been many cases of aggression against undocumented migrants by public authorities, who fail to comply with or distort the exercise of their attributes, and by individuals who take advantage of the vulnerable situation of undocumented migrants and subject them to ill-treatment or convert them into victims of crimes. The latter include different kinds of violent crime and arbitrary treatment, which regularly remain unpunished or are only penalized by light measures, utterly disproportionate to the gravity of the illegal acts that have been committed. In a resolution on “*Protection of migrants*” (A/RES/54/166, of 24 February 2000) – mentioned in the *Advisory Opinion* – the General Assembly of the United Nations expressed its concern for “the manifestations of violence, racism, xenophobia and other forms of discrimination and inhuman and degrading treatment to which migrants are subjected, particularly women and children, in different parts of the world.”

11. The vulnerability of migrant workers increases, reaching dramatic extremes that move the universal moral conscience, when they lack official authorization to enter and remain in a country and, consequently, form part of the category of those persons who are instantly identified as “undocumented,” “irregular” or, worse still “illegal,” workers. What should be an administrative description with well-defined effects becomes a “label” that results in many disadvantages and exposes the bearer to innumerable abuses. This sector is grouped under a significant heading: it is a “suspected category,” as the Inter-American Commission on Human Rights indicates – another *amicus curiae* brief alludes to “suspect category” – a concept elaborated on the basis of European case law and comparative law. In brief, it refers to “persons under suspicion,” with all that this implies and, furthermore, with all that it suggests and even allows.

12. Although it should be borne in mind, I will not go into detail about the nature of the treatment usually meted out to undocumented workers. It includes abuse and arbitrariness of different kinds in the workplace, but also outside of it, because of the lack of security that they endure, the treatment they receive, and other very diverse aspects of their personal and family life, even its most intimate and delicate aspects. Reports on this situation, which observers of different countries provide from time to time on conditions prevailing on different continents, illustrate this matter amply.

13. This is the situation in which millions of persons live, work and suffer in many countries in the world, some of which have historically been in the forefront of human rights and democracy. Thus, when alluding to the problem of undocumented migrant workers, the focus of *OC-18/2003*, reference is being made to a large number of human beings in different countries, as noted in the statistical contributions made by those who took part, as representatives of States or *amici curiae*, in the process of reflection which led to this *Advisory Opinion*.

14. *OC-18/2003* is based on the acceptance of the human rights recognized to all persons and required of all States. This corresponds, moreover, to the basic concept of fundamental rights in the words used in national declarations as of the eighteenth century and in the most important international instruments of the twentieth

century. This recognition, which is based on human dignity and transcends all political borders, is the most relevant moral, juridical and political fact in the current stage of law. The violations committed during the last century and in the one which is just beginning do not diminish the contemporary status of the individual, product of a long and eventful evolution, nor eliminate the enforceability of human rights before all States. To the contrary, they reinforce a concern shared by innumerable persons and underline the need to continue the struggle to ensure to everyone the most extensive enjoyment and exercise of those rights. We may add that this is the philosophy that sustains the major international organizations, such as the United Nations and the Organization of American States, in the words of their Charters, and it therefore binds the States that form part of them and have accepted their values and the commitments that the latter represent.

15. Thinking behind the declarations of rights and their contemporary expression cites the freedom and equality of all human beings. This entails, first implicitly, then explicitly in numerous documents – as indicated in this *Advisory Opinion* – the most complete and conclusive rejection of discrimination whatever the motive. This profound conviction is the source of the historic struggles of the individual against different forms of oppression – struggles that have culminated in the establishment of a successive series of fundamental rights – and the foundation on which the modern legal system is built.

16. Equality before the law and rejection of all forms of discrimination is at the forefront of texts that stipulate, regulate and guarantee human rights. They could be said to represent reference points, constructive elements, interpretation criteria, and options for the protection of all rights. Because of the degree of acceptance they have achieved, they are clear expressions of *jus cogens*, with the peremptory nature that this has over and above general or specific conventions, and with its effects for the determination of obligations *erga omnes*.

17. That idea, stated in *OC-18/2003*, was expressed during the preparatory work. Thus, the *amicus curiae* participation of the Central American Council of Ombudsmen, with the support of its Technical Secretariat, the Inter-American Institute of Human Rights, mentions, in its brief, that “owing to the progressive development of international human rights law, the principle of non-discrimination and the right to equal and effective protection of the law, must be considered norms of *jus cogens* and, in this respect, they are norms of peremptory international law that form part of an international public order (*ordre public*) which cannot be validly opposed by the other norms of international law, and much less the domestic norms of States.” Finally, in the absence of the embodiment and exercise of equality before the law and the rejection of discrimination, it would not be possible to understand human development and assess the present development of law.

18. True equality before the law is not measured by the mere declaration of equality in the law, but must take into account the true conditions of those who are subject to the law. There is no equality when, for example, in order to enter an employment relationship, an agreement is reached by an employer, who has ample resources and knows that he is supported by the law, and the worker, who only has his hands and perceives – or knows perfectly well – that the law does not offer him the support it provides to his counterpart. There is no equality either when there is a powerful defendant, armed with the means to defend himself, and a weak litigant, who lacks instruments to prove and argue his defense, regardless of the reasons and rights that support their respective claims.

19. In such cases, the law must introduce compensation or correction factors. This is what the Inter-American Court stated when, for the purposes of *Advisory Opinion OC-16/99*, it examined the concept of due process – which upholds setting those who are unequal for other reasons on an equal footing and permits just solutions to be reached in both material and procedural relations. I believe that it would be useful to quote a phrase of Francisco Rubio Llorente here, which can be applied to the point that I am making, without detriment to its more general scope. According to this Spanish scholar, all “law is intended to be fair and it is the idea of justice that leads directly to the principle of equality which, in some ways, constitutes its essential content.” Nevertheless, “equality is not a point of departure, but a an end” (“La igualdad en la jurisprudencia del Tribunal Superior,” in *La forma del poder (Estudios sobre la Constitución)*, Centro de Estudios Constitucionales, Madrid, 1993, pp. 644 and 656). The laws that regulate relationships between parties that are socially or economically unequal and the norms and practices of all aspects of judicial proceedings should tend towards and respond to this end.

20. The prohibition to discriminate does not admit exceptions or areas of tolerance that would shelter violations; discrimination is always rejected. In this respect, it is does not matter that the prohibition relates to rights that are considered fundamental, such as those that refer to life, physical integrity or personal freedom, or to rights to which some assign a different ranking or a different importance. It is discriminatory to establish different sanctions for the same offences because the authors belong to determined social, religious or political groups. It is discriminatory to deny access to education to members of an ethnic group and to provide it to members of another group; and it is discriminatory – following the same reasoning – to provide some individuals with all measures of protection that the performance of lawful work merits and deny such measures to other individuals who perform the same activity, on grounds that are unrelated to the work itself, such as those arising from their migratory status.

21. The principles of equality before the law and non-discrimination are put to the test when there is contact between different human groups, that are called on to take part in legal and economic relationships which imperil the rights of those who are weakest or least well equipped, owing to their circumstances and the way in which such relationships are established and developed. This has been seen – and is still seen – in many cases, for the most diverse reasons. Nationals and aliens, men and women, adults and minors, ethnic, cultural, political and religious majorities and minorities, winners and losers in domestic and international conflicts, deeply-rooted groups and displaced groups, are only some examples. This occurs among those who form part of the workforce in their own country and those who participate in the same economic processes alongside them, but lack the status of nationals. This status is a protective shield for some; and its absence is frequently the factor that leads to the exclusion or harm of others.

22. The permanent and uncompromising purpose of the human rights system, and also the ideas on which it is based and the goals it seeks, is to eliminate distances, combat abuses, and guarantee rights; in brief, to establish equality and see that justice is done, not merely for ethical reasons, which would in themselves be relevant, but also in strict compliance with the peremptory norms that do not admit exceptions and oblige all States: *jus cogens* and obligations *erga omnes*. In some cases, valuable although insufficient progress has been made; for example, legal equality between men and women – even though this is not yet a reality for all

– and, in others, such as the area of labor relations, where national and alien workers are involved, there is still much to be done.

23. *OC-18/2003* rejects the opinion suggesting there should be restrictions and reductions in the rights of the individual when he crosses the borders of his own country and moves abroad, as if this journey eroded his human condition and took away a migrant's dignity and, therefore, his rights and freedoms. The United Nations Inter-governmental Working Group of Experts on the Human Rights of Migrants – cited in the *amicus curiae* brief of the Center for Legal and Social Studies (CELS), the Ecumenical Service for the Support and Orientation of Refugees and Immigrants (CAREF) and the Legal Clinic for the Rights of Immigrants and Refugees of the Law School of the Universidad de Buenos Aires – pointed out that “[a]ll persons, regardless of their place of residence, have a right to the full enjoyment of all the rights established in the Universal Declaration of Human Rights. States must respect the fundamental human rights of migrants, irrespective of their legal status.” It added: “[a] basic principle of human rights is the fact of entering a foreign country, violating the immigration laws of that country, does not lead to losing the human rights of an immigrant with an irregular status; nor does it eliminate the obligation of a Member State (in an international instrument) to protect them.” However, this is not always acknowledged. To the contrary, as the representative of the United Nations High Commissioner for Refugees (UNHCR) indicated in his *amicus curiae* statement, when a person is classified as a migrant, “this means that he has no rights and therefore the State, exercising its sovereignty, may expel him, deport him, or violate his basic rights.”

24. This *Advisory Opinion* does not deny the possibility of establishing differences between categories of subjects: reasonable differences, based on objective information, with a view to attaining lawful objectives by legitimate means. Evidently, when regulating access to its territory and permanence in it, a State may establish conditions and requirements that migrants must fulfill. Non-compliance with migratory provisions would entail the relevant consequences, but should not produce effects in areas that are unrelated to the matter of the entry and residence of migrants.

25. In view of the above, it would be unacceptable, for example, to deprive an undocumented person of freedom of thought and expression, merely because he is undocumented. Likewise, it is unacceptable to punish non-compliance with migratory provisions by measures relating to other areas, disregarding the situations created in those areas and the potential effects, completely unrelated to the migratory offence. Taking any other course would, as has indeed occurred, deprive a person of the benefits of work already performed, alleging administrative errors: an expropriation, *lato sensu*, of what the worker has obtained for his work – through an agreement entered into with a third party, which has already produced certain benefits to the latter – which would become undue profit if the different forms of remuneration for the work performed are eliminated.

26. Taking into consideration the characteristics of the general obligations of States under general international law and international human rights law, specifically, with regard to these extremes of *jus cogens*, States must develop, as stated in *OC-18/2003*, specific actions of three mutually complementary types: a) they must ensure, by legislative and other measures – in other words, in every sector of State attributes and functions – the effective (and not only nominal) exercise of the human rights of workers on an equal footing and without any

discrimination; b) they must eliminate provisions, whatever their scope and extent, that lead to undue inequality or discrimination; and c) lastly, they must combat public or private practices that have this same consequence. Only then, can it be said that a State complies with its obligations of *jus cogens* in this area, which, as we have said, does not depend on the State being a party to a specific international convention; and only then would the State be protected from international responsibility arising from non-compliance with international obligations.

27. *OC-18/2003* focuses on rights arising from employment and thus concerning workers. Such rights belong to the category of "economic, social and cultural rights, which some scholars have classified as "second-generation" rights. Nevertheless, whatever their status, bearing in mind their subject matter and also the moment in which they were included, first in constitutional and then in international texts, the truth is they have the same status as the so-called "civil and political" rights. Mutually dependent or conditioned, they are all part of the contemporary statute of the individual; they form a single extensive group, part of the same universe, which would disintegrate if any of them were excluded.

28. Among these rights, the only difference relates to their subject matter, the identity of the property they protect, and the area in which they emerge and prosper. They have the same rank and demand equal respect. They should not be confused with each other; however, it is not possible to ignore their interrelationship, owing to circumstances. For example, let us say that, although the right to work cannot be confused with the right to life, work is a condition of a decent life, and even of life itself: it is a subsistence factor. If access to work is denied, or if a worker is prevented from receiving its benefits, or if the jurisdictional and administrative channels for claiming his rights are obstructed, his life could be endangered and, in any case, he would suffer an impairment of the quality of his life, which is a basic element of both economic, social and cultural rights, and civil and political rights.

29. The human rights of workers, namely, the fundamental labor rights, arise from two sources, which function together: a) the human condition of the owner, which, as I have already said, excludes inadmissible inequalities and discriminations; and b) the employment relationship established between the owner of those rights and the legal person, individual or group, to which he will provide, is about to provide or has provided his services; a relationship that arises from the very fact of providing, being about to provide or having provided a service, regardless of what has been formalized in a contract, which does not exist in many – probably, most – cases, although if it exists – and this is what is really important – it is the determining factor of the employment relationship, which is also a source of rights and obligations.

30. It is necessary to draw attention to these considerations with regard to all those who engage in activities in exchange for remuneration, but principally – since it is the issue being examined in *OC-18/2003* – with regard to those classified as workers, according to the usual description of this category in labor law: persons who provide dependent and subordinate services, and who form part of the most extensive sector of the vulnerable group owing to their migratory status, principally undocumented migrants.

31. The different international instruments, as well as the most progressive national texts, contain lists of labor rights that must be respected and guaranteed;

for example, the Universal Declaration of Human Rights, the American Declaration on the Rights and Duties of Man, the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights (Protocol of San Salvador), the International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families, and the ILO Declaration on Fundamental Principles and Rights at Work (86th Session, Geneva, 1998).

32. These and other instruments coincide in establishing the international standards for labor rights cited in this *Advisory Opinion* and applicable to the law and practice of States, according to this Opinion. Such standards are the product of constant and well-documented development, express the shared opinion of the members of the international juridical community, and are therefore doubly important owing to this circumstance and to the nature of the instruments in which they are enshrined.

33. Certain rights mentioned in the considerations of *OC-18/2003* are particularly important because they are the ones that are generally included in national and international norms, often constitute conditions or elements of other labor rights and, owing to their characteristics, determine the general framework for the provision of services and for the protection and welfare of those who provide them. The corresponding list – which is not exhaustive – includes the prohibition of obligatory or forced labor, the elimination of discriminations in the provisions of labor, the abolition of child labor, the protection of women workers and the rights corresponding to remuneration, the working day, rest and holidays, health and security in the workplace, association to form trade unions and collective negotiation.

34. In the “*Programme of Action*” issued by the World Conference against Racism, Racial Discrimination, Xenophobia and Related Intolerance (Durban, 2001) States were urged to ensure the full equality of migrants in the law, “including labor legislation”, and “to eliminate barriers, where appropriate, to their participation in vocational training, collective bargaining, employment, contracts and trade union activity; access to judicial and administrative tribunals dealing with grievances; seeking employment in different parts of their country of residence; and working in safe and healthy conditions” (*Programme* para. 28). They were also urged to “take all possible measures to promote the full enjoyment by all migrants of all human rights, including those related to fair wages and equal remuneration for work of equal value without distinction of any kind, and to the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond their control, social security, including social insurance, access to education, health care, social services and respect for their cultural identity” (*Programme*, para. 30(g)).

35. The mention of these rights in *Advisory Opinion OC-18* is not intended to establish a specific ranking of the human rights of workers, as one group of rights that could constitute the “hard core” and another that might have another nature, in some way secondary or non-essential. The *Opinion* merely highlights certain rights that are important for the employment relationship and for the needs and expectations of undocumented migrant workers and to which special attention should be paid to ensure that they are respected and guaranteed, without lessening the attention that should be paid to other rights not mentioned in the list.

36. Announcing rights without providing guarantees to enforce them is useless. It becomes a sterile formulation that sows expectations and produces frustrations.

Therefore, guarantees must be established that permit: demanding that rights should be recognized, claiming them when they have been disregarded, re-establishing them when they have been violated, and implementing them when their exercise has encountered unjustified obstacles. This is what the principle of equal and rapid access to justice means; namely, the real possibility of access to justice through the means that domestic law provides to all persons, in order to reach a just settlement of a dispute; in other words, formal and genuine access to justice.

37. This access is facilitated by due process, which the Inter-American Court of Human Rights has examined fully in the exercise of its advisory and contentious competence. Strictly speaking, due process is the means to ensure the effective exercise of human rights that is consistent with the most advanced concept of such rights: a method or factor to ensure the effectiveness of law as a whole and of subjective rights in specific cases. Due process – a dynamic concept guided and developed under a guarantee model that serves individual and social interests and rights, and also the supreme interest of justice – is a guiding principle for the proper resolution of legal actions and a fundamental right of all persons. It is applied to settle disputes of any nature – including labor disputes – and to the claims and complaints submitted to any authority: judicial or administrative.

38. Due process, for the purpose that interests us in *OC-18/2003*, entails, on the one hand, the greatest equality – balance, “equality of weapons” – between the litigants, and this is particularly important when on one side of the dispute is the vulnerable migrant worker and on the other the employer endowed with ample and effective rights, an equality that is only obtained – in most cases that reflect the true dimension of the collective problem – when the public authorities incorporate the elements of compensation or correction that I have mentioned above, through laws and criteria for interpretation and implementation; and, on the other hand, clear and flexible compliance with the State’s obligation to provide a service of justice without distinction, much less discrimination, which would entail the defeat of the weaker party at the very outset.

39. The clarifications in *OC-18/2003* have particular relevance. Indeed, undocumented workers usually face severe problems of effective access to justice. These problems are due not only to cultural factors and lack of adequate resources or knowledge to claim protection from the authorities with competence to provide it, but also to the existence of norms or practices that obstruct or limit delivery of justice by the State. This happens because the request for justice can lead to reprisals against the applicants by authorities or individuals, measures of coercion or detention, threats of deportation, imprisonment or other measures that, unfortunately, are frequently experienced by undocumented migrants. Thus, the exercise of a fundamental human right – access to justice – culminates in the denial of many rights. It should be indicated that even where coercive measures or sanctions are implemented based on migratory provisions – such as deportation or expulsion – the person concerned retains all the rights that correspond to him for work performed, because their source is unrelated to the migratory problem and stems from the work performed.

40. The *Advisory Opinion*, with which I agree in this *separate opinion*, deals with the issue of public policies posed in the questions raised by the requesting State. In this respect, it is acknowledged that States have the authority to adopt public policies – which are expressed in laws, regulations and other norms, plans, programs and different acts – in order to achieve legitimate collective goals. These policies

include those relating to demographic processes, which involve migratory issues, in addition to those relating to the management of the economy, the use of the workforce, the promotion of certain productive activities, the protection of specific sectors of agriculture, industry, commerce and services, and others.

41. There is a problem, however, when some specific aspects of State policy enter into conflict with the human rights of a certain sector of the population. Obviously, this should never occur. It is one of the State's functions – which responds to its democratic vocation and recognizes and guarantees the human rights of its inhabitants – to implement the various public policies so that these rights are preserved and, at the same time, the legitimate objectives for which those policies were designed are achieved. Let me repeat that achieving a commendable end does not justify using unlawful means. In such cases, the State's essential commitment to human rights prevails, because the guarantee of human rights is an underlying principle of the political structure, as has been stated constantly in the principal political texts of the modern era, produced by the major rebel and revolutionary movements of the United States and France in the latter part of the eighteenth century. If this is the essential ethical and legal basis of politics, a State cannot violate the human rights of the persons subject to its jurisdiction on the basis of specific policies.

42. On these grounds, *Advisory Opinion OC-18/2003* refers to several agreements of the international community – evidently based on profound convictions – with regard to migratory policies, the subject of the request submitted by the United Mexican States. In this respect, the “*Declaration*” and the “*Programme of Action*” resulting from the Durban Conference, and the corresponding resolution of the United Nations Human Rights Commission (Res. 2001/5) should be underscored; they are all mentioned by the Inter-American Court in the *Advisory Opinion*. The Declaration affirms the right of States to adopt their own migration policies and also that “these policies should be consistent with applicable human rights instruments, norms and standards” (*Declaration*, para. 47).

43. It would be unrealistic to believe that the opinion of a jurisdictional body – even though it is supported by the convictions and decisions of States representing hundreds of millions of individuals in this hemisphere – and the trend towards progress with justice that inspires many men and women of good will, could, in the short-term, reverse obsolete tendencies that are rooted in deep prejudices and sizeable interests. However, when combined, these forces can play their role in man's effort to move mountains. Making this effort and succeeding requires the adoption – as was said in Durban – of strategies, policies, programs and measures that are part of the “responsibility of all the States, with the full participation of civil society, at the national, regional and international level” (*Declaration*, para. 122). *OC-18/2003* fulfills its particular mandate in this effort. It does so, as corresponds to this Court, from its own specific position: the legal one, based on the principles that are at the root of the international human rights system.

Sergio García-Ramírez
Judge

Manuel E. Ventura-Robles
Secretary

CONCURRING OPINION OF JUDGE HERNÁN SALGADO PESANTES

This Advisory Opinion, requested by the State of Mexico and enhanced by the opinions of other States and the intellectual contribution of non-governmental organizations, allowed us to reflect on numerous issues, some of which I would like to take up again in support of the opinions expressed therein.

1. In light of the interrelation and indivisibility of human rights, equality and non-discrimination are rights that form a platform on which others are erected, particularly economic, social and cultural rights, whose content cannot omit the former. The same is true in the case of freedom.

2. Non-discrimination is inseparable from equality and determines the scope of the former. At the current stage in the development of human rights, I believe that equality and non-discrimination are two rights with an autonomous content that have a separate existence within this framework of indivisible interrelation.

3. In recognition of the diversity of human beings, it is acknowledged that equality accepts and promotes certain distinctions, provided they tend to increase rather than prevent the enjoyment and exercise of all rights, including equality itself. Consequently, such distinctions do not affect the right to non-discrimination; nor do they restrict the concept of equality.

4. In the context of this Opinion, the Court has differentiated between distinction and discrimination (paragraph 84) and has indicated the characteristic elements of the former, on which I would like to insist.

5. The concept of distinction refers to a treatment that is different from the one generally applied; in other words, a specific situation is singularized for certain reasons. To ensure that distinction does not become discrimination, the following requirements, established by human rights case law and theory, must be fulfilled.

6. It should pursue a legitimate goal and it should be objective, in the sense that there is a substantial and not merely formal difference, because, as this Court has indicated, distinction in treatment should be founded on "*substantial factual differences and [...] a reasonable relationship of proportionality between these differences and the aims of the legal rule under review.*"²⁰⁷

7. In addition, the difference must be relevant, have sufficient importance to justify a different treatment, and be necessary and not merely convenient or useful. For example, the difference between a man and a woman is not sufficient to impose a different treatment in the workplace, but the fact of pregnancy and maternity is.

8. There must be proportionality between the factual and juridical difference, between the chosen means and the ends; disproportion between the content of the different treatment and the proposed goal leads to discrimination. For example, in order to sustain a labor policy, it is decided that undocumented workers should be stripped of their fundamental rights.

9. Together with proportionality, appropriateness and relevance are usually

²⁰⁷ ICourTHR., *Proposed Amendments to the Naturalization Provisions of the Constitution of Costa Rica*. Advisory Opinion OC-4/84 of January 19, 1984. Series A No. 4, para. 57.

indicated, as regards the desired juridical consequences of the differentiated treatment, taking into account the concrete and actual circumstances in which the distinction will be applied.

10. But there is a common denominator with regard to the preceding elements, which fine tunes the content and scope of the other elements, and that is reasonableness. The use of these elements allows us to identify the presence of discrimination in a "suspect category," represented in this case by the undocumented migrant workers.

11. Undocumented migrant workers have – as has any human being – the rights to equality before the law and not to be discriminated against.

12. Equality before the law means that they must be treated in the same way as documented migrants and nationals before the law of the receiving country. The prohibition to work has to be considered in this context. The condition of undocumented worker can never become grounds for not having access to justice and due process of law, for failing to receive earned salaries, for not having social security benefits and for being the object of various forms of abuse and arbitrariness.

13. Such situations illustrate the existence of a series of discriminatory treatments that those responsible seek to found on the distinction between documented and undocumented.

14. As the Advisory Opinion states, this difference in treatment is neither justified, necessary nor proportionate, and its effects are not reasonable; it is at odds with the State's main function, which is to respect and ensure the rights of every individual who, for labor-related reasons, and with or without documents, is subject to its jurisdiction.

15. It should be borne in mind that grave violations of rights, as in the case of the undocumented migrant workers, end up by seriously affecting the right to life. In this respect, the Inter-American Court has stated that life includes, "*not only the right of every human being not to be deprived of his life arbitrarily, but also the right that he will not be prevented from having access to the conditions that guarantee a dignified existence.*"²⁰⁸

16. It is worth emphasizing that, as in the case of the other rights, the obligation to respect and ensure equality and non-discrimination embodied in international human rights law – with its treaties and case law – is also a non-derogable obligation in the domestic law of constitutional and democratic States.

17. I consider that an extremely important point in this Advisory Opinion is that of establishing clearly the effectiveness of human rights with regard to third parties, in a horizontal conception. These aspects, as is acknowledged, have been amply developed in German legal writings (*Drittwirkung*) and are contained in current constitutionalism.

18. It is not only the State that has the obligation to respect human rights, but

²⁰⁸ ICourtHR., the *Case of the "Street Children" (Villagrán Morales et al.)*. Judgment of November 19, 1999. Series C No. 63, para. 144.

also individuals in their relationships with other individuals. The environment of free will that prevails in private law cannot become an obstacle that dilutes the binding effectiveness *erga omnes* of human rights.

19. The possessors of human rights – in addition to the State (the public sphere) – are also third parties (the private sphere), who may violate such rights in the ambit of individual relationships. For the purposes of this Opinion, we are limiting ourselves basically to the workplace where it has been established that the rights to equality and non-discrimination are being violated.

20. Labor rights as a whole acquire real importance in relationships between individuals; consequently, they must be binding with regard to third parties. To this end, all States must adopt legislative or administrative measures to impede such violations and procedural instruments should be effective and prompt.

21. At the level of international responsibility, any violation of rights committed by individuals will be attributed to the State, if the latter has not taken effective measures to prevent such violation or tolerates it or permits the authors to remain unpunished.

22. The foregoing signifies that international human rights instruments also produce binding effects with regard to third parties. Likewise, the responsibility of the individual has a bearing on and affects that of the State.

I have participated in this Advisory Opinion, like my colleagues, aware of its importance for the countries of our hemisphere.

Hernán Salgado-Pesantes
Judge

Manuel E. Ventura-Robles
Secretary

CONCURRING OPINION OF JUDGE ALIRIO ABREU BURELLI

While being of the same opinion as the other judges of the Inter-American Court of Human Rights in rendering this Advisory Opinion, I wish to submit the following considerations separately:

I

On this occasion, the Court has defined the scope of the obligation of the member States of the Organization of American States to respect and guarantee the labor rights of undocumented migrant workers, irrespective of their nationality, by establishing that the principle of equality and non-discrimination, which is fundamental for the safeguard of those rights, belongs to *ius cogens*²⁰⁹.

This definition also leads the Court to declare that, regardless of whether or not States are party to a specific international treaty, they are obliged to protect the right to equality and non-discrimination and that this obligation has effects *erga omnes*, not only with regard to the States, but also with regard to third parties and individuals. Consequently, States must respect and guarantee the labor rights of workers, whatever their migratory status and, at the same time, must prevent private employers from violating the rights of undocumented migrant workers and the employment relationship from violating minimum international standards. For the protection of the labor rights of undocumented migrants to be effective, such workers must be guaranteed access to justice and due process of law²¹⁰.

A State's observance of the principle of equality and non-discrimination and the right to due process of law cannot be subordinated to its policy goals, whatever these may be, including those of a migratory character.

By voting in favor of the adoption of this Opinion, I am aware of its particular importance in endeavoring to provide legal answers, in international law, to the grave problem of the violation of the human rights of migrant workers. In general, despite their non-contentious nature, Advisory Opinions have indisputable effects on both the legislative and administrative acts of States and on the interpretation and application of laws and human rights treaties by judges, owing to their moral authority and the principle of good faith on which the international treaties that authorize them are based.

²⁰⁹ According to the European Court of Human Rights, the affirmation that the principle of equality and non-discrimination belongs to the domain of *ius cogens* has several legal effects: recognition that the norm ranks higher than any norm of international law, except other norms of *ius cogens*; in case of dispute, the norm of *ius cogens* would prevail over any other norm of international law, and the provision that contradicts the peremptory norm would be null or lack legal effects. (Taken from the arguments of the Legal Clinics of the College of Jurisprudence of the Universidad San Francisco, Quito).

²¹⁰ In Advisory Opinion OC-16/99 of October 1, 1999, the Inter-American Court of Human Rights indicated that "for 'the due process of law' a defendant must be able to exercise his rights and defend his interests effectively and in full procedural equality with other defendants. It is important to recall that the judicial process is a means to ensure, insofar as possible, an equitable resolution of a difference. The body of procedures, of diverse character and generally grouped under the heading of the due process, is all calculated to serve that end. To protect the individual and see justice done, the historical development of the judicial process has introduced new procedural rights. An example of the evolutive nature of judicial process are the rights not to incriminate oneself and to have an attorney present when one speaks. These two rights are already part of the laws and jurisprudence of the more advanced legal systems. And so, the body of judicial guarantees given in Article 14 of the International Covenant on Civil and Political Rights has evolved gradually. It is a body of judicial guarantees to which others of the same character, conferred by various instruments of international law, can and should be added.

II

In this Opinion, the Court has ruled on the rights that States must recognize and apply to workers who, due to different circumstances, emigrate from their countries in search of economic well-being, and who, because they do not have legal migratory status, may become victims of violations of such rights as their labor rights, and their rights to decent treatment, equality and non-discrimination. In this respect, the State that requested the Court to render an Opinion referred specifically to the fact that almost six million Mexican workers are outside national territory; and, of these, approximately two and a half million are undocumented migrant workers. It added that "in less than five months (in 2002), the Government of Mexico had to intervene, through its consular representatives, in the defense of the human rights of Mexican nationals in approximately 383 cases, in order to protect migrant workers with regard to employment-related discrimination, unpaid wages, and compensation for occupational illnesses and accidents, among others matters."

Likewise, Judge Antonio Cançado Trindade, in a study on enforced migratory flows, indicated that "... migrants seeking work and better living conditions amount to 80 million human beings today... The causes of forced migrations are basically no different from those of population displacement. In a 1992 analytical report on internally displaced persons, the Secretary General of the United Nations identified natural disasters, armed conflict, generalized violence and systematic human rights violations among the causes of massive involuntary migrations within State borders."²¹¹

According to Judge Cançado Trindade, other causes of massive migrations are, "the multiple internal conflicts, of an ethnic and religious nature, repressed in the past but set in motion in recent years. These are supplemented by the increase in chronic poverty, which, according to the United Nations Development Programme, today affects more than 270 million persons in Latin America alone... ." According to a report of the United Nations human rights body²¹², the causes of contemporary migrations in search of work are fundamentally poverty and the inability to earn or produce enough for personal or family subsistence in the country of origin. These reasons characterize not only migration from poor States to rich ones; poverty also encourages movement from developing countries to other countries where the work prospects appear to be better, at least from a distance. According to this report, there are other reasons that explain the departure abroad in search of work. War, civil conflict, insecurity or persecution derived from discrimination due to race, ethnic origin, color, religion, language or political opinions are all factors that contribute to the flow of migrant workers.

III

Limited to the strictly juridical sphere, established by regulatory, statutory and convention-related instruments that govern its proceedings, in exercise of its competence, the Court cannot go beyond the interpretation and application of legal norms in its judgments and advisory opinions. However, it is impossible to prevent the human tragedy underlying the cases it hears from being reflected in the Court's proceedings and reports. Frequently, the statements of the victims or of their next

²¹¹ Cançado Trindade, Antônio A. "Elementos para un Enfoque de Derechos Humanos del Fenómeno de los Flujos Migratorios Forzados". Publication of the International Organization for Migrations and the Inter-American Institute of Human Rights. Guatemala 2001, p. 11.

²¹² Cited by Antônio Cançado Trindade, ob. cit., p. 12.

of kin, who resort to the Court seeking justice, have moved the judges profoundly. The arbitrary death of children, of youth or, in general, of any person; enforced disappearance; torture; illegal imprisonment, and other human rights violations, submitted to the Court's consideration and decision, cannot be resolved by mere legal concepts; not even bearing in mind the Court's efforts to try and provide reparations for the damages suffered by the victims that go beyond monetary compensation. It continues to be an ideal – whose achievement depends on the development of a new collective conception of justice – that these violations should never be repeated and that, if they are, their authors should be severely punished. In this Opinion, stated in concrete legal – but also humanistic – terms, and taking into account the international obligations assumed by States, the Court has defined the conduct that States should observe in order to respect and guarantee the rights of undocumented migrants, to prevent them from becoming victims of exploitation or discrimination in the enjoyment and exercise of their labor rights. It is a ruling of the Court on the interpretation and application of norms that are in force and that are universally accepted because they are grounded on principles of *ius cogens*, that obliges all States equally; however, this ruling also contains an implicit call for social justice and human solidarity.

IV

In particular – and due to the possibility of doing so in this separate opinion – I consider that the tragedy represented in each case of forced migration, whatever its cause, cannot be bypassed for mere juridical considerations. Thus, the tragedy of all those who, against their will, abandon their country of origin, their home, their parents, their spouse, their children, their memories, in order to confront generally hostile conditions and become the target of human and labor exploitation owing to their particularly vulnerable situation, should give us cause for reflection. In addition to trying to repair the consequences of forced migrations, through instruments of international law, the creation of courts, migratory policies and administrative or other measures, the international community should also concern itself with investigating the real causes of migration and ensure that people are not forced to emigrate. In this way, it would be discovered that, apart from inevitable natural events, on many occasions migrations are the result of the impoverishment of countries, due to erroneous economic policies, which exclude numerous sectors of the population, together with the generalized fact of corruption. Other factors include dictatorships or populist regimes; irrational extraction from poor countries of raw materials for processing abroad by transnational companies, and the exploitation of workers with the tolerance and complicity of Governments; vast social and economic imbalances and injustice; lack of national educational policies that cover the entire population, guaranteeing professional development and training for productive work; excessive publicity which leads to consumerism and the illusion of well-being in highly developed countries; absence of genuine international cooperation in the national development plans; and macro-economic development policies that ignore social justice.

Faced with the magnitude of these problems, proposals have been formulated, some addressed at the construction of a new international order based on justice and the strengthening of democracy. In his book "El derecho Internacional de los Derechos Humanos en el siglo XXI", Judge Cançado Trindade considers that "... according to recent information from UNDP and CEPAL, the current phenomenon of *impoverishment*, and of the significant growth of contingents of "new poor" in so many Latin American countries, reveals the failure to observe, and even the

generalized violation of, economic, social and cultural rights. Certain rights, of an economic and social nature, such as the rights not to be submitted to forced labor or to discrimination in relation to employment, and also freedom of association to form labor unions, are closely linked to the so-called civil liberties... The 1992 Human Development Report of the United Nations Development Programme (UNDP) indicates that 'democracy and freedom depend on much more than the vote'. The expansion of democracy has been complemented by a greater acknowledgment of human rights. In brief, there are no human rights without democracy, as there is no democracy without human rights... Participative democracy and, in the final analysis, human development itself, are only possible within the framework of human rights... Today, the concept of democracy embraces both political democracy (with an emphasis on formal democratic processes) and "development democracy; in the latter, 'civil and political rights are considered vehicles for the advancement of the equality of conditions, and not merely opportunities.' ...The interrelation of human rights and democracy nowadays finds expression in the provisions of general human rights instruments at the global and regional level."²¹³

In Advisory Opinion OC-9/87 of October 6, 1987, the Court indicated, as it had in previous Opinions (OC-5/85, OC-6/86, OC-8/87), that the rule of law, democracy and personal freedom are consubstantial with the regime of human rights protection contained in the Convention and added: "In a democratic society, the rights and freedoms inherent in the human person, the guarantees applicable to them and the rule of law form a triad. Each component thereof defines itself, complements and depends on the others for its meaning."

It is possible that the establishment of a just society begins with the strengthening of a genuine democracy that fully guarantees the dignity of the human being.

Alirio Abreu-Burelli
Judge

Manuel E. Ventura-Robles
Secretary

²¹³ Cançado Trindade, Antônio A. "El Derecho Internacional de los Derechos Humanos en el siglo XXI", Editorial Jurídica de Chile, 2001.

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

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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 RRG 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 5th 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 5th 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. Kosztolány. 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 or 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* (6th 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, (9th 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* (6th 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 follows¹:

“(1) For the establishment, development, renovation, maintenance and operation of Budapest Ferihegy International Airport, and within this scope,

¹ 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* (9th 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 25th day of September 2006

_____ Signed _____

The Honorable Charles N. Brower

Dated this 22nd day of September 2006

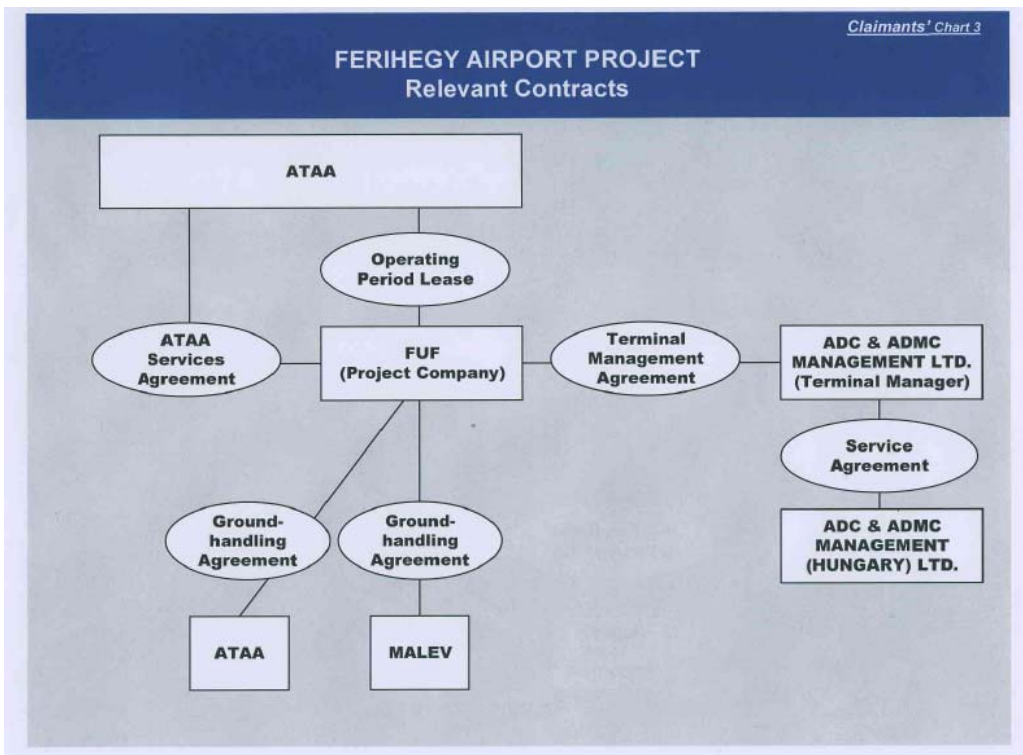
_____ Signed _____

Neil T. Kaplan CBE, QC

President

Dated this 27th day of September 2006

Appendix 1 Claimants' Chart 3



PARKERINGS-COMPAGNIET AS

Claimant

v.

REPUBLIC OF LITHUANIA

Respondent

AWARD

TRIBUNAL

Dr. Julian Lew Q.C., *Arbitrator*

The Hon. Marc Lalonde P.C., O.C., Q.C., *Arbitrator*

Dr. Laurent Lévy, *President*

Secretary of the Tribunal

Ms. Martina Polasek

Date of dispatch to the parties: September 11, 2007

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1. THE PARTIES

1.1 THE CLAIMANT

1. Parkerings-Compagniet AS (“Parkerings” or “the Claimant”) is a corporation organized and existing under the laws of Norway.
2. Parkerings’ principal business activity consists in the development and operation of public and private parking facilities, including the collection of parking fees and the enforcement of parking regulations.
3. Its corporate headquarters are located at:

Økernveien 145, 9. etg.
PO Box 158 Økern
N-0509 Oslo, Norway

4. The Claimant is represented in this arbitration by:

Mr. David W. Rivkin
Mr. Gaetan J. Verhoosel
Mr. William H Taft V
Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022
USA

Mr. Zilvinas Kvietkus
Norcous & Partners
A. Goštauto str. 12 A
01108 Vilnius
Lithuania

Ms. Carita Wallgren
Roschier Holmberg, Attorneys Ltd.
Keskuskatu 7A
00100 Helsinki
Finland

1.2 THE RESPONDENT

5. The Respondent is the Republic of Lithuania (“Lithuania” or “the Respondent”).
6. The Respondent is represented in this arbitration by:

Mr. Petras Baguska, Minister of Justice
Mr. Paulius Koverovas, State Secretary of the Ministry of Justice
Ministry of Justice

Gedimino pr. 30/1
011104 Vilnius
Lithuania

Mr Alexander Yanos
Freshfields Bruckhaus Deringer LLP
520 Madison Avenue, 34th floor
New York NY 10022
USA

Ms. Lucy Reed
Mr. Constantine Partasides
Mr Noah Rubins
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2, rue Paul Cézanne
75008 Paris
France

Ms. Renata Beržanskienė
Law Office Adamonis, Beržanskienė and partners Sorainen Law Offices
Jogailos 4
01116 Vilnius
Lithuania

2. THE ARBITRAL TRIBUNAL

2.1 CO-ARBITRATOR NOMINATED BY THE CLAIMANT

7. Nominated by the Claimant in its Request for Arbitration dated 11 March 2005:

Dr Julian D. M. Lew, Q.C.
20 Essex Street
London WC2R 3AL
United Kingdom

2.2 CO-ARBITRATOR NOMINATED BY THE RESPONDENT

8. Nominated by the Respondent by letter dated 9 September 2005:

The Honorable Marc Lalonde P.C., O.C., Q.C.
1155 René-Levesque Blvd West
33rd floor
Montreal, QC H3B 3V2
Canada

2.3 CHAIRMAN OF THE ARBITRAL TRIBUNAL

9. Jointly appointed by the parties by letter dated 3 October 2005:

Dr. Laurent Lévy
Schellenberg Wittmer
15 bis, rue des Alpes
P.O. Box 2088
1211 Geneva 1
Switzerland

3. SUMMARY OF THE ARBITRAL PROCEEDINGS

3.1 INITIATION OF THE ARBITRATION AND CONSTITUTION OF THE ARBITRAL TRIBUNAL

10. On 11 March 2005, the Claimant filed its Request for Arbitration with the Secretary-General of the International Centre for Settlement of Investment Disputes (“ICSID”). With respect to the “*method of appointment of the Tribunal and appointment of arbitrator,*” ¶¶ 72 of the Request set forth the following:

The Treaty does not set forth any particular method of appointment of the Tribunal. Having regard to Article 37 of the Convention and Rule 2 of the ICSID Arbitration Rules, Parkerings proposes that the Tribunal consist of three arbitrators, one appointed by each party and the President of the Tribunal appointed by agreement of the parties.

11. Under ¶¶ 73 of the Request for Arbitration, the Claimant appointed as its arbitrator Dr. Julian D. M. Lew, Q.C. On 21 June 2005, ICSID informed the parties that Dr. Lew had accepted his appointment as arbitrator.
12. On 17 March 2005, ICSID addressed to the Respondent a copy of the Request for Arbitration.
13. On 22 April 2005, ICSID requested, in accordance with Rule 2(1)(c) of the Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (Institution Rules), that the Claimant communicate to the Centre, on the one hand, “*information concerning the consent of Parkerings-Compagniet AS to submit the dispute with the Republic of Lithuania to ICSID,*” and, on the other hand, “*evidence of entry into force of the bilateral investment treaty between the Government of the Republic of Lithuania and the Government of the Kingdom of Norway of June 16, 1992.*” The Claimant provided the requested information by letter dated 29 April 2005.
14. On 16 May 2005, the Secretary-General of ICSID issued a “Notice of Registration,” stating that the Request for Arbitration, as supplemented by counsel for the Claimant’s letter of 29 April 2005, had been registered in the Arbitration Register. He also invited the parties to “*communicate [...] any provisions agreed by them regarding the number of arbitrators and the method of their appointment.*”

15. By letter dated 27 May 2005, the Respondent informed ICSID that *“it raises no objection to the Parkerings-Compagniet AS proposal regarding the Arbitral Tribunal consisting of three arbitrators.”*
16. By letter dated 8 August 2005, the Respondent requested an extension of the 15 August 2005 deadline for the constitution of the Tribunal to 15 September 2005. By letter dated 12 August 2005, the Claimant declared that it did not object to such time extension.
17. By letter dated 9 September 2005, counsel for the Respondent appointed the Honorable Marc Lalonde P.C., O.C., Q.C. as arbitrator. On 15 September 2005, ICSID informed the parties that Mr. Lalonde had accepted his appointment.
18. On 3 October 2005, counsel for the parties jointly informed ICSID of the parties’ agreement to appoint Dr Laurent Lévy as President of the Tribunal. By letter dated 10 October 2005, Dr Lévy accepted his appointment.
19. On 12 October 2005, ICSID informed the parties that all three arbitrators had accepted their appointment and that the Arbitral Tribunal was deemed to have been constituted and the proceedings to have begun on that same day.

3.2 FIRST SESSION OF THE TRIBUNAL

20. The Arbitral Tribunal held a first session on 25 November 2005 in London, UK. In addition to the Members of the Tribunal and the Secretary, the following persons attended the hearing:
 - (i) Representing Parkerings:
 - Ms. Carita Wallgren, Roschier Holmberg, Attorneys Ltd.,
 - Mr. Gaetan J. Verhoosel, Debevoise Plimpton LLP, and
 - Mr. Zilvinas Kvietkus, Norcous & Partners.
 - (ii) Representing Lithuania:
 - Mr. Paulius Koverovas, State Secretary of the Ministry of Justice of the Republic of Lithuania,
 - Mr. Constantine Partasides, Freshfields Bruckhaus Deringer LLP,
 - Mr. Noah Rubins, Freshfields Bruckhaus Deringer LLP, and
 - Ms. Renata Beržanskienė, Law Office Adamonis, Beržanskienė and partners Sorainen Law Offices.

21. A sound recording was made of the hearing, copies of which were sent to the parties. The Secretary also prepared summary minutes of the session, a certified copy of which was sent to the parties on 18 January 2006.
22. At the outset of the hearing, a number of procedural issues were dealt with. In particular, it was agreed that, pursuant to Article 44 of the ICSID Convention, the proceedings would be conducted in accordance with the ICSID Arbitration Rules in force since 1 January 2003. It was also agreed that the place of the proceedings would be Paris, France, and that, in accordance with Article 22 of the ICSID Arbitration Rules, the language of the proceeding would be English. During the course of the session, the parties acknowledged that the Tribunal has been duly constituted.
23. The Arbitral Tribunal and the parties agreed on the following time table:

The Claimant shall file its memorial on the merits by February 10, 2006;

The Respondent shall file its counter-memorial on the merits, any jurisdictional objections and any request for bifurcation of the proceeding by June 12, 2006;

The Claimant shall file its observations on the Respondent's request for bifurcation, if any, by July 3, 2006;

A pre-hearing conference limited to pending procedural questions will be held in Paris on August 28, 2006; and

A hearing on the merits or on jurisdiction or on both will be held in Paris on November 6-10, 2006.

3.3 PRE-HEARING WRITTEN PHASE

24. On 17 January 2006, the Claimant filed a request for the production of documents.
25. On 20 January 2006, the Respondent acknowledged receipt of the Claimant's document production request, and filed its comments thereon.
26. On 24 January 2006, the President of the Tribunal invited, on the one hand, the Claimant to submit its reply to the Respondent's observations within four days, and, on the other hand, the Respondent to submit its rejoinder within four days of the reply. The President of the Tribunal also invited the Respondent to gather and communicate to the Claimant all the documents that it accepted to produce without awaiting a decision from the Tribunal.
27. By letter dated 27 January 2006, counsel for the Claimant informed the Tribunal that the parties had agreed upon the following production schedule, subject to the agreement of the Tribunal:

1. By February 6, 2006, Respondent shall: (i) produce to Claimant the documents responsive to categories (a), (b), (d), (e), (f), (g), and (h) of the Application; and (ii) inform Claimant whether and, if so by when, it expects to be in a position to produce to Claimant the documents responsive to categories (c), (i), (j), (k), (l), and (m) of the Application.

2. If by February 6, 2006, Respondent confirms a schedule for the production of the documents responsive to categories (c), (i), (j), (k), (l), and (m), the parties shall endeavor to reach an agreement on any adjustments to the schedule of the arbitral proceedings required by such proposed schedule, on the understanding that: (i) any such adjustments

shall not affect the August 28, 2006 pre-hearing conference or the evidentiary hearing scheduled for November 6-10, 2006; (ii) Claimant's Memorial shall be due by a date no earlier than February 17, 2006; and (iii) any extension accorded to Claimant, at a minimum, shall not diminish the amount of time allotted to Respondent for the submission of its Counter-Memorial.

3. Should the parties have any dispute over the scope or schedule of production proposed by Respondent by February 6, 2006 in accordance with ¶¶ 1 or 2 above, they shall promptly submit such dispute to the Tribunal for resolution. The parties agree that, should such a dispute arise, Claimant's Memorial shall be due by a date no earlier than February 17, 2006, and the parties shall consult to agree on a mutually acceptable schedule for submissions, again with the understanding that the August 28, 2006 pre-hearing conference and the evidentiary hearing scheduled for November 6-10, 2006 shall not be affected and that such schedule, at a minimum, shall not diminish the amount of time allotted to Respondent for the submission of its Counter-Memorial.

28. Counsel for the Claimant added that *"in light of the [...] agreed Schedule, Claimant withdraws the Application at this time. Claimant's right to revive the Application in whole or in part is reserved in accordance with ¶ 3 of the Schedule."*

29. By letter dated 17 February 2006, counsel for the Claimant informed the Tribunal that the parties had agreed on the following further adjustments to the schedule of the arbitral proceedings, subject to the agreement of the Tribunal:

- *Claimant shall submit its Memorial on February 24, 2006.*
- *Respondent shall submit its Counter-Memorial on June 26, 2006.*
- *Claimant shall file its observations on Respondent's request for bifurcation, if any, by July 17, 2006;*

The dates scheduled for the pre-hearing conference (August 28, 2006) and the evidentiary hearing (November 6-10, 2006) remain unchanged.

30. On 17 February 2006, the Secretary wrote to the parties to confirm the new schedule for the submission of written pleadings as agreed upon by the parties.

31. On 27 February 2006, the Secretary received the Claimant's Memorial, with accompanying documentation (two witness statements, one expert report, exhibits numbered CE 1 through CE 259, and authorities numbered CA 1 through CA 57), under cover of a letter dated 24 February 2006

32. By letter dated 5 June 2006, the Claimant filed, in agreement with the Respondent, the following additional documents to complement its submission of 24 February 2006:

- (i) a supplemental statement by Mr. Carlos Lapuerta responding to corrected parking revenue data provided by Respondent following submission of Mr. Lapuerta's expert report on February 24, 2006;*
- (ii) four new exhibits (CE 260-263) consisting of documents produced by Respondent on May 22, 2006 in response to a supplemental document request by Claimant, including excerpted translations; and*
- (iii) in accordance with Arbitration Rule 25, the annexed list of corrections of accidental errors in Claimant's February 24, 2006 submission, as well as corrected versions of four exhibits submitted with Claimant's Memorial and/or their translations (CE 21, 54, 70 and 247). This list and these corrected exhibits were previously provided to Respondent on May 4, 2006.*

33. By letter dated 27 June 2006, counsel for the Respondent sought “*the Tribunal’s approval of the parties’ agreement to grant the Republic an extension for the filing of its Counter-Memorial until July 24, 2006, subject to the following two conditions: (i) the Republic’s commitment not to seek any bifurcation of the proceedings; and (ii) the maintenance of the remainder of the schedule as agreed at the procedural hearing (including the dates of the August 2006 pre-hearing/preliminary conference on procedural questions and the November 2006 hearing on the merits).*” Counsel for the Respondent further confirmed that “*the Republic will comply with the above conditions and will be filing its Counter-Memorial within the agreed deadline.*”
34. By email of 28 June 2006 and letter dated 30 June 2006, the Secretary informed the parties of the Tribunal’s approval of their agreement to extend the time limit for the filing of the Counter-Memorial until 24 July 2006.
35. On 25 July 2006, counsel for the Respondent filed its Counter-Memorial and accompanying documents (two witness statements, one expert report, exhibits numbered RE 1 through RE 94, and authorities numbered RA 1 through RA 49).
36. On 28 August 2006, the Tribunal, the parties, and the Secretary held a pre-hearing telephone conference, at the close of which the President of the Tribunal issued directions regarding the parties’ opening statements and the evidence that counsel for the parties would wish to present during the hearing. The President of the Tribunal further authorized the Claimant to file, by 15 September 2006 at the latest, two additional statements of new witnesses as well as new exhibits, provided that the issues discussed in the additional witness statements and the new exhibits be strictly limited to rebuttal of allegations made by the Respondent in its written submission or by the Respondent’s witnesses, and do not pertain to allegations already made by the Claimant or contemplated by its witnesses in prior submissions. The President also authorized the Respondent to file, by 20 October 2006 at the latest, additional statements of new witnesses (in principle, no more than two) or supplemental statements of existing witnesses, as well as additional exhibits, provided that the facts discussed in these additional/supplemental witness statements and exhibits be strictly limited to rebuttal of allegations made by the Claimant’s new witnesses or of the contents of the Claimant’s additional exhibits. The President of the Tribunal invited the parties to inform the Tribunal, by 27 October 2006 at the latest, which additional witness(es) would be called for oral examination and which adjustments would need to be made with respect to the sequence and timing of witness examination. Finally, the President of the Tribunal issued the following additional directions:
- *Witnesses will be allowed in the hearing room at any time (i.e before and after their examination). Either party may, however, apply for the exclusion of one or more witnesses from the hearing room, at certain or all times. To avoid wasting time on procedural issues during the hearing week, counsel are invited to confer before filing any such application.*
 - *The issue whether counsel shall have the opportunity to make oral closing statements and/or to file post-hearing briefs shall be discussed at the hearing. The Tribunal shall issue a determination in this respect by Wednesday 12 November 2006 at the latest, upon request from the parties, if not ex officio.*

- *Upon agreement between the parties, the hearing shall end on Friday at 1:30 p.m. at the latest.*

37. On 15 September 2006, Parkerings filed:

- two additional statements of new witnesses (Björn Öberg and Sigitas Burnickas);
- two new legal authorities that had allegedly only been issued and become available after Parkerings' submission of 24 February 2006 (CA 58 and CA 59); and
- 37 new exhibits (CE 264-CE 300).

38. On 20 October, Lithuania filed:

- two additional statements of new witnesses (Jonas Endriukaitis and Ingrida Simonyte);
- two new legal authorities (RA 50 and RA 51); and
- 9 new exhibits (RE 95-RE 103).

39. On the same date, Parkerings filed five additional documents (CE 301-CE 305).

40. On 30 October 2006, Lithuania wrote that it had no objection to the Claimant's submission of Exhibits 301-305. On the same date, Lithuania filed additional documents (RE 104 – RE 108). The Claimant did not object to the new exhibits.

3.4 THE EVIDENTIARY HEARING

41. On 27 October 2006, the Claimant addressed to the Tribunal a letter regarding the witnesses it would put forward at the hearing. On 30 October 2006, the Respondent filed a similar communication in this respect.

42. The evidentiary hearing was held in Paris on 6, 7, 8, 9 and 10 November 2006, in the course of which the following witnesses and experts were heard:

1. Mr. Bjørn Havnes
2. Mr. Sigitas Burnickas
3. Mr. Jonas Tamulis
4. Mr. Björn Oberg
5. Professor Gintautas Bartkus
6. Mr. Robertas Staskevicius
7. Mr. Raivydas Rukstele

8. Mr. Jonas Endriukaitis
 9. Ms. Ingrida Šimonytė
 10. Mr. Carlos Lapuerta
 11. Mr. Tim Giles
43. During the hearing, the Claimant filed additional documents (CE 306 – CE 311) and two additional authorities (CA 60 and CA 61)
 44. Shortly after the hearing, the Arbitral Tribunal and the parties agreed on the procedural follow-up to the hearing. In particular, they agreed that the parties would file simultaneous post-hearing briefs on 8 December 2006; the parties would file simultaneous reply post-hearing briefs consisting in a short letter response within one week of the first submission; and the parties would submit their respective statements on costs jointly with their post-hearing briefs and a statement summarizing the costs by 22 December 2006.

3.5 THE POST-HEARING BRIEFS

45. The parties simultaneously filed their first post-hearing briefs on 8 December 2006.
46. On 15 December 2006, Parkerings sent a letter to the Tribunal which identified errors in Lithuania's Counter-memorial and Lithuania's post-hearing brief.
47. On 22 December 2006, the parties filed their statement of costs.
48. On 19 January 2007, the Tribunal informed the parties that it did not find necessary to hold an additional hearing.
49. On 9 May 2007, Parkerings filed a revised statement of costs.
50. On 25 May 2007, the Tribunal declared the proceedings closed in accordance with Rule 38(1) of the Arbitration Rules.

4. MAIN FACTS RELATING TO THE MERITS OF THE DISPUTE

4.1 THE TENDER

51. Following Lithuania's gradual transition between 1991 and 1997 from a Soviet Republic to a candidate for EU membership and a market economy, the Municipality of the City of Vilnius decided to create a modern, integrated parking system for the City of Vilnius, in order to control traffic and protect the integrity of the City's historic Old Town.
52. The Municipality announced a tender (the "Vilnius Tender") for the purpose of obtaining private investment in connection with the design and operation of this parking system, including the construction of two multi-storey car parks ("MSCP").

53. On 13 November 1997, the “Organisation of Investment Development Tender Regulations” was approved by the Board of Vilnius City by Decision No. 1819V (**RE 7**). The Mayor charged the “Commission on Organization of Tenders for the Lease of Land Plots” with the organization of investment development tenders, and appointed his advisor, Robertas Staskevicius, as “head of the working party” (**RE 7**). The Commission retained the services of a Dutch consulting firm, Tebodin Consultants and Engineers (“Tebodin”), for technical advice on the tender process.

4.1.1 The Bidders

54. Of the seven potential bidders which responded to the City’s tender and expressed an interest in the construction of MSCP (**RE 8**), only two returned signed letters of intent to the City (**RE 9** and **RE 10**). These two bidders (the “Bidders”) were Egapris, a Lithuanian waste management company, and the “Getras Consortium” composed of Getras, a French investor acting through its Lithuanian subsidiary, UAB Getras Lietuva, and three Lithuanian partners, namely AB Ekinsta, Bank Hermis, and UAB Savy.
55. Together with a Swiss company, Egapris submitted a proposal (“Investment Project Vilnius Parking System”) to construct “*automated car parking lots and garages.*” More specifically, according to Egapris’ proposal, the funds were to be invested, *inter alia*, in ticket machines, MSCP, and various equipments and tools (**RE 13**).
56. The Getras Consortium, on the other hand, proposed, in its business plan on the “*development and exploitation of car parking lot system in Vilnius city,*” the construction of two underground parking lots near the Opera and Ballet Theatre, on the one hand, and the Railroad Station, on the other hand. The Getras Consortium predicted that the construction of the facilities could be completed within six years (**RE 12**).
57. On 7 July 1998, Tebodin issued an “*Evaluation of Proposals for the Parking System in Vilnius – Final Report*” (**RE 16**). In this Final Report, Tebodin concluded that “*the Egapris proposal generates higher risk to Vilnius Municipality. The quality provided to Vilnius’ residents a[n]d other system users will be lower and the risk of inconvenience is therefore higher. The parking offered by GETRAS may be constructed without any increased risk, following the rules for parking design (by the European Parking Association).*[...]”
58. A new commission created by the City, known as the “Investment Development Commission” (the “Commission”), in turn, issued the following recommendation:
- Considering evaluation done by international experts, to suggest to Vilnius city Board to approve consortium Vilniaus miesto urbanistinis vystymas (enterprise Getras, share company Ekinsta, private limited liability company Savy, share company bank Hermis, Lietuvos vystymo bankas) as a further negotiation partner in the contest of Investment Development regarding creation of Vilnius city parking lots system [(RE 16)].*
59. The City thereafter instructed that a second stage of negotiations take place with the above-mentioned two entities (Egapris and the Getras Consortium) under the existing tender. Indeed, on 10 September 1998, the Board of Vilnius City issued the following Decision No. 1709V:

1. *To approve the consortium Vilniaus miesto urbanistinis vystymas (company Getras, public company Ekinsta, private company Savy, share company bankas Hermis, Lithuanian Development Bank) and private company Egapris as further partners of negotiations in the Investment development tender for the development of Vilnius city car parking system.*
 2. *To obligate the commission for organization of investment development tenders to select, by 10 October 1998, one object at a time from the 1st stage of Multi-storey parking investment project program for technical planning in the following manner: 1) consortium Vilniaus urbanistinis vystymas, 2) private company Egapris [(RE 19)].*
60. The City then transferred the responsibility of the tender process to the Commission and replaced Tebodin with a German firm, MAS Consult, which was to provide services with respect to further submissions by Egapris and the Getras Consortium (RE 22).
61. In the course of a meeting held in March 1999, the Bidders advised the City that they did *“not agree to construct multi-storey parking lots without being entitled to manage the on-street parking system”* (RE 24). The City agreed to grant to the Bidders the management of the on-street parking system as well.

4.1.2 Parkerings

62. Parkerings was established in 1996. The founder and managing director of Parkerings since 1999 is Roger Skaug. Parkerings' majority shareholder, through the majority holding in Indre by Eindom AS, is Skips AS Tudor (“Skips”), an investment firm with a diversified industrial portfolio ultimately controlled by Mr. Wilhelm Wilhelmsen. Mr. Wilhelmsen is a well-known Norwegian entrepreneur and chairman of the Wilh. Wilhelmsen Group, a publicly listed conglomerate and a global leader in the car carrier industry. Skips acquired its participation in Eindom AS/Parkerings from Conceptor, a Norwegian development company, in December 2000.
63. With a view to participating in the Vilnius Tender, Parkerings incorporated Baltijos Parkingas UAB (“BP”), its wholly-owned Lithuanian subsidiary (CE 195).
64. On 8 April 1999, Egapris informed the City that BP would join the Egapris bid. A power of attorney signed on that date indicated that Egapris authorized, *inter alia*, “Mr. Jonas Tamulis – the consultant of UAB ‘Baltijos Parkingas’, ” and “Mr. Roger Skaug – the director of ‘Parkerings – Compagnies AS” to “lead negotiations regarding ‘Vilnius City on-street parking and construction of multi-storey car parks and creation of a unified system’ conducted by the municipality” (RE 25). A consortium agreement (the “Consortium Agreement”) was signed by Egapris and BP on 14 April 1999. Egapris and BP thereafter formed the “Egapris Consortium” (RE 26). The Consortium Agreement provided, *inter alia*, the following:
1. *By this agreement the Parties agree to establish a consortium and to participate jointly as consortium in the tender for the design, establishment and implementation of Vilnius City parking system announced by Vilnius City municipality, in such a way broadening financial and technical possibilities to satisfy the tender requirements.*
 2. *The Parties agree that from now on the Consortium shall participate in the tender, shall render offers and carry on negotiations as indivisible person, instead of UAB*

“Egapris”, all the rights and obligations whereof related with the participation in the tender, shall be transferred to the Consortium.

3. *The Parties undertake to jointly participate in negotiations with the representatives of Vilnius City municipality, taking into account the possibilities and aims of each other, by giving the preference to reasonable agreement to render efforts to the municipality only after agreement on the joint implementation, financial and technical sources thereof. The negotiations shall be carried out by the joint negotiation group [...].*
4. *The shareholders of UAB “Baltijos parkingas” – Parkerings Compagniet AS, a Norwegian enterprise, shall render technical consultations to consortium and provide the consortium with know-how, necessary for the successful completion of negotiations and implementation of the agreement with the City. UAB “Baltijos parkingas” shall be responsible for preparing all information and proposal as required by Vilnius City Municipality. UAB “Egapris” shall provide all required information on the company and technical information on equipment planned to be used. [...] [(RE 26)]*

65. In April 1999, UAB Savy left the Getras Consortium.

4.1.3 The Award of the Bid to the Egapris Consortium

66. On 25 May 1999, the Getras Consortium, on the one hand, and the Egapris Consortium, on the other hand, submitted summary letters outlining the terms of their final proposals.

67. The proposal prepared by the Getras Consortium read as follows:

6. *Investment obligations*
 - 6.1 *The construction of multi-storey car parks:*
 - 6.1.1 *The Consortium obliges to construct approximately 14 multi-storey car parks, i.e. to create approximately 5300 multi-storey parking places, taking into consideration the prepared Vilnius city parking plan.*
 - 6.1.2 *The Consortium obliges to project and construct not less than a minimal number (2) of multi-storey car parks within one year from the beginning of the construction works.*
 - 6.1.3 *The Consortium obliges to construct approximately 14 multi-storey car parks within 8 years from the beginning of the construction of the first two car parks, taking into consideration the prepared Vilnius city parking plan and the commercial validity.*
 - 6.1.4 *The Consortium obliges to invest necessary funds, not less than 120 million Litas, into the construction of multi-storey car parks during the defined period.*
 - 6.1.5 *The Consortium obliges to perform all necessary investments and works related to the construction of multi-storey car parks under the approved parking plan and schedule.*
 - 6.2 *The Consortium obliges to install ticket machines, serving for on-street parking places in Vilnius city under the plan and requirements, approved by the Municipality.*
 - 6.2.1 *The Consortium obliges to install 1 ticket machine for 15 on-street parking places. Ticket machines will be installed within 3 months after the signing of the Agreement, after interception of parking activities from SP UAB “Komunalinis ūkis”. [(emphasis added)]*

- 6.2.2 *The Consortium obliges to perform all other investments related to on-street parking under the parking plan, approved by the Municipality.*
 - 6.2.3 *The Consortium obliges to invest not less than 1800 Litas for one available and to be created in the future on-street parking place.*
 - 6.3 *The Consortium obliges to invest into the development of car parks, transferred under the exploitation agreement.*
 - 6.4 *All investments into the development of the parking system, established in the Agreement, will be performed by declaring contests (including for constructional works and machinery supply).*
- [...] [(RE 27)]

68. In turn, the proposal dated 25 May 1999, prepared by the Egapris Consortium read as follows:

- 6. *Investment obligations*
 - 6.1 *Construction of multi-storey car parks:*
 - 6.1.1 *The Consortium undertakes to construct not less than 10 multi-storey car parks, i.e. to develop not less than 3000 multi-storey parking places.*
 - 6.1.2 *The Consortium undertakes to start designing a minimum number (2) of multi-storey car parks immediately after the Signature of this Agreement and to commence their construction immediately after receipt or permits from relevant institutions and the Municipality.*
 - 6.1.3 *The Consortium undertakes to construct not less than two multi-storey car parks each year starting from 2000, subject to the general parking plan.*
 - 6.1.4 *During a defined period of time, the Consortium undertakes to invest in the construction of multi-storey car parks not less than LTL 140 million. This period will depend on the terms for approval of the general parking plan, the results of the pre-project works and the possibility to obtain requisite building permits from relevant institutions.*
 - 6.1.5 *The Consortium undertakes to make all necessary investments and to perform the works all in connection with the constitution of multi-storey parking lots according to the approved parking plan.*
 - 6.2 *The Consortium undertakes to install ticket machines serving the on-street parking places in the city of Vilnius according to the requirements approved by the Municipality, ensuring the possibility to make settlements in cash and by different types of cards.*
 - 6.2.1 *The Consortium undertakes to install, within 6 months as from the signature date of the Agreement, requisite number of ticket machines in the currently existing on-street parking places.*
 - 6.2.2 *The Consortium undertakes to install in Vilnius city, within 24 months as from the signature date of the Agreement, not less than 350 ticket machines according to the parking plan approved by the Municipality.*
 - 6.2.3 *The Consortium undertakes to install in total not less than 350 ticket machines in Vilnius city and to place 1100 parking signs according to the parking plan approved by the Municipality, upon receipt of relevant permits from the Municipality, the Police and other institutions.*
 - 6.2.4 *The Consortium undertakes to make other investments relating to the on-street parking according to the parking plan approved by the Municipality.*
 - 6.2.5 *The Consortium undertakes to invest not less than LTL 10,3 million in the on-street parking.*

6.2.6 *The Consortium will seek to build not less than 6000 on-street parking lots within the 5 years period.*

6.3 *All investment in the development of the parking system contemplated in this Agreement will be made by way of tender (Including tenders for construction and equipment supply works).*

[...] [(RE 28)]

69. MAS Consult thereafter issued a report recommending that the City refrain from naming a winner (RE 29). With respect to the technical aspects of the project, MAS Consult stated that *“it is foreseen that the awarded tender will have to construct and develop 3,000 multi-storey parking spaces, as well as to automate and manage 6,000 on-street parking spaces (the data may be corrected in the process of preparation of the parking layout)”* (RE 29).
70. On 6 June 1999, the Commission, on the other hand, *“approve[d] the position suggested by the negotiation group to orientate in further negotiations to a 10-year agreement validity term [...]”* (RE 30). The Commission concluded that *“taking into consideration the agreement validity terms suggested by the consortium of UAB Egapris and UAB Baltijos parkingai and the consortium Vilniaus miesto urbanistinis vystymas [...], and having adopted the initial position regarding the agreement validity term [mentioned above], the proposal of the consortium of UAB Egapris and UAB Baltijos parkingai [was] more favourable to Vilnius City Municipality”* (RE 30). The Commission therefore resolved to *“recommend to the committees of Vilnius City Council and the Board of Vilnius City to consider the possibility of negotiations on the conditions of the agreement with the consortium of UAB Egapris and UAB Baltijos parkingai, and to familiarize them with the proposals made by the consortium Vilniaus miesto urbanistinis vystymas”* (RE 30).
71. On 29 July 1999, the Egapris Consortium sent to the City a first draft agreement (the “First Draft”). Article 7.3 read: *“The Municipality undertakes to insure the investments of the Consortium partners against political risk”* (RE 33).
72. By decision No. 1478V issued on 19 August 1999, the Board of the City of Vilnius *“approve[d] the Consortium of UAB Egapris and UAB Baltijos parkingas as further partner of negotiations regarding the creation of conditions for development of Vilnius city parking system”* (RE 35), thus awarding the bid to the Egapris Consortium.

4.2 THE AGREEMENT BETWEEN THE EGAPRIS CONSORTIUM AND THE VILNIUS MUNICIPALITY

4.2.1 The Negotiations Regarding the Agreement

73. In the course of a negotiation meeting held on 19 October 1999, the representatives of the Municipality, UAB Komunalinis ūkis, MAS Consult, and the Egapris Consortium discussed the issue of the *“collection of parking fee and distribution thereof between the Municipality and the Consortium”* (RE 36). According to the minutes of this meeting, it was *“proposed to divide the parking fee in pay parking places into two parts – local charges for the Municipality and the fee for the Consortium; the relative part of the local charge, as compared to the total fee, will be defined in further stages of*

negotiation; it will be approved by Vilnius City Council; [...] (RE 36). The solution proposed for the on-street parking concession was thus that of a hybrid fee, according to which the parking fee would be divided into a local parking fee component, on the one hand, which the Egapris Consortium would collect for the City and give to the latter in its entirety, and a service fee component, on the other hand, which would not be a parking fee and which the Egapris Consortium would therefore be entitled to keep.

74. During meetings held on 23 and 28 October 1999, the issue of the “*mechanism and legal grounds for granting land to the Consortium for construction of multi-storey car parks*” was discussed (RE 37 and RE 38).
75. According to the minutes of the meeting of 23 October 1999, it was resolved that “*the negotiation group of VCM [“Vilnius City Municipality”] [would] analyse the draft ‘Basic provisions of the Joint Venture Agreement’ submitted by the Consortium, defining the proposals of the latter regarding granting of land for the construction of multi-storey car parks, and [would] submit its comments and recommendations*” (RE 37).
76. At the meeting of 28 October 1999 regarding the “*use of land plots intended for multi-storey car parks and the obligations of VCM and the Consortium relating thereto,*” “*VCM propose[d] that all multi-storey car parks be considered as infrastructure objects and that formation of land plots in the location of the parking lots be postponed until the expiry of the agreement with the Consortium. The Consortium [, in turn] wishe[d] that VCM prepared a project anticipating the mechanism of such land use, which would be analysed by the Consortium and which would be discussed in the course of further negotiations*” (RE 38).
77. On 20 December 1999, MAS Consult issued a “*Report on negotiations with the Consortium of UAB Egapris and UAB Baltijos Parkingas*”. The report provided that (RE 39):

2.3.1 *The Consortium shall:*

- *work out the parking plan on the basis whereof the parking system will be developed;*
- *develop the parking system in the manner defined in the Agreement and the parking plan as approved by the Municipality:*
 - *Building at least 450 ticket machines;*
 - *Building of at least 10 multi-storey car parks*
 - *Co-ordination of all actions with the Municipality and performance thereof in the manner prescribed by the European Standards;*

2.3.2 *The Municipality shall:*

- *consider and determine the changes in the level of public parking order and the fees, consider and adopt the decisions regarding the normative acts and issues relating to parking, adopt the decision on the approval of the parking plan;*
- *provide the Consortium with the full information requisite for the preparation of the parking plan, as well as the information concerning the existing parking system, give necessary assistance and ensure participation of its employees in the preparation of the parking plan;*

- *transfer the right to the Consortium allowing to collect local charges in the street parking place and set the limits of the extra fee that can be collected by the Consortium for the parking.*

78. On 28 December 1999, the Sorainen Law Office issued, at the City's request, a legal opinion (the "Sorainen Memo"), based on the "legal acts of the Republic of Lithuania which were in effect on December 27, 1999" (CE 11). This Memo discussed, in particular, the issue of the legality of the hybrid fee, stating, in substance, that Lithuanian courts were likely to view both components of the parking fee as a unitary whole and, therefore, to consider them as being regulated by the Law on Fees and Charges. According to the Sorainen Memo, if the fee were to be treated as a unitary whole, then the collection of money by the Egapris Consortium would be contrary to the law, due to the fact that the initial tender did not provide for such payment to be made to the concessionaire by the City. Indeed, with respect to this issue, the Sorainen Memo opined the following:

[...] In view of the provisions of Article 5.1.3 of the Agreement, a conclusion should be drawn that the local fee, which, in accordance with Articles 2 and 3 of the Law on [sic] of the Republic of Lithuania on Local Fees, may be fixed for the time vehicles were parked in the on-street parking places designated by the Vilnius City Council, will be comprised partly for the vehicle parking time in the public on-street parking places designated by the Vilnius City Council. In this instance, the legal basis of the remaining part of the fee for the vehicle parking time in the on-street parking places designated by the Vilnius City Council, which in accordance to Article 5.1.3 of the Agreement goes to the Consortium, becomes questionable.

We are of the opinion that any tax, fee or payment of any kind, which is paid or is demanded to be paid, including the exceptions applied to certain person categories, for the vehicle parking time in on-street parking places designated by the Vilnius City Council, is the regulatory subject-matter of the aforementioned Law on the Republic of Lithuania on Local Fees, and should be considered the local fee, as it is defined in Article 2 of the same Law with all the ensuing consequences (Article 7 of the aforementioned Law).

While analyzing the legality of the commitment of the Municipality to transfer the right to collect a fee for vehicle parking time and for violations of the Parking Regulations for on-street parking places designated by the Vilnius City Council, we draw the conclusion that the legal acts of the Republic of Lithuania do not create any legal obstacles to make such a commitment and exercise its existing right, which is a precondition of such obligation.

Whereas the legal basis of the fee, which goes to the Consortium according to articles 5.1.3-5.1.7 of the Agreement for the vehicle parking time for on-street parking places designated by the Municipality Council, raises doubts. Such conclusion shall be drawn due to the following reasons, listed hereinafter:

- 1) *Vehicle parking lots are the property, which belongs to the Municipality by the Public property right, which was obtained by basis of the Law on State property transfers to the property of Municipalities based on Law or created anew;*
- 2) *The Consortium does not obtain ownership of vehicle parking lots on the grounds of the Law on Lease or other grounds to administrate the property, for the usage of which the arbitrary fee may be collected from users of parking places.*
- 3) *Any fee or other payment for vehicle on-street parking places designated by the Vilnius City Council, in our opinion, is the regulatory subject-matter of the Law of the Republic of Lithuania on Local Fees, and should be considered a local fee, as it is defined in Article 2 of the same Law.*

In view of what was presented in clause 3 hereinbefore, we would take the view that the legal acts of the Republic of Lithuania and contractual deeds and obligations, indicated in

the Agreement of the Municipality and the Consortium, do not create sufficient and clear legal ground for the Consortium to have a right to collect a portion of the fee for vehicle parking time for on-street parking places designated by the Municipal Council, which is derived from the entire fee, established in Article 5.1.3, less local charges approved by the Municipality Council. [...] [(CE 11)]

79. On the other hand, a legal opinion prepared of 29 December 1999 by Lideika, Petrauskas, Valiūnas ir Partneriai (or “Lawin” firm), the Lithuanian legal counsel of the Egapris Consortium, provided that the hybrid fee was in accordance with the law. Indeed, this opinion provided the following:

Following your request, we would like to comment the legal situation relating to collection of payment for car parking in places designated by the Municipality (streets and squares). The agreement between Vilnius City Municipality and the Consortium establishes that such payment will consist of local charges and the portion of payment falling on the Consortium.

The portion of payment falling on the Consortium is to be legally qualified as payment for service, which will be rendered by the Consortium to car drivers. The scope of this service is the development of parking system in the city and its administering. Car parking in pay place is to be qualified as a behaviour of a driver expressing his/her will to use the service rendered by the Consortium and to pay for it according to the rate set by the Consortium [(RE 40)].

80. On 29 December 1999, the Vilnius City Council adopted Decision No. 482, approving the draft agreement between the parties, and authorizing Mayor Imbrasas to sign the agreement with the Egapris Consortium on behalf of the Municipality (CE 12). On the same day, the City also adopted Decision No. 483 regarding the performance of the Agreement (RE 41).

4.2.2 The Agreement

81. On 30 December 1999, the Egapris Consortium and the Municipality signed an agreement (“the Agreement”)(CE 13). The Agreement was signed by each of the Egapris Consortium members. According to the Agreement, BP and Egapris were jointly and severally liable for the Egapris Consortium’s performance of the Agreement (Article 1.2 of the Agreement).
82. The Agreement pertained to the creation, development, maintenance and enforcement of the public parking system in the City of Vilnius. More specifically, the Agreement provided for an exclusive concession to operate the city’s street parking and to operate ten MSCP.
83. The Consortium was granted an exclusive right to act as a “sole partner of the Municipality” for the organization, maintenance, development and enforcement of the public parking system in the areas of the City of Vilnius designated by the Agreement. Article 1.2 of the Agreement defined the terms “sole partner of the Municipality” as “a person, that is granted the exclusive rights to collect local charges and penalties for violation of parking regulations in the streets and squares as established in the city Council, and to construct multi-storey car parks in the locations specified in Annex No. 1 to this Agreement.”

84. Thus, the Egapris Consortium was granted an exclusive thirteen-year right to operate all the street parking, that is specifically to collect the parking fees, and to enforce the parking regulations namely through the clamping of vehicles. With respect to the Consortium's right to enforce parking regulations through clamping, the Agreement foresaw the transition to a fine system as soon as the applicable legislation would have been passed (Article 5.3.4 of the Agreement).

85. With respect to the parties' liability, Article 7.2.1 of the Agreement provided the following:

The liability of the Parties deriving from the terms and conditions of the present Agreement is understood as responsibility for the actions of the Party itself or failure to perform such actions due to which the undertakings of the Party will not be properly, fully and in due time fulfilled. Neither Party shall be liable and no sanctions shall be imposed on it if the breaches of this Agreement will occur due to the actions or failure to act by the other Party or any other third party, as well as due to irresistible forces (force majeure), as defined in the Government Resolution No. 840 "On the Approval of Rules for Release from Liability due to Irresistible Forces (force majeure)" dated 15 July, 1996.

86. The latter Resolution provided the following:

1. *The term "force majeure" shall serve to define extraordinary circumstances that cannot be foreseen or avoided, or removed by using any means.*

[...]

2. *A party shall not be financially held liable for failure to perform any of its obligations if it is capable of proving that:*

2.1 *it has failed to fulfill the obligations due to the obstacle being beyond its control;*

2.2 *it cannot be anticipated that at the moment of entering into the contract the party could have foreseen that obstacle or its [e]ffect on the ability to perform the obligations;*

2.3 *it could not avoid or overcome the obstacle or at least its effect;*

3. *The obstacles, mentioned in clause 2 hereof, may arise as a result of the following events below:*

[...]

3.5 *lawful or unlawful acts of state government institutions (except for those acts which, pursuant to other contractual provisions, were taken by a party requesting release from liability [...]) [(RE 5)].*

4.2.2.1 The Consortium's Obligations under the Agreement

87. Under the Agreement, the Consortium was to comply, *inter alia*, with the following main obligations.

88. First, the Consortium was to "*initiate, prepare, co-ordinate and submit to Vilnius city Council for approval a plan of public parking system in Vilnius city [(the "Parking Plan")]* [...]" (Article 1.4.2 of the Agreement; see also Article 2.1.1 of the Agreement). The Parking Plan was to "*include parking signs, parking zones, the recommended fee structure, parking control and regulations, and conditions and priorities for construction of multi-storey car parks. Upon preparation and approval of the Parking plan the*

Parties [were to] agree upon its implementation schedule” (Article 1.4.2 of the Agreement). “ The objective of the Parties [was] to design a plan which [could] provide the basis for a detailed regulation of traffic flow and parking” (Article 2.1.3 of the Agreement).

89. The Consortium was to create, manage and operate the “*public parking system for Vilnius city, including installation of ticket machines and construction of multi-storey car parks, complying with the Standards; [...] invest into the present parking system in order to establish the public parking system and structure of Vilnius city in accordance with the approved plan, terms and conditions of this Agreement; [and] plan and design the modifications of the current parking system in accordance with the Agreement and the approved Parking plan and carry out the investments related thereto*” (Article 1.4.2 of the Agreement).

90. The key elements of the so-called “Investment Program” were the following:

- *the Consortium constructs multi-storey car parks – no less than 10 in total;*
- *the Consortium improves the current street parking system (purchases and installs equipment, trains the employees, purchases other equipment, including IT hardware, vehicles etc.);*
- *the Consortium installs 450 new ticket machines with the terms established in the schedule of implementation of the Parking plan;*
- *the Consortium installs new parking signs and traffic flow control signs – approximately 1050 signs;*
- *the Consortium creates integrated parking information system;*
- *the Consortium develops the street parking system according to the Standards and this Agreement;*
- *the Consortium develops the street infrastructure according to this Agreement, the Joint Activity Agreement and the approved Parking plan (Sub-Clause 4.1.1 of the Agreement). (CE 13, Article 4.1.1)*

91. With respect to MSCP, the Consortium had to “*plan, design, and construct multi-storey car parks in accordance with the laws and regulations of the Republic of Lithuania and in a line with this Agreement, the Parking plan and its implementation schedule in order to develop an adequate car parking structure and capacity*” (Sub-Clause 1.4.2 of the Agreement). The Consortium was to construct no less than ten MSCP in the city of Vilnius, “*two [...] every year during the life-time of this Agreement, except for the first year*” (Article 4.4.5 of the Agreement), in the locations specified in Annex No. 1 to the Agreement. The full ownership of the MSCP was to be retained by the Consortium (**CE 13**).

92. The Agreement provided the following with respect to the planning and construction process of the MSCP:

- 4.4.2 After the Municipality issues the full collection of the design conditions, in each individual case the parties shall sign the Joint Activity Agreement, [...] in the form of Annex No. 8. [setting forth the time allocated for the design and construction of the MSCP] [...].*

4.4.3 *Not later than within 9 months after the Joint Activity Agreement is signed, unless the shorter term is established in the Joint Activity Agreement, the Consortium shall prepare and co-ordinate the design project of a multi-storey car park [which] shall be submitted to the Municipality. After the design projects are approved, the Municipality, with the participation of the Consortium, shall obtain construction permits in the name of itself and/or the Consortium, or the Consortium, with the participation of the Municipality, shall obtain construction permits in the name of itself and/or the Municipality.*

4.4.4 *After the Municipality obtains the construction permits in the name of the Municipality and/or Consortium [...], the [latter] shall construct said car parks in accordance with this Agreement and the Joint Activity Agreement [...], and shall ensure that the multi-storey car parks are constructed and made ready for use pursuant to the Procedure for Approving of the Constructions for Use STR.1 1.01:1996, approved by Order No. 108 of the Ministry of Construction and Urban Development as of 23 August 1996, and not later than within 24 months after the construction permits were issued, unless the Joint Activity Agreement provides for the shorter period.*

[...]

4.4.8 *Within [twenty] one day after the date of this Agreement, the Consortium shall evaluate the preliminary locations for construction of multi-storey car parks specified in Annex No. 1, and shall indicate two locations for which the detailed plans are already prepared and shall file applications for the issue of design conditions. The Municipality of Vilnius City shall, upon receipt of the application submitted by the Consortium, issue to the Consortium the collections of the design conditions for the specified locations, whereupon the Consortium shall commence the design works under the terms of this Agreement.*

93. *With respect to street parking, “the Consortium [undertook] to install 450 new ticket machines within the period established in the schedule of implementation of the Parking plan in the spaces of the streets and squares of Vilnius City which locations are defined by the Decision of the Vilnius city Council and correspond to the parking program. [...] The additional locations of the streets and squares where the Consortium shall be granted the right to collect payments for the parking of vehicles, shall be established by the Decision of the Vilnius City Council in accordance with the Parking plan approved according to the established procedure after the ticket machines in the above mentioned places are installed by the Consortium accordingly with the schedule of implementation of the parking plan” (Articles 4.3.1 and 4.3.2 of the Agreement).*

4.2.2.2 The Municipality’s Obligations under the Agreement

94. *Article 1.5.1 of the Agreement provided that “in order to achieve its aims and create favourable conditions for the Consortium to fulfill its obligations under this Agreement, the Municipality shall, within the [?] time limits of its competence, undertake the following:”*

- *to consider and establish the public parking order in the city and the adjustments of parking fee level taking into account suggestions and recommendations made by the Consortium and the needs of the city’s population;*
- *to refrain from any amendments to the present city parking order that would deteriorate the Consortium’s possibilities and conditions for implementing of its obligations hereunder. This obligation does not include the adjustments to local duties if such adjustments are made before March 1, 2000, in accordance with the conditions of this Agreement;*

- *to assign to the Consortium the right to collect local charges established by the Vilnius city Municipality Council, including penalties imposed for the violation of the parking order, in the streets and squares as defined by the Vilnius city Council in accordance with the conditions of this Agreement and the approved parking plan;*
- *within one month from the date of coming into force of the Agreement to hand over to the Consortium all necessary information (agreements for use of the parking spaces) related to the parking in the streets and squares specified in Annex No. 4 to this Agreement [(Annex No.4: list of streets and squares in which car-parks have been equipped pursuant to the established procedure and in which the Consortium, consisting of UAB Baltijos parkingas and UAB Egapris, will have the right to collect local duty, clamp vehicles for the non-observance of the provisions relating to the Collection of Charges established for the owners of the vehicles (drivers) for the use by the latter of watched car-parks in the streets and squares of Vilnius and to collect charges for the unclamping of the vehicles)];*
- *timely and in accordance with appropriate procedure to consider legislative and regulatory issues related to parking, including parking signs, penalty level and structure (clamping, other means of blocking of the vehicle or a fine charge notice);*
- *in accordance with the terms and conditions of this Agreement and valid legal acts to consider and make decisions regarding the approval of the public parking system plan as worked out by the Consortium;*
- *to ensure the way of use of the land plots, permits and approvals necessary for the construction of multi-storey car parks in accordance with the conditions of the Joint Activity Agreement attached as Annex No. 8 hereto;*
- *to consider and determine the fee structure and fee rates for street and ground parking in accordance with the conditions and procedure established by this Agreement;*
- *to ensure the service rendering according to the city maintenance and cleaning rules;*
- *to use all its efforts in order to ensure that the necessary decisions of the institutions not subordinated to the Municipality are taken for successful development of the parking system (including appropriate modifications of the laws and other statutory acts, relevant traffic signs, fee levels and structure, use of land and other relevant issues);*
- *to provide the Consortium with all information necessary for drawing up of the Parking plan which information is defined in Annex No. 3, or provide with a possibility to get access to such information and photocopy it, and to ensure the participation of appropriate Municipality's subdivisions within the limits of their competence in the process of the drawing up of such plan. The Parties understand that the Municipality does not possess all the information necessary for the drawing up of the plan and that this may affect the quality of the Parking plan;*
- *not to extend agreements concluded prior to the Agreement, if that does not constitute the breach of such agreement, and to refrain from making any new agreements that would impede creation of the unified parking system in the city according to the conditions of this Agreement;*
- *to provide the Consortium with the possibility to use the city GIS in the process of drawing up the Parking plan;*
- *to fulfill all other obligations under this Agreement.*

95. The Agreement specifically provided, under Article 1.5.2 *in fine*, that “*undertakings of the Municipality shall be limited to the scope of its competence, or the competence of institutions subordinated to it.*”

4.2.2.3 Revenue Sharing Mechanism under the Agreement

96. The Consortium - which had to prepare the Parking Plan - was responsible for the equity and debt financing for the construction of the MSCP and the establishment of the Parking Plan. In order to ensure that the Consortium would obtain a reasonable return on its investments, Article 5 of the Agreement provided that the proceeds of the maintenance and enforcement of the Vilnius public parking system would be shared among the parties to the Agreement. The Consortium was entitled to three different income streams.
97. First, in accordance with its exclusive right to operate for thirteen years all the street parking in the city, collect the parking fees, and enforce the parking regulations through the clamping of vehicles, the Consortium was entitled to a service fee portion of the public parking fee that it was to collect. The public parking fee indeed consisted contractually of two elements: a local charge for the Municipality and a service fee for the Consortium.
98. With respect to the determination of the local charge and the service fee, Articles 5.1.1, 5.1.2, and 5.1.3 of the Agreement provided that *“the Consortium shall collect charges established by the Vilnius City Council for the duration of parking in the places of streets and squares that are determined by the Municipality Council, and shall transfer such charges to the account indicated by the Vilnius City Municipality. [...] The local charges for the parking time of the vehicles in the places of streets and squares that are determined by the Municipality Council shall be fixed by the Vilnius City Council according to the Law On Local Charges for the Republic of Lithuania. [...] The local charges constitute a part of the parking fee for the parking time in the places of streets and squares that are determined by the Vilnius City Council. The other part of the parking fee falls upon the Consortium.”* The part of the fee that was allowed to the Consortium thus depended on the amount of the local charge for one hour of parking established by the Vilnius City Council, its ceiling being fixed in the Agreement under Article 5.1.3.
99. The service fee was to be fixed either by the Consortium, in which case it was to be calculated in accordance with the provisions of Articles 5.1.3.1 through 5.1.3.5 of the Agreement, or by separate agreement between the parties, in which case it was to be calculated in accordance with Article 5.1.4 of the Agreement. The Consortium was to collect the entire amount and then transfer the portion corresponding to the local charges to the Municipality.
100. Second, the Consortium was entitled to the full amount of the parking fees it would collect in MSCP.
101. In this respect, Article 3.1.5 of the Agreement provided that *“multi-storey car parks constructed shall not be transferred to the Municipality, and they will remain the property of the Consortium or its members. All rights regarding management and operation of the multi-storey car parks shall be retained by the Consortium or the companies established by it.”* According to the Agreement, there was no time limitation

on the right to operate MSCPs. Furthermore, Article 5.1.9 of the Agreement stipulated that “*the parking fee for the parking time in the multi-storey car parks owned by the Consortium shall be fixed by the Consortium.*”

102. Third, the Consortium was entitled to seventy percent of unclamping charges. It was the Consortium’s right to enforce parking regulations thus generating an independent revenue stream. Indeed, the Agreement granted to the Consortium the right to collect “clamping fees” for the release of each clamped vehicle, seventy per cent of which the Consortium was entitled to keep, the remaining thirty per cent going to the Municipality.

103. In this respect, Articles 5.1.11, 5.1.12, and 5.1.13 of the Agreement provided the following:

The Consortium shall as from the day it is granted the right to collect local charges in accordance with Item 5.1.6, be obliged to clamp the vehicle by technical means or limit the usage of the vehicle by other means established by statutory acts, if the vehicle owner has failed to pay according to the established procedure prescribed for parking in the payable parking places or has parked the vehicle in violation of the rules of parking established for the places specified in Annex No. 4 to this Agreement. The Consortium shall, as from the day on which it is entitled to collect legal charges according to Item 5.1.6 hereof, collect the fee from vehicle owners in the streets and squares as indicated in Annex No. 4 to this Agreement for unclamping of the vehicles, which fee shall be based on tariffs approved by the Vilnius City Council [...]. The Consortium shall be obliged to transfer 30 per cent of the collected fee for unclamping to the account indicated by the Vilnius City Municipality for every month in arrears until the tenth day of the next month.

104. The Agreement provided that the transition to a fining system would occur “*as soon as there is a legal base and the technical means of state authorities create appropriate conditions*” (Article 5.3.4 of the Agreement).

105. In accordance with the above, the Consortium thus undertook to pay to the City:

- a fixed fee of LTL 200,000 (EUR 57,924) to be paid in equal monthly installments (Article 5.1.14 of the Agreement);
- thirty percent of the fees collected by the Consortium in connection with the unclamping of vehicles that would have failed to pay the parking fees;
- Additionally, Article 5.1.15 of the Agreement provided that

In case the aggregated sum of the revenues received in the financial year by the Municipality under Items 5.1.1, 5.1.13 and 5.1.14 of this Agreement is less than 1.000.000 Litas, the fixed amount established in Item 5.1.14 shall be increased by such amount that the annual revenue of the Municipality received under Items 5.1.13 and 5.1.14 equals to 1.000.000 Litas. The consortium undertakes within 30 days after the end of the financial year to transfer to the account indicated by the Vilnius City Municipality the sum equal to the amount by which the fixed amount established in Item 5.1.14 is increased.

4.2.3 The incorporation of the Operator

106. According to the Agreement, the Consortium was to establish a management company that would run the street parking concession.

107. Article 1.2 of the Agreement defined the “management company” as

a private company incorporated by the Consortium in accordance with Item 3.1.3 of [the] Agreement that shall own the ticket machines installed in accordance with the Agreement, integrated management information system and other resources needed for operation of the parking system and collection of the local charge for the public parking of vehicles in the city of Vilnius.

108. On 28 January 2000, BP and Egapris entered into an Agreement on Business Principles (the “ABP,” **CE 14**) to allocate to each of the Consortium members the functions, responsibilities and liabilities related to the exercise of the Consortium’s rights and obligations under the Agreement. One of the purposes of the ABP was to provide a determination on the issue of ownership of the above-mentioned management company.

109. The ABP granted BP the right to incorporate and operate the project management company that would be responsible for the performance of all of the obligations of the Egapris Consortium under the Agreement, except the construction of MSCP. The Consortium’s rights and duties relating to the construction of the MSCP were to be equally shared by its members. Once duly delivered, all the MSCP would be leased to the project management company.

110. It was agreed in the ABP that BP would incorporate the management company Vilniaus Parkavimo Kompanija (“VPK”).

111. Pursuant to Sub-Clause 1.3 of the ABP,

With effect from the date of the Company’s registration and up until the execution by EGAPRIS of the Call Option referred in clause 2 below, BP shall be sole and lawful successor to all the rights and obligations assumed by Consortium under the Agreement with Municipality in respect to management operation of the Management Company.

112. It was agreed that Egapris would have the right to purchase 49 percent of VPK from BP for LTL 1,960,000 (EUR 567,655) (Call Option) (Article 2.4 of the ABP).

113. Egapris could also waive its right to purchase the VPK shares in exchange for a payment from BP of LTL 4,000,000 (EUR 1,200,000) (Article 2.11 of the ABP). Article 2.12 of the ABP further provided that, should BP fail to pay Egapris the amount due in case of waiver of Egapris’ right to participate, “*out of 1 000 000 (one million) Litas initially contributed by BP for the shares of the Company, 500 000 (five hundred thousand) Litas will be deemed as a penalty for non-performance and will count as having been made for the benefit of Egapris as its contribution/payment for 50% of the shares in the Company. Notwithstanding the above, the rights of the shareholder holding 50% (fifty percent) of the shares in the Company will be granted to Egapris only upon contribution by BP and Egapris in equal sums – 1 500 000 (one million five hundred thousand) Litas each – of the remaining Company’s share issue price.*”

114. On 17 February 2000, BP registered VPK as the project management company in accordance with the “Articles of Association of the Private Company ‘Vilniaus

Parkavimo Kompanija” (the “Articles of Association of VPK,” **CE 23**), paying LTL 4 million into VPK’s capital.

115. On 1st February 2000, Egapris notified that it irrevocably and unconditionally waived its right to claim compensation under Article 2.11 of the ABP and also irrevocably declared its decision not to elect to exercise its Call Option provided under Article 2.2 of the ABP (**RE 43**).
116. In January 2001, Egapris purported to exercise the call option. BP however refused to tender the shares. The dispute was taken to court, and on 19 November 2003, the Vilnius district court ruled as follows:

The court, upon hearing the case,

(...)

DECIDED:

Not to examine a part of the law suit where the Claimant requested:

- 1) to acknowledge a non performance by the Defendant UAB Baltijos Parkingas of the obligations set forth in Clauses 2.5, 2.10, 2.11 and 2.12 of the Agreement on Business principles made between UAB Egapris and UAB Baltijos Parkingas on January 28, 2000, for which reason the said Agreement was not implemented;*
- 2) to obligate the Defendant to perform the obligations set forth in Clause 2 of the Agreement on Business Principles to execute the agreement on purchase-sale of 50% of the shares of UAB Vilniaus Parkavimo Kompanija;*
- 3) to restitute the violated rights of UAB Egapris to acquire 50% of the shares of UAB Vilniaus Parkavimo Kompanija;*
- 4) to repeal the Loan Agreement No. 144000902069/22 and pledge of 50% of shares of UAB Vilniaus Parkavimo Kompanija, which transactions were made in violation of the Agreement on Business Principles between UAB Egapris and UAB Baltijos Parkingas, as of January 28, 2000.*

To reject the remaining part of the law suit.

[...]

This Decision may be appealed against before the Lithuanian Court of Appeals by appeal filed via this court within 30 days [(CE 187)].

117. On 1 July 2004, however, the Court of Appeals repealed the decision of the court of first instance, and instructed “*Defendant UAB ‘Baltijos parkingas’ [...] to perform the obligation, i.e. to conclude the agreement with Plaintiff UAB ‘Egapris’ [...] regarding sale-purchase of fifty percent (50%) of shares in UAB ‘Vilniaus parkavimo kompanija’ [...] in accordance with the terms laid down in clauses 3.12 and 2.13 of the Agreement on Business Principles (made between UAB ‘Egapris’ and UAB ‘Baltijos parkingas’ on January 28, 2000) and in exchange of consideration of LTL 1 500 000*” (**CE 216**).
118. On 1 March 2000, the Municipality adopted Decision No. 519, determining “*that the collection of local fees and charges shall be effected by UAB Vilniaus Parkavimo Kompanija, established by the Consortium, constituted by UAB Baltijos Parkingas and UAB Egapris,*” and that “*the collection of fees and charges shall be executed by the employees of UAB Vilniaus Parkavimo Kompanija holding the certificates of UAB Vilniaus Parkavimo Kompanija*” (**CE 25**).

4.3 LEGALITY OF THE AGREEMENT AND MODIFICATIONS OF LAWS

4.3.1 The legality of the parking fee

119. By letter dated 8 February 2000, the local representative of the National Government in Vilnius¹ (the “Government Representative”) wrote to Mayor Imbrasas, stating that “*certain provisions of the [...] Agreement approved by Vilnius City Council’s Decision No 482 [were] in contradiction with effective laws and regulatory acts*” (CE 17). This Government Representative therefore requested that at the next meeting of the Vilnius City Council, the issue of the amendment or revocation of Decision No 482, which approved the Agreement, be discussed (CE 17; see also CE 18). More specifically, the Government Representative raised the following three issues and provided the following explanations:

[...] Income received on local fees and charges must be accounted for in the Municipal budget item as “other payments”. However, under the approved Agreement, the Consortium is granted the right to collect a local charge, fixed by the Vilnius City Council, for the duration of parking. Local charge is treated as a constituent element comprising the tax for the duration of parking in the places specified by the Municipality. Another portion of the tax goes to the Consortium; the portion of the tax is defined by the Consortium itself. However, the Law of the Republic of Lithuania on Local Fees and Charges does not provide for the possibility that collection of local charges might be delegated to enterprises; moreover, it does not provide for the possibility that enterprises shall fix the portion of the local charge that goes to them.

[...]

Under the Agreement on Joint Activity, the Municipality undertakes to ensure that any free plots of state-owned land located in the construction place of the infrastructure object will not be formulated and those plots of land will not go to land sales or lease auctions following the procedure established by the Government Resolution No 692 “On Sales and Lease of New Plots of State-owned Land Designated for Non-agricultural Purposes (activity)” as of 2 June 1999, and none of the third persons will be authorized to use land in the above area or to hindrance management and use of the mentioned land. In addition, the Municipality undertakes to provide the Consortium with a possibility to construct the infrastructure object in the specified place. The Law of the Republic of Lithuania on Construction prescribes that the right of the builder shall be exercised in cases when the builder owns a plot of land or holds and uses it on other grounds established by the laws of the Republic of Lithuania, and the builder has a prepared, in a prescribed manner, and approved design documentation of a construction work, and builder has a construction permit issued in the prescribed manner. Since the Municipality will not formulate new plots of land, and construction permits are issued by the Inspection of Construction of a Construction Work of Administration of County Governor, it might be maintained that construction of multi-storey car parks is in general impossible [(emphasis added)].

The main Agreement prescribes that the Consortium shall be sole partner of the Municipality, which is entitled with an exclusive right to collect a local charge and be engaged in construction of multi-storey car parks in the places specified by the Municipality. However, the Law of the Republic of Lithuania on Competition prescribes that any arrangement with the purpose to restrict competition or any arrangement which restricts or might restrict competition shall be prohibited and therefore null and void [(emphasis added)]. [...][(CE 17)]

¹ The Government Representative has the constitutional authority and duty to supervise the legality of all municipal acts. Specifically, the Government Representative has to ensure consistency of municipal acts with Lithuanian laws and decrees and protect the rights of individuals and organizations.

120. In the course of a meeting held on 11 February 2000, the Vilnius City Council rejected the Government Representative's request and voted to uphold Decision No. 482 (CE 19). By letter dated 25 February 2000, Mayor Imbrasas informed the Government Representative of the Vilnius City Council's decision to uphold Decision No 482 (CE 24).
121. This decision was supported by a report issued by the Municipality's legal counsel (CE 20).
122. On 8 March 2000, notwithstanding the decision of 11 February 2000 of the Vilnius City Council, the Ministry of Justice of the Republic of Lithuania stated the following in a letter to the Government of the Republic of Lithuania:

[...] it is assumed that a fee/charge and a tax by nature are different categories. Consequently, local fee/charge cannot be treated as a constituent element of tax. Moreover, the laws do not grant private legal entities the right to collect local fees/charges defined by the Municipal Council. Granting of exclusive rights normally restricts competition within a certain field of activity. Therefore, it is maintained that granting of exclusive rights should neither be in contradiction with the interests of other economic entities nor restrict competition. Therefore, the statements of the Government Representative in Vilnius County, produced in presentation No 2T as of 8 February 2000, with respect to treating a local charge as a constituent element comprising the tax, with respect to delegating to a private legal entity the right to collect local charges, with respect to granting a private legal entity exclusive rights, in our opinion are based on the Law on Local Fees and Charges and the Law on Competition [(emphasis added)] [(CE 27)].

123. Arguing that "certain provisions of the Contract approved by Vilnius City Municipal Council Decision No. 482 are inconsistent with the applicable laws and secondary legislation," the Government Representative filed, on 9 March 2000, a complaint with the Administrative Court of Vilnius District, requesting that the latter "satisfy the complaint and [...] recognis[e] as invalid and repeal Decision of 29 December 1999 of Vilnius City Council" (CE 28). The Government Representative reiterated the explanations provided in his letter of 8 February 2000, as follows:

[...] the approved Contract grants the right to the Consortium to collect the local charge established by Vilnius City Municipal Council for car parking time. The local charge is treated as a component part of the fee for car parking time in the areas established by the Council of the Municipality. The other part of the charge is received by the Consortium who determines on its own discretion the amount of charge due to it. However, the Republic of Lithuania Law on Fees and Charges does not provide for the possibility to delegate the collection of local charges to companies, let alone the right to determine the amount of such local charge by such companies themselves.

[...] The Law of the Republic of Lithuania promulgates that the builder's right shall be realized after the available land plot acquired by right ownership, lease of any other right provided for by law is prepared, the construction project is coordinated and a construction authorization is acquired in the established manner. In view of the fact that the Municipality will not form new land plots, and authorizations are issued by the Constructions Building Inspectorate of the County Governor's Administration, in general, construction of multi-storey parking areas should be considered as not possible.

According to the Framework Contract, the Consortium will be a single partner of the Municipality enjoying exclusive right to collect local charge and construct multi-storey parking areas on the sites designated by Vilnius City Council. The Republic of Lithuania Law on Competition promulgates that all agreements aimed at limiting competition or

which limit or might limit competition, shall be prohibited and recognized as null and void as from the moment of their drafting. [...] [(CE 28)]

124. On 19 May 2000, the Vilnius District Administrative Court issued a decision in which it “resolved [...] to satisfy petition by Government’s Representative in Vilnius District in part [and] repeal the Decision No. 482 of Vilnius City Council as of 29 December 1999 Regarding Approval of the Agreement between Vilnius City Municipality and Consortium formed between UAB Baltijos Parkingas and UAB Egapris to the extent approving Paragraphs 2.4.1, 5.1.3, 5.1.3.1, 5.1.3.2, 5.1.3.3, 5.1.3.4, 5.1.3.5, 5.1.4 and 5.1.13 of the Agreement, as well as paragraph 1 of Article 5 of Joint Activity Agreement under Annex No. 8 hereof” (CE 33).
125. Although this Court rejected the Government Representative’s claim that Lithuanian law prevented the Municipality from giving the parking fee collection service into private concession (the Court stressed that Articles 4.2 and 6.1 of the Law on Local Fees and Charges grant the Municipal Council the right to delegate collection of local charges to other entities), the Court found the hybrid parking fee to be inconsistent with existing laws and regulations. The Court consequently annulled Decision No 482 to the extent that it authorized the Municipality to include in the Agreement provisions considered inconsistent with Lithuanian law, on the basis of the following considerations:

Under the Agreement between Vilnius City Municipality and Consortium a local charge is treated as a component part of the fee (tax) for car parking time in the areas established by the Council of the Municipality. Such treatment does not correspond to the provisioning of the Law on Tax Administration and the Law on Local Fees and Charges. [...]

The Law on Local Fees and Charges does not provide for a possibility to split a local charge into two means of payment – local charge and parking fee (tax) – [and paragraph 4 of Article 3 of the said law] treats the local charge as a single and indivisible. [Besides, according to Article 7] of the said law, income received from local fees and charges shall be credited to the item of other payments of the budget of the municipality. Therefore, a part of Paragraph 2.4.1 of the Agreement establishing transfer from the municipality to the Consortium of the right to collect parking fees, as well as a part of Paragraph 5.1.3 establishing that a local charge is a component part of the parking fee (tax) and that the other part of the charge is received by the Consortium who determines in its own discretion the amount of charge due to it, as well as Paragraphs 5.1.3.1, 5.1.3.2, 5.1.3.3, 5.1.3.4, 5.1.3.5 and 5.1.4 establishing ratio between the local charge due to the municipality and the fee due to the Consortium are not compatible with the law.

[...] the said fee for unclamping shall be treated as a variety of the local charge and shall be subject to collection and accounting rules governing local charges. Therefore, Paragraph 5.1.13 of the Agreement, to the extent establishing contribution of 30 per cent of the collected fee for unclamping to the account of municipality, is not compatible with the Law on Tax Administration and the Law on Local Fees and Charges. [...] [(CE 33)]

126. The Municipality appealed the decision of the Vilnius District Administrative Court, which was repealed in April 2001 by the Supreme Administrative Court, for lack of jurisdiction of the lower court. The Supreme Administrative Court decided to “repeal the Decision passed by Vilnius Administrative Court and hand over the case for a hearing by Vilnius First County Court” (CE 85).

4.3.2 The new Law on Fees and Charges

127. On 13 June 2000, the Parliament adopted a new Law on Fees and Charges (the “new Law on Fees and Charges”), which replaced the 1996 Law (see Article 18 of the new Law on Fees and Charges) (**CE 136**). The new Law on Fees and Charges provided, in its Article 11(2) – authorizations subject to local fees and charges – that “*a payer of local fees and charges may not be required to pay for an object on which local fees or charges are levied in any other way than by paying a local fee or charge*”. This new Law further provided, in its Article 13.2, that “*the rates of local fees and charges shall be established in LTL in round numbers.*”

4.3.3 The new Law on Clamping

128. On 5 September 2000, the Government passed Decree No. 1056 Regarding Authority to Define and Approve Procedures for Forced Removal or Clamping of Vehicles Using Clamping Devices. This Decree “*authorize[d] the Ministry of Interior to define and approve before the 1st of October 2000, the Procedures for Forced Removal or Clamping of Vehicles Using Clamping Devices.*” Decree No. 1056 nullified the Decree of 29 July 1991 Regarding Approval of Regulations of Forced Removal or Clamping of Vehicles (**CE 41**).
129. On 24 November 2000, the Mayor of the Municipality of Vilnius wrote to the Government of the Republic of Lithuania (**CE 56**): “*Upon the entering into force of the present Resolution [the decree No. 1056], municipalities lose their legal basis to block vehicle running gear in cases of paid parking rules violations; rights and functions of municipalities, defined by the Law on Local Fees [...] are violated*”. The Municipality requested the Government to re-authorize the municipalities to regulate clamping on their territory.
130. On 27 November 2001, the Government adopted Decree No. 1426 (**CE 97**). This Decree re-authorized clamping, provided that clamping be done in the presence of a police officer. Indeed, Article 14 of the Decree provided that “*in cases specified in paragraph 13.1 above the vehicles shall be clamped by the police officer using clamping devices, and in cases specified in paragraph 13.2 – by police officer together with the person authorized so by municipality by taking use of the clamping devices provided by municipality.*”
131. On 3 December 2001, BP alleged that it was losing substantial amounts of money as a result of this change in the regulatory system. BP characterized the legislative changes with respect to clamping as a *force majeure* (**CE 98**).
132. On 10 April 2002, the Vilnius City Council implemented Decree No. 1426 through its Decision No. 542 Regarding Partial Amendment of the Vilnius City Council’s Decision No. 151 of 11 September 1996 Regarding Imposition on Vehicle Owners (Drivers) of Duty for the Use of Pay Car Parking Spaces and Parking Lots (**CE 115**). Article 12 of this Decision provided that “*vehicles ignoring the pay parking regulations [...] shall be clamped using mechanical devices. Clamping of vehicles shall be undertaken by a*

police officer, acting concertedly with an employee of UAB Vilniaus Parkavimo Kompanija possessing a special authorization certificate [...].”

4.3.4 The amendment of the Law on Self-Government

133. On 12 October 2000, the Law on Self-Government was amended (**CE 47**). Until then, this Law did not establish, at least not expressly, any restrictions on the ability of municipalities to enter into Agreements on Joint Activity (JAAs) with private entities. Article 9 of the October 2000 version of the Law on Self-Government reads as follows:

1. *Municipalities may exercise other State functions (public administration and public service rendering), which are not provided for in this Law, under contracts concluded with State institutions or agencies. A municipality may conclude such contracts only in the event that the municipal council gives its consent. [...]*
2. *For general purposes a municipality may conclude joint activity contracts or public procurement contracts with State institutions and (or) other municipalities.*

134. Thus, in this new version, the Law on Self-Government restricted the right of municipal authorities to conclude JAAs to other public counterparties only.

4.4 THE PERFORMANCE OF THE AGREEMENT

4.4.1 The submission of Parking Plans

135. In the course of a meeting held on 28 January 2000, the Consortium submitted to the Municipality a “*list of information necessary to draft the parking plan*” (**CE 15**).

136. Also in January 2000, “*the Consortium submitted a tender to the Vilnius Development Department of the Vilnius Municipality tender on issuing the technical requirements of construction of the underground parking lot next to the Opera and Ballet Theatre*” (**CE 15**). Each Consortium partner proposed its first site for the construction of a MSCP. BP proposed a site near the Pergales Movie Theatre (the “Pergales MSCP”) and asked the Municipality to issue a list of the conditions for the design (**CE 30**). Egapris proposed another location for its own MSCP.

137. The Municipality’s Development Department asked BP to start planning work for a second MSCP in Gedimino site instead of the Pergales MSCP.

138. On 24 August 2000, BP addressed to the Municipality a draft Parking Plan (**CE 37**) and on 1st September 2000, completed draft parking plans were officially submitted (**CE 40**).

139. On 6 October 2000, the Municipal Enterprise Vilniaus Planas proposed that (**CE 44**) “*the draft in essence could be approved provided certain supplements and adjustments were made [...]*”.

140. On 11 October 2000, the Municipality’s Energy and Facility Department suggested that the draft should be adjusted. The Department observed that (**CE 45**) “[...] *some*

elements in terms of scope of the parking plan as defined an Annex 2 of the Agreement between Vilnius city municipality and the consortium [...] were missing [...].

141. On 13 October 2000, the Municipality's Transport Council discussed the Plans and resolved (**CE 48**):

- 1.1 *Reconstruction of Pylimo street as a segment comprising the Old City ring under the draft Vilnius City Parking Plan, by introducing two-ways traffic is not supported by any calculations. [...] Calculation should be produced that would substantiate advantages of the proposed alterations of the traffic organisation when compared with current situation.*
- 1.2 *The street net and traffic organisation provided in the draft is not quite definite. Detailed planning of the street net is necessary.*
- 1.3 *The draft should be supplemented by a scheme of public transport communication system.*

142. On 20 October 2000, the National Monument Protection Commission ("NMPC") objected to the parking plan. The NMPC decided to object to the project of construction of the parking for the following reason (**CE 49**):

Projects of such type and scale like the project of the construction of planned underground garages in the Old Town of Vilnius should be developed concurrently taking into consideration the possible direct and indirect environmental impact of planned works and also the impact on cultural properties. In the opinion of the State Monumental Protection Commission, the planned garages [...] would change the character of the Old Town of global value; destroy large areas of unexplored cultural layer. Also, the intensity of traffic and air pollution in the Old Town is likely to increase. The Old Town might become less attractive in terms of tourism and to the residents and visitor, and this would be a great loss.

143. On 24 November 2000, the Environmental Protection Department of Vilnius Region stated that (**CE 57**):

The plan does not contain the assessment of consequences of solutions from the viewpoint of environment.

Based on the first assessment, we do not approve of the construction of underground garages in Sereikiskiu Park. Their need in this place is not sufficiently grounded, and the territory is unique and valuable both from environmental and other aspects. [...]

Opinion: We do not in essence object to the Vilnius city car parking plan. In further project-making stages, to assess environmental impact, project the means of compensation for cutting down greenery and built-up squares.

144. On 12 December 2000, the Vilnius Urban Development Department stated (**CE 60**) that *"the division approves of the main ideology stated by the preparers of the plan with regard to the organisation and management of the traffic in the city's historical centre, vehicle parking on the streets, and the necessity of construction of underground (multi-storey) garages, and, essentially, to their positioning as specified in the plan."*

145. On 22 December 2000, the Vilnius Territorial Division underlined that (**CE 61**):

- 1.1 *the solutions presented in the referred documents directly affect a cultural monument old city of Vilnius [...];*

1.2 *the delivered document was drafted without having obtained under the established procedure the conditions with regard to special planning document formulation issued by the Department of Cultural Heritage protection (Vilnius Territorial Division) and without having implemented the requirements established by the procedures and rules with respect of special planning documents formulation as prescribed by relevant laws of the Republic of Lithuania and other legal acts, i.e.:*

1.2.1 *the requirements with respect of formulation of certain purpose special planning as prescribed by the Law on the Territorial Planning;*

1.2.2 *the requirement with respect to formulation of certain purpose special planning laid down in the general regulations for formulation, coordination and approval of special planning documents;*

1.2.3 *the requirements with respect to formulation of certain purpose special planning laid down in the regulations for formulation and issue of the conditions with respect to territorial planning documents. [...]*

146. Despite all the oppositions, the Municipality decided, on 4 January 2001, to “*permit to the UAB to design an underground parking lot on the Gedimino Ave. section from Jogailos Str. to Katedros SQ*” (CE 67). On 26 January 2001, the Mayor of Vilnius City Arturas Zuokas (CE 70) “*approves the construction of the underground garage in Gedimino Avenue between Odmiiniu and Savivadybes Squares and notifies that the Municipality will provide the required assistance to realize this project*”.

147. However, on 12 March 2001, the State Monument Protection Commission of the Republic of Lithuania issued unfavorable opinions regarding the project and stressed that (CE 81) “*upon installation of garages, a big portion of archaeological heritage of the old city of Vilnius will be destroyed; use of multiple up-to-date materials and technologies will damage the authenticity of the old city of Vilnius [...]*”. Nevertheless, the Ministry of Environment of the Republic of Lithuania wrote that (CE 84) “*while being well-aware of the importance of the Old Town of Vilnius and the need to preserve the cultural and natural heritage, we are of the opinion that it’s too early to declare the loss of authenticity of the Old Town of Vilnius. Similar parking areas have been constructed in the centres of many cities throughout Europe while reconciling the needs of heritage, modern economy and social development*”. [...]

148. Finally, the Municipality changed its mind and decided, on 22 March 2001, to develop exclusively the Pergales MSCP (see RE 63).

149. Two weeks after the decision to abandon the Project of MSCP on Gedimino Avenue, the Mayor Arturas Zuokas, in a letter of 27 April 2001, reminded BP that the first Parking Plan (near the Pergales Theater) “*after coordination, public debate and checking by the territorial planning supervisory authority had to be furnished to the Council of Vilnius on 11 08 2000*” (CE 86).

150. The Mayor added “[w]e hereby propose the 6-month term calculated from the receipt of this official letter for furnishing the parking Plan coordinated, deliberated and checked in the established manner for approval to the council of Vilnius city. In the Event of the failure to submit the Parking Plan by the specified deadline, the Municipality or Vilnius City will terminate the Contract with the consortium [...]

151. During a meeting of 19 June 2001 with the Vilnius City Development Department Commission for the Construction of Underground Garages, BP argued that **(CE 87)** *on the initiative of the heads of the City it was decided to implement the project of Gedimino Avenue which did not justify itself, and, as a result realization of the project for construction of multi-storey underground parking areas was delayed.*
152. In September 2001 **(CE 90)**, BP submitted its second Parking Plan.
153. During a meeting of the Working Group (see ¶ 161) on 22 November 2001, the City accused BP of non-compliance with its contractual obligation, that is the delivery of concrete plans for the construction of the Pergales MSCP as stated on 27 April 2001 **(CE 96 and RE 70)**. In its letter dated 3 December 2001, BP alleged that the delay was also due to the City's delay in taking the necessary action to procure the necessary land and in the delivery of the design conditions for the Pergales Parking **(CE 98)**.
154. In February 2002, Mayor Zuokas requested BP to *“provide written reasons of the failure to submit within the established deadlines the parking plan”* **(CE 106)**.
155. On 20 March 2002, BP wrote to Mayor Zuokas **(CE 108)**. In its letter, BP explained that

“the main reasons to the delayed approval of the parking plan are as follows:

- a) the city had not all the necessary information, and it had to be collected separately;*
- b) the technical task was submitted to the company with a long delay;*
- c) discussions of the plan in committees were not properly organized;*
- d) terms of heritage preservation were submitted just in March 2001;*
- e) the Municipality changed its position regarding the car parks under Gedimino Avenue and car parks in the Old Town in March 2001;*
- f) the Municipality has still not made a clear decision on the ways of solution of parking problems (construction of car parks) in the Old Town.*

We would like to draw your attention to that the approved parking plan is the company's concern first of all, and very important one. The plan is necessary for the company in order to plan a proper and effective parking system, to know and evaluate the business development, the required investments, terms and return. [...]

We are enclosing the prepared parking plan to this letter once again. In the plan, you find two alternative versions, basically of the uncertainty concerning the Old Town”.

156. In his response of 19 April 2002, Mayor Zuokas stated that *“delayed preparation of the Parking Plan may not be substantiated by absence of the technical task, because legal acts regulating territorial planning establishes that the technical task is not necessary for the preparation of the special plan. Provisions of the Contract and Law on Territorial Planning require furnishing the Municipality with the Parking Plan after its coordination, public debates and verification by the territorial planning supervisory authority. The Municipality is not obligated to deliberate the Parking Plan which does not satisfy this requirement, and submission of such plan may not be considered a proper discharge of the Consortium's obligation. The term of the preparation of the Parking Plan should not be influenced by the Municipality's position on the construction of multi-storey parking areas in the sites other than those specified in Annex No.1 to the Contract. By virtue of*

Clause 2.2.2 of the Contract, the Parking Plan shall be prepared in observance of sites specified in the Annex. No.1 for the construction of multi-storey parking areas and their detailed plans. Neither decision of the Municipality regarding the ways of settlement of parking problems in the Old Town of public transport system development strategy is an obstacle for the discharge of the consortium's obligation to prepare the Parking Plan" [(CE 16)].

4.4.2 The Joint Activity Agreement

157. A form of Agreement on Joint Activity ("JAA") was appended to the Agreement as Annex No. 8 (CE 13). The JAA pertained among others to the transfer to the Consortium of land for the construction of the MSCP.

158. On 26 March 2002, Mayor Arturas Zuokas sent to the Consortium a draft of Joint Activity Agreement for the Pergales parking (CE 110) emphasizing:

Construction of over ground building with commercial functions [...] is not a priority of the Municipality of the City of Vilnius, is not foreseen in the Main Agreement and existing detailed plans of sites, and should not be foreseen in the joint activity agreements on multi-storey underground parking constructions.

159. On 9 April 2002, BP sent a revised draft of Joint Activity Agreement in which all references to construction above the Pergales parking were deleted (CE 113).

160. However, the Municipality refused to sign the Joint Activity Agreement, given that, in the meantime, the legislation of Lithuania seemed to have taken a negative view of JAAs with private parties (see CE 104; the Republic of Lithuania's Counter-Memorial, ¶¶ 121-122 and the Claimant's Memorial, ¶¶ 107-108). On 5 July 2002, the Mayor Zuokas wrote to BP (CE 126):

Construction of the multi-storey parking lots is one of the major obligations of the Consortium consisting of UAB Baltijos Parkingas and UAB Egapris foreseen by the agreement signed on 30 December 1999 by the Municipality and the Consortium. The agreement foresees that the multi-storey parking lots will be constructed on the basis of joint activity agreements. However, according to the Local Autonomy Law of the Republic of Lithuania (edition of 12 October 2000) Article 9 Part 2 the Municipality can make joint activity agreements or common public purchase agreements with the state institutions and (or) other municipalities for common purposes. This provision of the law is still not interpreted unanimously and there is a great probability that the joint activity agreement signed by the Municipality will be contested in court as contradicting the above mentioned provision of law. It also could be impeded by the fact that the multi-storey parking lots will be private property, not the Municipality's. Considering this factor we suggest, in the short run, considering the possibility of amending the agreement signed on 30 December 1999 rejecting the Consortium's obligation to construct multi-storey parking lots foreseen by the agreement and respectively the Municipality's obligation to ensure the method of land use for the Consortium, organisation of permissions and co-ordination according to the provisions of the joint activity agreement. According to the amended agreement of 30 December 1999, as suggested the Consortium would preserve the right and obligations connected with providing parking services and charging local fees on overground parking lots, also, considering the decreased volumes of investments into development of parking infrastructure, correcting the expiry date of the Agreement and revenue allocation between the Consortium and the Municipality.

161. Thus, on 29 July 2002, Mayor Zuokas established a Working Group for reconsideration of the Agreement of 30 December 1999 (**CE 127**).
162. On 5 September 2002, BP proposed the conversion of the Joint Activity Agreement into a Cooperation Agreement as the Municipality had done with the Company Pinus Proprius (see ¶¶ 167-171) (**CE 133**).
163. On 9 September 2002, the Working Group decided to (**CE 134**) “*conclude partnership agreements instead of joint activity agreements on the construction of multi-storied car parks [...]*”.
164. On 24 February 2003, the Vilnius District Court decided to (**CE 155**) “*nullify [...] annex 8 [the form of JAA] of the Agreement made between Vilnius City Municipality and UAB “Baltijos parkingas” and UAB “Egapris”, which Agreement was approved by Decision No. 482 [...]*”.
165. On 6 May 2003, the Director of the Administration of the Municipality of Vilnius, Raivydas Rukštelė wrote to the Government Representative that (**CE 169**)

[d]uring the meeting of the representatives of the Parties held on 9 September 2002, on proposal of the Municipality it was decided to sign cooperation agreements instead of joint activity agreement. However, changing only the title of the contract and of the designation of the Parties’ obligations might be insufficient for eliminating the inconsistencies. Therefore, it would be very important to the Municipality to know the opinion of the Government Representative, as of the authority supervising the legitimacy of the legal acts passed by the Municipality [...]

166. On 22 May 2003 (**CE 168**), the Lithuanian Court of Appeals decided to “*uphold the Decision passed by Vilnius District Court on 24 February 2003, and reject the Appeal*”.

4.4.3 The Pinus Proprius Project

167. In April 2001, the City discussed the possibility of building a Parking under Gedimino Avenue and southern part of Municipality Square with the company Pinus Proprius UAB. Pinus Proprius was proposing the development of property it owned partly while the City owned the rest. Pinus Proprius owns a building on Gedimino Avenue and was planning the renovation of the building into a hotel (**RE 56**).
168. On 24 October 2001, the Municipality approved, by Decision No. 417, the signing of a Joint Activity Agreement with Pinus Proprius (**CE 95**). However, on 18 January 2002, the Representative of the Government, Gintautas Jakimavicius, requested the Vilnius District Administrative Court to revoke the Decision No. 417 on the approval of the JAA:

a conclusion should be made that the Law does not provide for the right for municipalities to conclude joint venture agreement with private persons and that Vilnius City Municipality Council having passed the decision No.417 of 24 October 2001 and by Clause 1 thereof approved the draft joint venture agreement with Pinus Proprius UAB exceeded the scope of competence of public authorities [(CE 104)].

169. The Vilnius District Administrative Court sent the case to the Vilnius District Court, which was within its jurisdiction.

170. On 27 March 2002, the Vilnius City Council decided (Decision No. 530) to approve a Cooperation Agreement between the Municipality on Vilnius and Pinus Proprius. On 19 April 2002, the Government Representative, Gintautas Jakimavicius, wrote the Vilnius District Court (**CE 117**):

The Vilnius city Council on March 27, 2002, issued decision No. 530 "On the Approval of the Cooperation Agreement" whereby item 1 approved the Cooperation Agreement between the Municipality of the City of Vilnius and Joint Stock Company "Pinus Proprius." By this decision the Vilnius City Council actually changed decision No. 417 of 10/24/01 "On Approval of the Partnership Agreement," i.e. it became out of force. Since the decision became out of force, the legal issue also disappeared. Consequently, the case was dismissed.

Considering the presented circumstances [...] I withdraw the claim and therefore ask the Court: To dismiss the case [...].

171. Thus, on 20 August 2002, the City of Vilnius concluded a Cooperation Agreement with Pinus Proprius (**CE 128**).

4.4.4 The modification of the Agreement of 30 December 1999

172. The Agreement of 1999 provided that the multi-storey parking lots will be constructed on the basis of a Joint Activity Agreement. However, the Municipality considered that, by virtue of the 12 October 2000 amendment of the Law on Self-Government, it had become impossible to conclude such kind of contracts with private companies, namely with persons other than State institutions or municipalities (see ¶ 168). Thus, with the avowed purpose of ensuring the lawfulness of the Agreement, the Municipality decided to establish a working group in order to bring the Agreement in conformity with the revised Law on Self-Government.

173. During the meeting of 9 September 2002, the representatives of the City of Vilnius and the representatives of BP agreed (**CE 134**):

1. *To exclude the provisions of the Agreement on the rights and obligations of the Consortium to collect parking fees and fines for violation of parking rules. To appeal to the Government of the Republic of Lithuania with the request to issue a consent granting the right to Vilnius city Municipality to carry out public procurement from the single source. [...]*
3. *To conclude partnership agreements instead of joint activity agreements on the construction of multi-storied car parks. [...]*

174. However, on 2 October 2002, Mayor Zuokas and Bjorn Avnes, a representative of Parkerings, discussed also the opportunity to cancel the Agreement. Following this discussion, Bjorn Avnes addressed a letter dated 11 October 2002 to Mayor Zuokas summarizing the remarks made during the meeting of 2 October 2002 (**CE 137**):

The unexpected obstacles, that have been met during the implementation of the Agreement, might prove that the step was a bit too brave. We have suffered serious economical losses and setbacks in the development of the project. I am therefore prepared to meet with your request to renegotiate the Agreement, in order to arrive at a mutually acceptable solution.

As we discussed, there are two main options available to us:

- (a) *The Municipality cancels the Agreement.*

- (b) *the Agreement is renegotiated on all terms, basically so that the Municipality takes back the right to the land for construction of car parks as requested in your letter dated 5th July 2002 [CE 126], and our company becomes the subcontractor to the City solely for street parking and parking house management.*

Alternative (a) is regulated under the Agreement and would imply that we are reimbursed for our expenses (investments and losses) plus ten percent, and the Municipality retains all rights and obligations, but also including the parking house close to the market place, parking plan and operational systems.

According to my knowledge, the amount would be in the order of 15 millions LITAS, including the ten percent.

Alternative (b) is more elaborate. As we would be giving up the real-estate opportunities present in the Agreement at this time, this will need to be economically compensated. [...]

Making a reasonable assumption on the outcome of a renegotiation as outlined above, the total cost to the Municipality to regain major parts of the Agreement would be in the order of 11 million LITAS. [...]

175. On 8 November 2002, Mayor Arturas Zuokas replied to Bjorn Avnes:

[...] This Agreement is very important to Vilnius Municipality. I entirely agree with you that both partners must cooperate in seeking the way out of the difficult situation we are in now. [...]

Therefore, I would like to stress the main points determining Municipality's decision on the issue, once again:

- *The object of the competition that took place in 1997 and was followed by competitive negotiations and by signing the Agreement with Consortium in 1999, was the construction of parking lots – not any other real estate development projects which could be profitable even if separate from the whole parking system. This meant to us and to both competitors that a part of the parking fees collected in public places should cover the expenses of construction of parking lots. [...]*

[...] I may only express serious doubts about the amounts of funds, indicated in you letter as desired compensations for the member of Consortium in case of changing or terminating the Agreement.

Implementation, renegotiation or termination of the Agreement is a complex problem. Possible ways of solving it should be pointed out by the specialists representing both partners. Therefore I suggest you to present your proposals, considering the change and termination of the Agreement, for the negotiations which are being carried out by specially appointed representatives. [...] [(CE 140)]

176. Regardless of the correspondence between Bjorn Avnes and Mayor Arturas Zuokas, the Working group continued the negotiation. On 27 November 2002, during a meeting of the Working Group, BP asked the representatives of the Municipality why (CE 142):

[...] despite an agreement reached between the Parties, Vilnius City Municipality does not implement the decision adopted by the working groups to apply to the Government with regard to the permission granting the right to carry service procurement from the single source. [...] In the opinion of BP representatives, the decision of the working groups was not influenced by any other additional circumstances and its implementation lies exclusively within the competence of the Mayor of the Municipality. BP representatives outlined that inactivity of responsible authorities of the Municipality poses a threat to the continuity of the Agreement of 30 December 1999 and raises doubts about the effectiveness of initiated negotiations.

177. The representatives of the Municipality responded (CE 142) that there were [...] “two reasons due to which no application was submitted to the Government: [...] the

Consortium hasn't yet implemented an obligation set forth in point 5.1.15 of the Agreement regarding the payment of the sum of LTL 626,187 for the year 2001 to the Municipality and hasn't yet provided information indicated in points 3.2 and 3.3 of the Agenda" [...]. Thus, a dispute was arising over BP's performance of the Agreement especially over its payment.

178. In its letter dated 28 November 2002, Skips AS Tudor (Parkerings' parent corporation) underlined the failure by Vilnius Municipality to address the Lithuanian Government for permission to carry out public procurement of the Consortium's parking service. Skips AS Tudor also argued that the Agreement [of December 1999] allowed commercial development on the top of the multi-storey car parks (**CE 143**). Moreover, concerning the payment of the amount set forth in point 5.1.15 of the same Agreement, Skips AS Tudor emphasized that (**CE 143**):

As you may know, the key source of the consortium's income are originating from the two contractual rights - the right to collect parking fees and the right to collect re-clamping penalties - which rights have been temporarily assigned to us by Vilnius Municipality by virtue of the Agreement, made in 1999. As a consequence of force majeure situation, resulting from the actions of the Government and the Parliament, one of those rights and related income streams was vanished, and the other one was significantly reduced. Accordingly, the total income of the consortium was adversely affected and we have suffered a serious financial loss. The Agreement defines the revenue sharing scheme that is based on the income, not on profit. Therefore, once force majeure had a direct impact on the income, it had a direct impact on overall revenue sharing. We cannot understand how Vilnius Municipality, having lost the right that was temporarily assigned to the consortium, still requests the same amount of the revenue originating from such right.

179. On 3 February 2003, during a meeting with the Working Group, both parties maintained the same position. BP representatives proposed to submit the dispute concerning the payment of the sum under point 5.1.15 of the Agreement to a court or to any other impartial authority. However, the parties agreed to continue the negotiation (**CE 150**).

*During the next meeting of the Working Group on 13 February 2003, the Municipality representatives informed BP that (**CE 153**) "the Municipality is preparing to appeal to the court regarding the fulfillment of the obligation provided for in point 5.1.15."*

180. On 24 February 2003, the Vilnius District Court ruled in favour of a challenge to the hybrid fee structure brought by the Government Representative under the New Law on Fees and Charges (see ¶ 124 and **CE 155**). As a result, the parking fee provision of the Agreement of December 1999 was cancelled. This decision was confirmed on 22 May 2003 by the Lithuanian Court of Appeals (**CE 168**).

181. By letter dated 25 March 2003, the Mayor of the City of Vilnius proposed to the Consortium various actions, especially the termination of the Agreement that had become incompatible with applicable law and the conclusion of a new contract for fee collection service (**CE 156**).

182. On 16 May 2003, BP made a counter proposal, consisting in a direct agreement with VPK, namely the Operator, that is the management company for the BP-Egapris Consortium for the collection of local fees and charges, and a second and separate agreement with BP for the construction of the Multi-storied Parking (**CE 166**).

183. On 24 October 2003, VPK submitted its proposal for a renegotiated agreement for collection of parking fees (**CE 180**):

- 1.1 *VPK shall provide the following service to the Municipality:*
 - a) *operate and develop the car parking system of the Municipality [...];*
 - c) *collect parking charges [...];*
- 2.1 *The contract shall be valid for 20 years, and VPK shall have the right of option to extend it by 10 years.*
- 3.1 *The Municipality shall pay to VPK the consideration for services [...] on a monthly basis. The amount of payment shall be calculated as a percentage from collected income. [...]*

184. On 17 November 2003, a provisional agreement was concluded between the Municipality and VPK (**CE 186**), to ensure the continued collection of parking charges pending negotiation.

185. On 9 December 2003, the Municipality responded to the VPK proposal of 24 October 2003 with a counter-proposal for an agreement with a duration of four years, at the end of which all shares of VPK would be transferred to the Municipality free of charge (**CE 190**).

186. On 18 December 2003, VPK responded to the Municipality counter-proposal of 9 December 2003. In substance, VPK proposed either a 15-year agreement without the construction of the multi-storey parking or a 10-year agreement with VPK's rights and obligations to construct multi-storey parking (**CE 192**).

187. The Municipality responded on 15 January 2004 (**CE 204**):

Due to the amended legal acts, further implementation of the Agreement concluded [...] on December 1999 is no longer possible and there are no legal preconditions for revising this Agreement.

The conditions specified in the written proposal submitted by VPK on 18 December 2003 regarding the establishment of new legal relations with Vilnius City Municipality are not acceptable to Vilnius City Municipality. We remind you that a proposal from Vilnius City Municipality of 9 December 2003 regarding the conclusion of the Agreement with VPK and the fulfillment of the obligations set in the Agreement of 30 December 1999 has already been submitted to you.

[...] [W]e also would like to remind you that the deadline set by Vilnius City Municipality Council for negotiations expires on 27 January 2004. Upon the expiry of this term and in case of failure to conclude a new Agreement, VPK will be deprived of its right to collect local charges for parking in Vilnius City.

4.4.5 The termination of the Agreement by the Municipality

188. By decision N° I-221 dated 21 January 2004, the Municipality of Vilnius decided to terminate the Agreement between the Municipality of the City of Vilnius and the Consortium Formed by UAB Baltijos Parkingas and UAB Egapris dated 30 December 1999 with effect from 1 March 2004 (**CE 206**).

189. By another decision N° I-222 date 21 January 2004, the Municipality of Vilnius decided to annul the local regulations that allowed VPK to collect the parking fee (**CE 207**).

190. The notice of termination of the Agreement was sent to the parties on 27 January 2004. In substance, the reasons for termination were the followings (**CE 210**):

The Agreement dated 30 December 1999 is terminated [...] by reason of material breach on the part of the Consortium formed by UAB Baltijos Parkingas and UAB Egapris of the following provisions of the Agreement:

- 1) *Omission to draw up, coordinate and submit for approval by the Vilnius City Council of the Parking Plan introducing the public parking system in the Vilnius City within the time-limits defined in the Agreement [...];*
- 2) *Failure to ensure to the Municipality [...] the availability of, and direct and real time access to, all information specified [...];*
- 3) *Failure to make investments defined in the Agreement, including failure to build and equip multi-storey car parks within the time-limits defined in the Agreement [...];*
- 4) *Failure to pay to the Municipality of the City of Vilnius the amounts due under the Agreement [...];*

191. Moreover, the Municipality requested the immediate and gratuitous transfer of 100 percent of the shares of VPK.

192. Following the Agreement's repudiation, the Municipality sued BP and VPK in recovery of the Clause 5.1.15 amount (see ¶¶ 179). On 29 June 2005, the Vilnius Regional Court decided that (**CE 234**):

The consortium was deprived of the right to collect from the owners of cars a fee for unblocking road wheels and thus lost one of contractual sources of income. Plaintiff [the Municipality] indicates that the increase of the fixed fee under Clause 5.1.15 of the Agreement is unconditional and not subject to any circumstances. However, such argument of Plaintiff is not recognized as grounded. Defendants [BP] substantially show that if such argument of Plaintiff is accepted, it should be recognized that LTL 1,000,000 must be paid even if the consortium's right to collect local charge is annulled by a certain legal regulation. The court decides that such interpretation of the Agreement would obviously conflict with the principles of good faith and common sense in general and would mean breach of such principles while interpreting this particular Agreement.

193. The decision of the Vilnius Regional Court was confirmed on appeal on 20 October 2005 (**CE 235**).

5. POSITION OF THE PARTIES

5.1 THE CLAIMANT

5.1.1 On jurisdiction

194. As set out in fuller summary in Section 7.2.1 below, Claimant argues that the Tribunal has jurisdiction.

5.1.2 On the merits

195. Parkerings contends that it is an investor subject to the protection of the Agreement between the Government of the Republic of Lithuania and the Government of the Kingdom of Norway on the Promotion and Mutual Protection of Investments dated 16 June 1992 (hereinafter the “Treaty” or “BIT”).
196. The Claimant alleges that through the acts and omissions of its municipal and national authorities, Lithuania has violated Parkerings’ investors rights under the Treaty and must be held responsible.
197. Parkerings has thus based its claim on a three-pronged argumentation:
- (i) Lithuania has violated its duty to grant the investment equitable and reasonable treatment and protection under Article III of the Treaty;
 - (ii) Lithuania has violated its duty under Article IV of the Treaty to afford the investment protection no less favourable than that afforded to investors from a third State;
 - (iii) Lithuania has violated its duty not to indirectly expropriate without compensation under Article VI of the Treaty.

5.1.2.1 Breach of the duty to grant equitable and reasonable treatment

198. According to the Claimant, the Treaty obligation to grant “equitable and reasonable treatment” holds Lithuania to a stricter standard of conduct than the “fair and equitable treatment” standard more commonly found in other bilateral investment treaties. A showing of breach of Article III of the Treaty therefore requires less than a showing of breach of the standard of “fair and equitable treatment” (see ¶ 272 below).
199. The Claimant submits that Lithuania’s conduct falls within the concept of unfair, inequitable or unreasonable treatment prohibited by the Treaty. Through the acts and omissions of its central and municipal authorities, Lithuania did:
- (i) Engage in grossly unfair and discriminatory conduct (see Section 8.1.2.1 below);
 - (ii) Engage in arbitrary and opaque conduct (see Section 8.1.3.1 below);
 - (iii) Frustrate Parkerings’ legitimate expectations (see Section 8.1.4.1 below);
200. In light of the above, the Claimant submits that Lithuania breached Article III of the Treaty beyond any possible doubt.

5.1.2.2 Breach of the obligation of protection

201. The Claimant alleges that the Respondent failed to protect its investment in violation of Article III of the BIT (see full summary in Section 8.2.1 below).

5.1.2.3 Breach of the duty to afford no less favourable treatment

202. The Claimant argues that the core of Lithuania's obligation under Article IV of the Treaty is to provide Norwegian nationals engaging in commercial activities the same standard of treatment as nationals from any other State (see Section 8.3.1 below).
203. According to the Claimant, Lithuania has treated Pinus Proprius, an investment of Litprop Holding BV, a Dutch investor, more favourably than BP. The Claimant submits that Lithuania breached Article IV of the Treaty.

5.1.2.4 Breach of the duty not to expropriate without compensation

204. The Claimant alleges that Lithuania destroyed BP's value by undermining and then terminating the Agreement. The Claimant argues that Lithuania indirectly expropriated Parkerings' ownership interest in BP. By failing to provide compensation, Lithuania breached its obligations under Article VI of the Treaty (see full summary in Section 8.4.1 below).

5.1.2.5 Damages

205. The Claimant argues that Parkerings is entitled to full compensation for all injuries arising out of Lithuania's violations of the Treaty. The purpose is to eliminate all consequences of the violations and reinstate the situation which would have likely existed in the absence of any violation.
206. Pursuant to Article VI (2) of the Treaty, the appropriate measure of compensation in cases of lawful expropriation is the market value of the investment immediately before the date of expropriation. While this provision requires the expropriation to be lawful, Parkerings contends that it also provides the relevant standard for determining the appropriate measure of compensation for Lithuania's violations of the Treaty, which entailed the destruction of BP.
207. The definition of fair market value has been established under international law as being the price a buyer would be willing to pay the seller under circumstances in which each party had reliable information in order to maximize its financial gain and neither party was under duress or threat. Fair market value should be measured at the time the investor suffered the injury that gave rise to a right to compensation, that is 21 January 2004 in the present case, *i.e.* the date on which the Municipality decided to terminate the Agreement in breach of the Treaty.
208. According to the Claimant, the fair market value compensation must take into account the future profitability of BP, given that continued demand for its services was guaranteed in the relevant market. In other words, the fair market value of BP in January 2004 would reflect the strong demand for its service and the predictability of revenue streams guaranteed by the Agreement. Accordingly, BP's value should be determined by reference to the company's reasonably anticipated profitability using the discounted cash flow (DCF) method.

209. Tribunals have long accepted that forecasting future cash flows will necessarily implicate some degree of uncertainty but that the mere existence of such uncertainty does not warrant preclusion of compensation for future profitability. The use of a DCF valuation in the present case is particularly appropriate for two reasons:
- (i) first, the parking business stands out for its stability, low risk, and predictability, which reduces the margin of uncertainty to a minimum. In BP's case, predictability was enhanced by the nature of its contractual rights under the Agreement, in that it was to be the sole partner of the Municipality in the design, development and operation of the integrated parking system;
 - (ii) second, several buyers (e.g. NCC and Skanska) made arms-length offers for a stake in BP in 2000 and 2001 using the DCF method to establish their offer price, which is consistent with general valuation practice in the parking industry.
210. The Claimant further argues that any diminution of value attributable to or associated with Lithuania's conduct should be discarded. The purpose of this rule is to preclude the host State from using its executive, legislative or judicial branches to progressively reduce the value of an asset and then expropriate it. This is of particular importance in the present case where Lithuania gradually eroded the value of BP, first by litigating and legislating away the legal framework of the investment, then by refusing to either perform or renegotiate the Agreement in good faith, and finally by unlawfully terminating the Agreement. Thus, full compensation of the fair market value of BP on 21 January 2004 requires the Tribunal to disregard any diminution in the value of BP that might have been caused by each of these various steps leading up to the destruction of BP.
211. In light of the above, the Claimant contends that its expert, Mr. Lapuerta, has correctly valued BP as of January 2004 in the amount of EUR 38.5 million taking into account the following assumptions:
- (i) BP would build the five MSCPs assigned to Egapris under the ABP, given that BP and Egapris were jointly and severally liable and that the latter had no prospect of carrying out the work itself pursuant to its insolvency;
 - (ii) Egapris was not able to enforce its call option under the ABP for 50% of the shares in VPK.
212. After deduction of the projected investment in the construction of 10 MSCPs that BP was unable to make due to Lithuania's breach, as well as of the returns BP could have made using these funds elsewhere, Mr. Lapuerta reaches the amount of EUR 20.4 million (NOK 176.4 million at the exchange rate on 21 January 2004) as compensation owed to Parkerings for the destruction of BP, in addition to the interest computed thereupon.

5.1.3 Prayers for relief

213. Based upon all the above submissions, Parkerings requests the following relief:²

Parkerings respectfully requests that the Tribunal:

- (a) *Declare that Lithuania has breached its obligations under the Treaty and international law;*
- (b) *Award Parkerings damages in the amount of NOK 176.4 million as the fair market value of BP as of January 21, 2004;*
- (c) *Award Parkerings interest at the NIBOR rate, compounded monthly for the period January 22, 2004 through the day of payment;*
- (d) *Direct Lithuania to pay all of Parkerings' costs and expenses, including legal fees, incurred in connection with this arbitration; and*
- (e) *Order any such further relief as may be available and appropriate in the circumstances.*

5.2 THE RESPONDENT

5.2.1 On jurisdiction

214. As set out in fuller summary in Section 7.2.2 below, the Respondent argues that most of Parkerings' claims are groundless and fall outside the scope of the Tribunal's jurisdiction under the Treaty. Therefore, Lithuania submits that the claims should be dismissed for lack of jurisdiction.

5.2.2 On the merits

215. According to the Respondent, all of the Claimant's claims must fail on the following grounds.

5.2.2.1 Lithuania has not frustrated Claimant's legitimate expectations

216. The Respondent argues that the Claimant's attempt to lower the standard for a violation of the duty to treat the investment fairly and equitably is meritless (see ¶¶ 282 *et seq.*).

217. The Respondent argues that a claim based upon the frustration of legitimate expectations due to governmental action requires the investor to show that such action frustrated expectations that the host State created or reinforced through its own conduct. In the present case, Lithuania cannot be held responsible for Parkerings' failure to conduct the required due diligence prior to signing the Agreement nor its failure to obtain other guarantees that investors typically demand in agreements with States or their agencies (see Section 8.1.4.1 below).

² See Claimant's Memorial, ¶ 272

218. Concerning Claimant's allegation of arbitrary conduct, the Respondent alleges that it clearly explained during the negotiations that the Agreement was untested and was subject to legal challenges. Moreover, the Respondent argues that the claims set out by the Claimant are only allegations of contract breach (see Section 8.1.3.1 below)

5.2.2.2 There has been no expropriation by Lithuania

219. The Respondent submits that Parkerings cannot bring a claim for expropriation on the basis of the alleged wrongful termination of the Agreement.

220. The Respondent also argues that Parkerings has not been substantially deprived of its ownership of BP.

221. Furthermore, a claim of contract breach cannot form the basis of an expropriation claim where, as here, the Claimant, pursuant to the Agreement, could seek redress before the Lithuanian courts (see Section 8.4.1 below).

5.2.2.3 Lithuania has not violated its duty to grant Claimant protection

222. According to the Respondent, protection within the meaning of the Treaty is not intended to generate an all-encompassing duty for the host State. The Respondent alleges that the guarantee of protection is characterized by the standard of due diligence.

223. As to Parkerings' specific argument that the Government should have backed up BP in its contractual dispute with the Municipality and challenge the termination of the Agreement, the Respondent argues that it is inconsistent with the purpose of the Treaty (see Section 8.2.1 below).

224. Therefore, the Respondent argues that it has not violated its duty to protect the Claimant.

5.2.2.4 The Claimant was not subject to any discrimination

225. The Respondent alleges that in order to make out a claim for discrimination, that is to say a violation of the Treaty's Equitable and Reasonable Treatment provision and/or a violation of the Treaty's Most Favored Nation's provision (MFN), the Claimant must show that two separate investors were similarly situated and that the two investors were treated differently.

226. The Respondent contends that the Claimant did not show that a third investor was similarly situated and treated differently (see full summary in Section 8.1.2.1 and 8.3.1 below).

5.2.2.5 The Claimant is not entitled to compensation

227. The Respondent has shown that Parkerings' claims are meritless. Accordingly, no compensation can be claimed.

228. Further, Parkerings' claim for damages is entirely speculative and flawed on several grounds, namely:

- (i) The Claimant has not established any causation between the alleged Treaty violations and the damages it seeks. The Claimant is only entitled to damages with respect to harm that was the direct result of the State's unlawful acts. The specific provision on expropriation of which the Claimant avails itself cannot provide any guidance on the measure of compensation for other Treaty violations;
- (ii) The Claimant's claim for damages based upon an estimation of BP's future profits had it built all 10 MSCPs and operated them until 2012 is equivalent to a claim for lost profits. No tribunal has awarded lost profits where as here, the claiming party has not made the investment which would give rise to the cash flow claimed. On the contrary, tribunals have adopted a cautious approach to the use of the DCF method.

229. It is undisputed that the Claimant's integrated parking system never became operational. Parkerings never made any investment in any of the MSCPs nor did it begin construction of a single one. As a result, the parking project never existed as required in the DCF model.

230. According to the Respondent, damages should be limited to proven net out-of-pocket expenditures. However, the Claimant has made no submissions in this respect and has not met the onus of proving its damages accordingly. The Respondent submits that Parkerings actually never made any significant investment expenditures. At any rate, any investment costs that the Claimant incurred must be reduced by the benefit that it received from BP.

231. Furthermore, the claim for lost profits *per se* is erroneous for the following reasons:

- the valuation date is not 21 January 2004, as it overlooks the preceding four years during which many intervening factors could have altered BP's value. The only reliable date for calculation is the year 2000, which is closer to the alleged detrimental State actions and thus minimizes any speculation about the ensuing period;
- BP and VPK are not devoid of any value. On the contrary, BP's assets are worth at least LTL 188'590 and BP further owns all shares of VPK, a fully operational company;
- Mr. Lapuerta's analysis is overstated, as it should not have (1) included a corruption-risk related discount, (2) excluded expenditures or revenues for 2000 and 2001, (3) disregarded Egapris' call option upon VPK's shares, or (4) included an eleventh MSCP (*i.e.* the Turgaus MSCP) in the calculation. As a matter of fact, the net present value (NPV) of Claimant's investment was near zero, whether valued in 2000 or 2004: it was negative in 2000 and below EUR 0.95 million as of 2004;

- the two arms-length offers the Claimant refers to do not provide any indication as to the fair market value of its investment. In any event, such offers made in 2000 and 2001 are only useful insofar as a DCF analysis is carried out for 2000 as opposed to 2004. Further, the Respondent points out that NCC and Skanska's offers were contingent upon certain events and conditions that were contrary to the assumptions made in Mr. Lapuerta's report (e.g. the right to develop additional MSCPs, the premium for project legality or the premium for the extinction of Egapris' call option).

5.2.3 Prayers for relief

232. Based upon all the above submissions, Lithuania requests the following relief:³

For the foregoing reasons, the Respondent respectfully requests that the Tribunal:

- DISMISS all of the Claimants' claims in their entirety; and*
- ORDER the Claimant to pay all of the costs and expenses of this arbitration, including the fees and expenses of the Republic's expert, Mr. Tim Giles, the fees and expenses of any experts to be appointed by the Tribunal, the fees and expenses of the Republic's legal representation in respect of this arbitration, and any other costs of this arbitration.*

6. ISSUES TO BE DETERMINED BY THE TRIBUNAL

233. In light of the facts and submissions of the parties set forth above, the questions arising for the Tribunal's determination are the following:

- Does the Tribunal have jurisdiction over Parkerings' claims? (see Section 7 below);
- What is the applicable standard for the duty of "equitable and reasonable treatment" within the meaning of Article III of the Treaty? (see Section 8.1 below) Has Lithuania violated Article III of the Treaty? In particular, did Lithuania engage in unfair and discriminatory or arbitrary and opaque conduct with respect to Parkerings' investment? (see Section 8.1.2 and 8.1.3 below) Did Lithuania frustrate Parkerings' legitimate expectations? (see Section 8.1.4 *et seq.* below);
- Has Lithuania violated its obligation of protection pursuant to Article III of the Treaty? (see Section 8.2 below);
- Has Lithuania violated its duty to afford no less favourable treatment under Article IV of the Treaty? (see Section 8.3 below);
- What is the applicable standard in terms of expropriation within the meaning of Article VI of the Treaty? (see Section 8.4 below) Has Lithuania breached its duty not to expropriate Parkerings' investment? (see Section 8.4.2 below);

³ *Idem*, ¶ 342.

- (vi) Is Parkerings entitled to any compensation and if so, what is the measure thereof? This question may be moot depending on the decision in the foregoing issues;
- (vii) What are the costs of this case and how should they be apportioned between the Parties?

7. JURISDICTION

7.1 ISSUES FOR DETERMINATION

234. The Tribunal's jurisdiction over the claims of the Claimant will be examined in light of the requirement of the ICSID Convention and the BIT.

235. Article 25(1) of the ICSID Convention provides as follows:

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 or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, 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.

236. Article IX of the BIT contains the following dispute settlement clause:

1. *Any dispute which may arise between an investor of one contracting party and the other contracting party in connection with an investment on the territory of that other contracting party shall be subject to negotiations between the parties in dispute.*
2. *If any dispute between an investor of one contracting party and the other contracting party continues to exist after a period of three months, the investor shall be entitled to submit the case:*
 - A. *Either to the International Centre of Settlement of Investment Disputes having regard to the applicable provisions of the Convention on the Settlement of investment disputes between States and Nationals of other States opened for signature at Washington D.C. on 18 March 1965,*
 - B. *or in case both contracting parties have not become parties to this Convention, to an arbitrator of International ad hoc Arbitral Tribunal established under the Arbitration Rules of the United Nations Commission on the International Trade Law. The parties to the dispute may agree in writing to modify these rules. The Arbitral Award shall be final and binding on both parties to the dispute.*

7.2 THE PARTIES' POSITION

7.2.1 Parkerings

237. Parkerings contends that the Tribunal has jurisdiction.

238. The Claimant argues that it is a company incorporated under the laws of Norway and is an investor subject to the protection of the Treaty. The Claimant specifies that it owns

100 percent of the shares of the Lithuanian company BP, which constitutes an investment in Lithuania.

239. The Claimant contends that through the acts and omissions of its municipal and national authorities, Lithuania has violated the Treaty.⁴
240. The Claimant argues that Article IX of the Treaty, which governs the dispute between a contracting party and an investor, "*grants the Tribunal jurisdiction over any and all disputes in connection with an investment, including disputes arising out of breaches of contract or violation of domestic law*"⁵.
241. The Claimant underlines that it pleaded breaches of Lithuania's obligations under the Treaty and not breaches of the Agreement. The Claimant alleges that the Respondent cannot deny its Treaty claims arguing that some facts do not rise to the level of a Treaty breach.
242. Finally, the Claimant is opposed to the Respondent's opinion that the Lithuanian Courts were able to remedy to the present problems.⁶

7.2.2 The Republic of Lithuania

243. The Respondent argues that Parkerings' claims fall outside the scope of the Tribunal's jurisdiction under the Treaty. Specifically, more than half of the claims concern alleged breaches of the Agreement; these commercial disputes cannot be the basis of a claim under the BIT. Furthermore, the Respondent argues that the Tribunal has no jurisdiction under the BIT on several grounds:

- (i) Parkerings is not a party to the Agreement and has no rights thereunder;⁷
- (ii) Lithuania as host State is not responsible on an international level for acts of its agencies. The conduct of State organs including municipalities is not attributable to the State, unless such conduct had legal effects on an international level⁸
- (iii) BP and the Municipality agreed to submit all disputes arising under the Agreement to the Lithuanian Courts. In order to observe this contractual choice, ICSID tribunals do not have jurisdiction over purely contractual claims which do not amount to claims for Treaty violations. Claims arising out of contracts between investors or their subsidiaries and the Government or its agencies do not constitute claims cognizable under bilateral investment treaties. Further, the Treaty does not, in the present case, contain an umbrella clause. However, the Respondent admits that where the foreign investor is denied a remedy for a contractual breach in a domestic forum, such breach of contract may constitute

⁴ See Claimant's Memorial, ¶ 190.

⁵ See Claimant's Post-hearing Brief, p. 4.

⁶ See Claimant's Post-hearing Brief, p. 6-7.

⁷ See Respondent's Counter-memorial, ¶ 140.

⁸ See Respondent's Counter-memorial, ¶¶ 148-151.

an international wrong. This is not the case here, given that the Agreement provided for dispute resolution before the Lithuanian Courts. The Respondent alleges that the Lithuanian Courts were perfectly able to protect Claimant's rights.⁹

244. Therefore, Lithuania submits that the following claims should be dismissed for lack of jurisdiction:¹⁰

- (a) *Claimant's allegation of breach of the Equitable and Reasonable Treatment Clause by virtue of the City's supposed failure to properly recognize an event of force majeure under Section 7.2.1 of the Agreement;*
- (b) *Claimant's allegation of breach of the Equitable and Reasonable Treatment Clause by virtue of the City's supposed failure to disclose material information during contract negotiations, as required under the good faith duty set out under Lithuanian law;*
- (c) *Claimant's allegation of breach of the Equitable and Reasonable Treatment Clause by virtue of the City's supposed failure to issue consistent directions to BP regarding its performance under the Agreement, as required under Section 1.5.1 of the Agreement;*
- (d) *Claimant's allegation of breach of the Equitable and Reasonable Treatment Clause by virtue of the City's supposed failure to defend the Agreement against measures adopted by the Government as required under Section 1.5.1 of the Agreement;*
- (e) *Claimant's allegation of breach of the Equitable and Reasonable Treatment Clause by virtue of the City's supposed failure to renegotiate in good faith as required under the good faith duty set out under Lithuanian law;*
- (f) *Claimant's allegation of breach of the Full Security and Protection Clause by virtue of the City's supposed failure to renegotiate in good faith as required under the good faith duty set out under Lithuanian law; and*
- (g) *Claimant's allegation of breach of the Expropriation Clause by virtue of the City's supposed termination of the Agreement on grounds that were not permitted under Article 7 of the Agreement.*

7.3 DISCUSSION ON THE TRIBUNAL'S JURISDICTION

245. There is no doubt that the conditions *rationae personae* of the ICSID Convention are met, as the parties are, on the one hand, a national of the Kingdom of Norway, Parkerings, and on the other hand, the Republic of Lithuania.

246. The parties gave their consent to arbitration: the Republic of Lithuania, on 16 June 1992, by signing the BIT and Parkerings, on 11 March 2005, with its Request for Arbitration.

247. The Arbitral Tribunal notes that pursuant to Article IX of the BIT, any dispute in connection with an investment shall be subject to negotiations between the parties. If the dispute continues to exist after a period of three months, the investor is entitled to

⁹ See Respondent's Counter-memorial, ¶¶ 152-158 and Respondent Post-Hearing Brief, p.1.

¹⁰ See Respondent's Counter-Memorial, pp. 56-57.

submit the case to an arbitral tribunal. In the absence of parties' determination on that matter, the Tribunal considers that the conditions of Article IX of the BIT are met.

248. Thus the first question for the Tribunal to resolve here is whether the Claimant is an investor in Lithuania.

7.3.1 The Claimant's Investment

249. In accordance with Article 25 of the ICSID Convention, an arbitral tribunal established pursuant to the ICSID Convention has jurisdiction *ratione materiae* over "any legal dispute arising directly out of an investment." No definition of "investment" is to be found in the ICSID Convention.

250. Article I of the BIT gives the definition of the term "Investment":

The term "Investment" means every kind of asset invested in the territory of one contracting party in accordance with its laws and regulations by an investor of the other contracting party and includes in particular, though not exclusively:

(...)

(II) Shares, debentures or any other forms of participation in companies.

251. UAB Baltijos Parkingas (BP) is a Lithuanian company, registered with the Lithuanian Company Register. Parkerings, which is a company registered in Norway, is "the owner of sixty five thousand (65,000) ordinary shares of the Company [BP] for the value of one hundred (100) Litas each, comprising 100% of the authorized capital of the Company."¹¹

252. In the *Vivendi* case, the ICSID *ad hoc* Committee held that "[...] the foreign shareholding is by definition an investment and its holder an investor [...]"¹².

253. In this case the Tribunal accepts the Claimant's contention that "Parkerings' direct 100 percent ownership interest in BP constitutes an investment in Lithuania within the meaning of the Treaty."¹³

254. The Arbitral Tribunal is therefore of the opinion that Parkerings is an investor in Lithuania for the purpose of the ICSID Convention and within the meaning of the BIT, since it owns the entirety of the shares of a Lithuanian company which is BP.

255. The issue is thus to determine whether the dispute arises in connection with such investment in Lithuania.

¹¹ See Exhibit **C 195**.

¹² *Compañía de Aguas del Aconquija S.A and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, July 3, 2002, *reprinted in 19 ICSID Rev.—FILJ 89* (2004), ¶ 50.

¹³ See Claimant's Memorial p. 60; Exhibit **CE 195**.

7.3.2 Did the claims fall under the Treaty?

256. The Claimant asserts that its claims arise from action that the Republic of Lithuania undertook in violation of the BIT. The Claimant does not base its request on breaches of the Agreement.¹⁴
257. The Respondent, however, rightly distinguishes between disputes arising out of contract breaches and disputes under the BIT. In particular, the Respondent states that investor-state arbitration is only available to adjudicate rights contained in the Treaty.¹⁵
258. However, the issue lies elsewhere. It is uncontroversial that this dispute is between Parkerings and the Republic of Lithuania whilst the Agreement was entered into by two different entities, namely BP and the City of Vilnius, both of which are not parties to this arbitration. It is undisputed that States are responsible on an international level for acts of municipalities (and other State *constituent subdivisions*)¹⁶ that are contrary to international law and that States are not liable internationally for acts of their agencies that are wrongful under domestic law. For instance, the *ad hoc* Committee in *Vivendi* held:

*[...] in the case of a claim based on a treaty, international law rules of attribution apply, with the result that the state of Argentina is internationally responsible for the acts of its provincial authorities. By contrast, the state of Argentina is not liable for the performance of contracts entered into by Tucumán, which possesses separate legal personality under its own law and is responsible for the performance of its own contracts.*¹⁷

259. In the present case, the Claimant alleges that the Republic of Lithuania itself, and not the City of Vilnius, violated its obligations under the BIT by virtue of the attribution to the State of the acts of the Municipality. As a result, the proper parties to the dispute are Parkerings and the Republic of Lithuania. That the Claimant was not a party to the Agreement is irrelevant as the Arbitral Tribunal is not ruling on breaches of the Agreement but on violation of the BIT. Put differently, the Claimant is alleging treaty violation and there is nothing convincing in the record that may lead to the suspicion of the Claimant having disguised contract claims with Treaty claims for the benefit of jurisdiction. Whether the Respondent did in fact violate the Treaty (or the international law) is a matter of substance and merit rather than of jurisdiction.

¹⁴ See Claimant's Memorial, p. 60 *et seq.*

¹⁵ See Respondent's Counter-Memorial, p. 48-49.

¹⁶ See *Generation Ukraine Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, September 16, 2003, p. 39, reprinted in 44 *ILM* 404 (2005). See, e.g., Luigi Condorelli, *L'imputation à l'état d'un fait internationalement illicite: solutions classiques nouvelles tendances*, 1984 («sont attribués à l'Etat, d'après le droit international, tous les comportements de tous ceux qui, dans l'ordre interne de l'Etat concerné, exercent effectivement les prérogatives de la puissance publique»). Free translation: *The attribution to a State of an internationally wrongful fact: classical solution, new tendencies* ("According to international law, will be attributed to a State, all the conduct of those who, in the domestic body of law of the State, will actually exercise the prerogatives of sovereignty").

¹⁷ See *Compañía de Aguas del Aconquija S.A and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, July 3, 2002, *supra* note 12 ¶¶ 96.

260. Furthermore, the Claimant is rightfully alleging that its claim is based on its investment that went sour. This is an adequate response to Respondent's argument that the Lithuanian Courts do have jurisdiction over claims based on the Agreement. As a matter of rights, the Arbitral Tribunal has no jurisdiction over the claims based on the Agreement.
261. The phrase "*any dispute [...] in connection with the investment*" as provided by Article IX (1) of the BIT is a general provision that provides the basis for an international Arbitral Tribunal's competence over any disputes related to an investment.
262. This is recognized in the decisions of past international tribunals.¹⁸ For instance, in the case *SGS v. Republic of the Philippines*, the Arbitral Tribunal held that:

[t]he term "dispute with respect to investments" is not limited by reference to the legal classification of the claim that is made. A dispute about an alleged expropriation contrary to Article VI of the BIT would be a "dispute with respect to investments".¹⁹

263. In *Vivendi*, the *ad hoc* Committee stated that:

it is not open to an ICSID tribunal having jurisdiction under a BIT in respect of a claim based upon a substantive provision of that BIT, to dismiss the claim on the ground that it could or should have been dealt with by a national court. In such a case, the inquiry which the ICSID tribunal is required to undertake is one governed by the ICSID convention, by the BIT and by applicable international law.²⁰

[...]

It is not the Committee's function to form even a provisional view as to whether or not the Tucumán conduct involved a breach of the BIT, and it is important to state clearly that the Committee has not done so. But it is nonetheless the case that the conduct alleged by Claimants, if established could have breached the BIT. The claim was not simply reducible to so many civil or administrative law claims concerning so many individual acts alleged to violate the Concession Contract of the Administrative law of Argentina. It was open to Claimants to claim, and they did claim, that these acts taken together, or some of them, amounted to a breach of [...] the BIT.²¹

264. The Arbitral Tribunal notes that the Claimant alleged exclusively violations of the BIT and particularly failure to afford its *investment equitable and reasonable treatment and protection, to accord its investment treatment no less favorable than the treatment accorded to investment by investors from a third State*, and last, a breach of its *obligation not to expropriate without compensation*.²²
265. *Prima facie*, the conduct of the Republic of Lithuania through its subdivision constituent (the Municipality of the City of Vilnius) had an impact on the investment of the

¹⁸ The Tribunal is of the opinion that it must pay due consideration to earlier decisions of international tribunals.

¹⁹ *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, January 29, 2004, *reprinted in 8 ICSID Rep.* 518 (2005), ¶ 131.

²⁰ See *Compañía de Aguas del Aconquija S.A and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, July 3, 2002, *supra* note 12, ¶ 102.

²¹ *Idem*, ¶ 112.

²² See Claimant's Memorial p. 60-77.

Claimant. The claims are therefore *in connection with the investment* and fall under the Treaty. The Arbitral Tribunal emphasizes that the substantive justification of the Claimant's claims is not a matter of jurisdiction but of merit. This question will be developed below.

266. As the claims fall under the Treaty, whether the Claimant should have submitted the dispute before the Lithuanian courts is not relevant at the stage of examination of the jurisdiction. The Arbitral Tribunal concludes that it has jurisdiction under Article IX of the Treaty.

8. MERITS

267. The Claimant's substantive claim under the BIT is, as stated in paragraph 197 above under three main headings:

- i Lithuania has violated its duty to grant the Claimant's investment in Lithuania "equitable and reasonable treatment and protection" as required under Article III of the Treaty;
- ii Lithuania has violated its duty to accord the Claimant's investment in Lithuania "treatment no less favourable than that accorded to investments made by investors of any third state as required under Article IV of the Treaty;
- iii Lithuania has violated its duty not to indirectly expropriate the Claimant's investment without compensation as required under Article VI of the Treaty.

8.1 CLAIMS FOR VIOLATION OF THE DUTY OF EQUITABLE AND REASONABLE TREATMENT (ARTICLE III OF THE TREATY)

268. Article III of the Agreement between the Government of the Republic of Lithuania and the Government of the Kingdom of Norway on the Promotion and Mutual Protection of Investments provides that:

Each contracting party shall promote and encourage in its territory investments of investors of the other contracting party and accept such investments in accordance with its laws and regulations and accord them equitable and reasonable treatment and protection. Such investments shall be subject to the laws and regulations of the contracting party in the territory of which the investments are made.

269. The Claimant alleges that Lithuania breached its obligation to accord Parkerings's investment *equitable and reasonable treatment*. The Claimant alleges:

- "*the Treaty accord equitable and reasonable treatment holds Lithuania to a stricter standard of conduct than the fair and equitable treatment standard more commonly found in other investment treaties*"²³ (see below 8.1.1);

²³ See Claimant's Memorial, p.61

- “Lithuania subjected BP to grossly unfair and discriminatory treatment”²⁴ (see below 8.1.2);
- “Lithuania’s conduct was grossly arbitrary and opaque”²⁵ (see below 8.1.3);
- and finally, that: “Lithuania frustrated Parkerings’s legitimate expectations”²⁶ (see below 8.1.4).

270. The Arbitral Tribunal will examine each of these arguments separately.

8.1.1 The distinction between the notions of fair and reasonable

271. Unlike other BITs, the Treaty refers to “*equitable and reasonable*” in its Article III. This led to a discussion on the content of such standard and to whether it has the same meaning as “*fair and equitable*” standard.

272. Regarding the applicable standard, the Claimant alleges that “*the Treaty obligation to accord equitable and reasonable treatment holds Lithuania to a stricter standard of conduct than the fair and equitable treatment standard more commonly found in other investment treaties*”.

273. To support its opinion, Claimant relies on the French text of Olivier Corten that discusses the notion of “*équitable*” and “*raisonnable*”: what is “*reasonable*” could not be inequitable but an equitable solution might be unreasonable if it is insufficiently rational²⁷.

274. The Respondent alleges that “*Claimant’s analysis does not comport with the dictates of the Vienna Convention on the Law of Treaties (the Vienna Convention) which governs the Treaty’s interpretation.*” The Respondent underlines that “*a Treaty should 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 light of its object and purpose.”*”²⁸ Moreover, the Respondent contends that the terms “*reasonable*” and “*fair*” are “*virtually synonymous*.”²⁹ The Respondent finally argues that “*the set of bilateral investment treaties signed by Norway, where the formulae “fair and equitable “ and “equitable and reasonable” seem to have been used indistinctively within the standard clause generally devoted to the promotion and protection of investments*” confirms that the two phrases are synonymous.”³⁰

²⁴ *Idem*, p. 64.

²⁵ *Idem*, p. 66.

²⁶ *Idem*, p. 68.

²⁷ See Oliver Corten, *L’utilisation du “raisonnable” par le juge international*, Editions de l’Université de Bruxelles, 1997.

²⁸ See Respondent’s Counter-Memorial, ¶ 167.

²⁹ *Idem*, ¶ 169.

³⁰ *Idem*, ¶ 171.

275. The Arbitral Tribunal considers that the interpretation of the Treaty is effectively governed by the Vienna Convention which provides that a Treaty should be interpreted, pursuant to Article 31, “*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.*”
276. The interpretation given by the Claimant, based on Corten’s interpretation of the terms equitable and reasonable, is not convincing. If the two phrases are given their plain meaning, it is far from apparent that they should differ in any way. Thus, under this approach, treatment is fair when it is “*free from bias, fraud or injustice; equitable, legitimate [...]*”; and, by the same token, equitable treatment is that which “*is characterized by equity or fairness, [...] fair , just , reasonable.*”³¹
277. The standard of “*fair and equitable treatment*” has been interpreted broadly by Tribunals and, as a result, a difference of interpretation between the terms “*fair*” and “*reasonable*” is insignificant. The Claimant did not show any evidence which could demonstrate that, when signing the BIT, the Republic of Lithuania and the Kingdom of Norway intended to give a different protection to their investors than the protection granted by the “*fair and equitable*” standard.
278. Thus the Arbitral Tribunal intends to identically interpret the notion “*equitable and reasonable*” and the standard “*fair and equitable.*”
279. The Claimant raises three issues that shall now be examined:
- Did Lithuania engage in unfair and discriminatory treatment?
 - Did Lithuania engage in arbitrary conduct?
 - Did Lithuania frustrate Parkerings’ legitimate expectations?

8.1.2 Was the Treatment “*unfair and discriminatory*”?

8.1.2.1 The position of the parties

280. The Claimant alleges that Lithuania subjected BP to grossly unfair and discriminatory treatment. The principle of *fair and equitable treatment* is violated where a host State’s conduct is grossly unfair or discriminatory. Discrimination is a significant element in determining whether the standard of fair and equitable treatment has been breached.
281. In the present case, the Claimant contends Lithuania subjected BP to the following unfair and discriminatory measures:
1. the Municipality instructed BP to relinquish the Gedimino MSCP on the grounds of cultural heritage concerns and public opposition in April 2001, at a time BP had already carried out important planning and design works. Further, in breach of the Agreement whereby BP was to be the sole partner of

³¹ Stephen Vascianne, in Bishop, Crawford and Reisman, *Foreign Investment Dispute*, ¶ 7, p. 1015.

the Municipality, the Mayor handed over the project to another contractor, Pinus, six months later;³²

2. the Mayor chose to sign the JAA relevant to the Pergales site with the Municipality's newly selected contractor to the detriment of BP and advocated the validity of his decision in the local court litigation with the Government Representative;³³
3. after VPK lost the clamping and part of the parking income, the Municipality claimed that BP should have foreseen the clamping prohibition, without, however, considering it as a *force majeure* event which should have released BP of its obligations under Clause 5.1.15 of the Agreement, as confirmed by the Lithuanian Courts. Further, when clamping resumed, the Municipality was receiving 40% of the fees whilst VPK was receiving nothing;³⁴
4. the City of Vilnius refused to renegotiate the Agreement unless BP provided the payment of the amount of Clause 5.1.15 of the Agreement.³⁵

282. The Respondent is of the opinion that “[i]n international law, the principle of non-discrimination encompasses both “most favored nation treatment” (between aliens) and “national treatment” (between aliens and nationals).”³⁶

283. The Respondent argues that any discrimination claim must establish that similar situations were treated differently by the host State. In other words, the Claimant has not established a different treatment of Parkerings and Pinus under like circumstances..³⁷

284. The facts relating to the MSCP built by Pinus and those relating to Parkerings are distinct. In particular, the MSCP projected by BP in Gedimino was significantly bigger than the MSCP built by Pinus Proprius and encroached into the City Old Town. The location of the MSCP built by Pinus Proprius outside of the Old Town entailed a different treatment of the two projects by the Cultural Heritage Commission.

285. The MSCP built by Pinus Proprius had to be sold to the City after construction was completed. The MSCP built by BP did not have to be sold to the City.

286. As to the Cooperation Agreement entered into between the Municipality and Pinus Proprius, it did not involve any transfer of land belonging to the City as opposed to any

³² See Claimant's Memorial, ¶ 201.

³³ *Idem*, ¶ 202.

³⁴ *Idem*, ¶ 203.

³⁵ *Idem*, ¶ 205.

³⁶ See Respondent's Counter-Memorial, ¶ 238.

³⁷ *Idem*, ¶ 241.

potential cooperation agreement with BP which would have required the lease or the sale of land through a public auction pursuant to the applicable law on land.³⁸

8.1.2.2 Discussion

287. Various tribunals have held that a discriminatory conduct is a violation of the standard of the *fair and equitable treatment*. In CMS Gas Transmission Company v. The Argentine Republic, the Tribunal considered that:

*any measure that might involve arbitrariness or discrimination is in itself contrary to fair and equitable treatment. The standard is next related to impairment: the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of the investment must be impaired by the measures adopted.*³⁹

288. In order to determine if there is discrimination in violation of the standard of *the fair and equitable treatment*, one has to make a comparison with another investor in a similar position (*like circumstances*). For instance, in the case Antoine Goetz et consorts c. République du Burundi (Award of 10 February 1999), the Tribunal stated that:

*[u]ne discrimination suppose un traitement différencié appliqué à des personnes se trouvant dans des situations semblables.*⁴⁰

289. The Tribunal considers that the conduct of the City of Vilnius could possibly amount to a contractual breach of the Agreement. It should be noted, however, at the outset of the present dispute, that a possible breach of an agreement does not necessarily amount to a violation of a BIT.
290. As to arguments (3) and (4) (see above ¶ 280), even if a contractual breach had occurred, the evidence in the record does not show any comparison made by the Claimant with another investor which could bring under the BIT the actions mentioned in those arguments. The Tribunal is not in a position to determine if there had been a discriminatory measure against the Claimant as no comparison is possible with another investor. As a result, the arguments (3) and (4) are not evidence of discrimination within the meaning of Article III of the Treaty.
291. Concerning the arguments (1) and (2) (see above ¶ 280) the violations alleged by the Claimant and the position of the Respondent are substantially the same as those discussed under *Most-favoured-Nation Treatment* (MFN) (see below section 8.3) In certain situations where an MFN clause has been incorporated within a BIT, establishing a discrimination under the standard of *fair and equitable/reasonable treatment* is not necessary (see below ¶¶ 366 *et seq*). Consequently, the Arbitral Tribunal refers to the discussion of the *Most-Favoured-Nation Treatment* under section 8.3 below.

³⁸ *Idem*, ¶¶ 247-250.

³⁹ CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/08, Award, May 12, 2005; *reprinted in* 44 *ILM* 1205 (2005), ¶ 290; See also Stephen Vascianne, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, Brit. Y.B. Int'l L. 99, 133 (1999).

⁴⁰ See Antoine Goetz and others v. Republic of Burundi, ICSID Case No. ARB 95/3, Award, February 10, 1999, *reprinted in* 15 *ICSID Rev.—FILJ* 457 (2000), ¶ 121.

292. However, the Tribunal shall review the question whether the conduct of the Respondent was arbitrary.

8.1.3 Was the conduct of the Respondent “arbitrary”?

8.1.3.1 *Position of the parties*

293. The Claimant alleges that the conduct of the Republic of Lithuania was grossly arbitrary and opaque in violation of Article III of the Treaty. According to the Claimant, it is well established that fair and equitable treatment inherently precludes arbitrary and capricious actions against investors. Inconsistency of State action and complete lack of transparency are a clear showing of arbitrariness. A foreign investor may expect the host State to act consistently, *i.e.* without arbitrarily revoking any pre-existing decisions or permits issued by the State, which were relied upon by the investor to assume its commitments, as well as to plan and launch its commercial and business activities.

294. The obligation to afford investments fair and equitable treatment also places the State under an affirmative obligation not to approve investments on terms that are inconsistent with Government policies or laws. A State cannot escape its international responsibility by requiring the investor to be more knowledgeable about its laws and regulations than its own authorities.

295. The Claimant submits that Lithuania subjected BP to arbitrariness and lack of transparency:⁴¹ Lithuania failed to disclose to Parkerings information pertaining to the viability of the hybrid parking fee concept prior to the execution of the Agreement. Although the Municipality of Vilnius was in possession of a legal opinion (“*the Sorainen Memo*”) questioning the conformity of the parking fee with the Lithuanian law, it did not inform BP before the signing of the Agreement. The Municipality of the City of Vilnius failed to warn BP about the imminent changes to the applicable law.⁴²

296. Examples of arbitrariness on the part of the Republic of Lithuania include:

- The Municipality of the City of Vilnius arbitrarily refused to acknowledge the existence of a force majeure event and insisted on full payment of Article 5.1.15 of the Agreement.⁴³
- The Municipality and various public entities adopted a “*blatantly contradictory and ambiguous position in connection with the Parking Plan.*”⁴⁴
- The Municipality changed its opinion several times concerning the first MSCP site.

⁴¹ See Claimant’s Memorial, p. 66 *et seq.* and Claimant’s Post-Hearing Brief, p. 60 *et seq.*

⁴² See Claimant’s Post-Hearing Brief, p. 61

⁴³ *Idem*, p. 62.

⁴⁴ See Claimant’s Memorial, ¶ 210.

- The Municipality arbitrarily refused to issue the necessary design conditions and to enter into the necessary land-use agreement.
- The Municipality accused BP of failure to perform its construction obligation, refused to negotiate in good faith and then terminated unlawfully the Agreement.⁴⁵

297. The Respondent states that the *Sorainen Memo* was disclosed to BP before the signing of the Agreement. The Respondent alleges that it made it clear that the measures set out in the Agreement were untested and could be subject to legal challenges.⁴⁶ For the Respondent, the State is not responsible for the consequence of “*unwise business decisions or for the lack of diligence of the investor.*”⁴⁷

298. The Respondent underlines that BP was granted a force majeure claim by the Lithuanian Courts.⁴⁸

299. The Respondent is of the opinion that the conduct alleged by the Claimant does not give rise to a claim under the Treaty and that the conduct alleged is “*nothing more than allegation of contract breach.*”⁴⁹

8.1.3.2 Discussion

a) The Sorainen Memo

300. It is not disputed by the parties that arbitrariness is incompatible with the standard of *fair and equitable treatment*.

301. Based on the facts as discussed by the Parties, the Tribunal finds that a memo (“*the Sorainen Memo*”) concerning the Law on Fees and Charges was effectively in possession of the City of Vilnius prior to the execution of the Agreement on 30 December 1999.⁵⁰ Indeed, the memorandum is dated 28 December 1999 and the Respondent does not allege that it received the document after 30 December 1999. Mr. Robertas Staskevicius confirmed that “[...] *it was before City Council. It was on 28th of December. When we’ve got this -- [Sorainen memo] it was immediate discussion of that because it was quite serious issue.*”⁵¹

302. The record does not convincingly show that any information contained in the *Sorainen Memo* and, *a fortiori*, a copy of the memorandum, was given to the Claimant by the City of Vilnius before the conclusion of the Agreement. Accordingly, the Tribunal assumes

⁴⁵ See Claimant’s Post-Hearing Brief, p.81.

⁴⁶ See Respondent Counter-Memorial, p. 68.

⁴⁷ *Idem*, p. 72.

⁴⁸ See Respondent Post-Hearing Brief, p. 17.

⁴⁹ *Idem*, p. 11 *et seq.*

⁵⁰ See CE 11 ;

⁵¹ See Robertas Staskevicius, Tr. 1307:17-21.

that Mr. Tamulis did not receive a copy of this memorandum and that the Claimant was unaware of its existence (up to April 2000).⁵²

303. In substance, the *Sorainen Memo* contains a brief (5 pages) legal opinion regarding the draft of the Agreement between the Municipality of Vilnius and the Consortium. In its most relevant part, the Memorandum reads as follows:

we would take the views that the legal acts of the Republic of Lithuania and contractual deeds and obligations, indicated in the Agreements of the Municipality and the Consortium, do not create sufficient and clear legal ground for the Consortium to have right to collect a portion of the fee for vehicle parking time for on-street parking places designated by the Municipality Council, which is derived from the entire fee, established in Article 5.1.3, less local charges approved by the Municipality Council.

304. The information contained in the *Sorainen Memo* is characterized as the opinion of a law firm regarding the Agreement. The document does not provide any information which was not, at the time of its drafting, accessible to the public or at least to any other qualified law firm. The Claimant could have also obtained an opinion from another law firm.

305. It is not disputed that the Claimant did, in fact, receive a legal opinion dated 29 December 1999 from another law firm, namely the Lawin Firm. The opinion concluded that:

“Following your request, we would like to comment the legal situation relating to collection of payment for car parking in places designated by the Municipality (streets and squares). The Agreement between Vilnius City Municipality and the Consortium establishes that such payment will consist of local charges and the portion of payment falling on the Consortium.

The portion of payment falling on the Consortium is to be legally qualified as payment for services, which will be rendered by the Consortium to car drivers. The scope of this service is the development of parking system in the city and its administering. Car parking in pay place is to be qualified as a behaviour of a driver expressing his/her will to use the service rendered by the Consortium and to pay for it according the rate set by the Consortium.”⁵³

306. Mr. Tamulis testified convincingly that such opinion was only a “*small piece of an exhibit from the legal opinion which we had from Lawin regarding the whole thing around the hybrid parking fee.*”⁵⁴ In the view of the Arbitral Tribunal, the Claimant, when it requested such opinion, was without doubt aware that the business environment, and especially various provisions of the Agreement, were not certain. In fact, it would have been foolish for a foreign investor in Lithuania to believe, at that time, that it would be proceeding on stable legal ground, as considerable changes in the Lithuanian political regime and economy were undergoing.

307. Another matter is whether, in itself, failing to disclose a legal opinion (such as the *Sorainen Memo*) to the counter-party before entering into an Agreement has

⁵² See Claimant’s Memorial, ¶ 45.

⁵³ See Exhibit R 40.

⁵⁴ See Jonas Tamulis Stmt, Tr. 514-515.

international consequences for a State party. Such a conduct is often considered as a breach of good faith or a “*culpa in contrahendo*”. However, such a conduct, while objectionable, does not, in itself, amount to a breach of international law. It would take unusual circumstances to decide otherwise; in particular, the Claimant has been unable to show that the Sorainen Firm (or the Municipality of Vilnius) was in possession of information unavailable to the public, especially to other legal experts.

308. In *MTD v. Republic of Chile*, the Tribunal noted that:

*[the State is not] responsible for the consequences of unwise business decisions or for the lack of diligence of the investor. Its responsibility is limited to the consequences of its own action to the extent they breached the obligation to treat the Claimants fairly and equitably.*⁵⁵

309. The Tribunal concludes that the City of Vilnius did not act arbitrarily when it failed to disclose the *Sorainen Memo* and its content to BP. Whatever the effect of the non-production of the *Sorainen Memo* on the Claimant’s contractual rights is not a matter for this Tribunal.

b) The Force majeure

310. As already stated, breaching the Agreement will not automatically result in a violation of the Respondent’s international law obligations under the BIT. In the present instance, the Tribunal concludes that the force majeure (see ¶ 295) claim and any breaches of the Agreement do not reach the status of a BIT breach.

311. In fact this issue has been reviewed by the Lithuanian Courts. On 29 June 2005, a Lithuanian court ruled on the problem of *force majeure*:

*“[h]aving evaluated the arguments presented by the parties, the court decides that the grounds do exist to recognize that non-performance of the Defendant’s contractual obligations as a consequence of lost income from unblocking road wheels was conditioned by Force majeure events, i.e. Government Resolution no 1056, therefore there are ground to release Defendants [BP] from fulfilment of obligations related to such part of income”.*⁵⁶

312. The Lithuanian Court of Appeals confirmed this decision and held that:

“[...] upon adoption of Government Resolution No 1056, Defendants [BP] could not perform the obligation under Clause 5.1.1 of the Agreement. [...] Thus Defendants did not fulfil part of the monetary obligation under the Agreement for objective reasons and the court of first instance had sufficient grounds to release them from the part of the obligation the performance of

⁵⁵ MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, Award, May 25, 2004, available at <http://www.asil.org/ilib/MTDvChile.pdf>, ¶ 167.

⁵⁶ See Exhibit C 234.

*which was directly related with the collection of the unclamping fee and its transfer to Plaintiff.*⁵⁷

313. Two layers of Lithuanian Courts confirmed that the City of Vilnius acted wrongfully when it refused to recognise the existence of a force majeure situation. On that point, the Courts ruled in favour of BP. The fact that the Lithuanian Courts denied some of BP's claims is not relevant in the present proceedings; indeed subject to denial of justice, which is not at issue here, an erroneous judgment (if there should be one) shall not in itself run against international law, including the Treaty. On that matter, the Respondent did not act arbitrarily in contradiction with the provisions of the Treaty.

c) The termination of the Agreement

314. The Claimant alleges that the City of Vilnius (see ¶ 295) did not act in good faith during the contractual relationship, refused to renegotiate the Agreement in good faith, and finally, decided unilaterally to terminate the Agreement.
315. Fair and equitable treatment is denied when the investor is treated in such an unjust or arbitrary manner that the treatment is unacceptable from an international law point of view.⁵⁸ Indeed, many tribunals have stated that not every breach of an agreement or of domestic law amounts to a violation of a treaty. For instance, in the Saluka v. Poland case, the Tribunal stated:

*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. [...] 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. (¶¶ 442-443).*⁵⁹

316. Under certain limited circumstances, a substantial breach of a contract could constitute a violation of a treaty. So far, case law has offered very few illustrations of such a situation. In most cases, a preliminary determination by a competent court as to whether the contract was breached under municipal law is necessary⁶⁰. This preliminary determination is even more necessary if the parties to the contract have agreed on a specific forum for all disputes arising out of the contract. For the avoidance of doubt, the requirement is not dependent upon the parties to the contract being the same as the parties to the arbitration.

⁵⁷ See Exhibit C 235.

⁵⁸ See S.D. Myers, Inc. v. Government of Canada, NAFTA UNCITRAL Arbitration, First Partial Award, November 13, 2000, available online at <http://www.dfait-maeci.gc.ca/>, p. 65.

⁵⁹ See UNCITRAL Arbitration, Partial Award, March 17, 2006; See also Azurix Corp. v. Argentine Republic, ICSID Case No. ARB/01/12, Award, July 14, 2006, available online at http://www.worldbank.org/icsid/cases/pdf/ARB0112_Azurix-Award-en.pdf

⁶⁰ See for instance, Generation Ukraine Inc. v. Ukraine, ICSID Case No ARB/00/9, Award, September 16, 2003, *supra* note 16, p. 91 and Waste Management, Inc. v. United Mexican States, ICSID Case No. ARB(AF)/00/3, Award, April 30, 2004, reprinted in 43 ILM 967 (2004), ¶¶ 114-115.

317. However, if the contracting-party is denied access to domestic courts, and thus denied opportunity to obtain redress of the injury and to complain about those contractual breaches, then an arbitral tribunal is in position, on the basis of the BIT, to decide whether this lack of remedies had consequences on the investment and thus whether a violation of international law occurred. In other words, as a general rule, a tribunal whose jurisdiction is based solely on a BIT will decide over the “treatment” that the alleged breach of contract has received in the domestic context, rather than over the existence of a breach as such.
318. In the case at hand, there is no doubt that BP had access to the Lithuanian Courts. In fact, neither BP nor the Claimant has challenged the alleged violation of the Agreement, with the exception of *force majeure* case, before the Lithuanian Courts as provided by the Agreement⁶¹(see above ¶ 310). The experts confirmed that the Lithuanian Courts are independent⁶² and that levels of corruption had declined substantially.⁶³.
319. Mr. Bjorn Havnes declared that “[t]o be honest with you, I don’t think it would stand a chance in the Lithuanian courts.”⁶⁴ However, again, this testimony seems to show the emotion of the witness rather than reflect the actual reliability of the Lithuanian judiciary. The failure to complain of the violation of the Agreement before the Lithuanian Court leads to two consequences. First, the Claimant failed to show that the Municipality of Vilnius terminated the Agreement wrongfully and therefore breached the Agreement. Second, even supposing that the Agreement has been wrongfully terminated, the Claimant failed to show that the right of BP to complain of the breach of the Agreement has been denied by the Republic of Lithuania and thus that its own investment was actually not accorded, by the Respondent, an equitable and reasonable treatment in such circumstances.
320. Given the above circumstances, the Arbitral Tribunal cannot reach the conclusion that Article III of the BIT was breached.

8.1.4 Legitimate expectations

8.1.4.1 Position of the parties

The Claimant contends that the Republic of Lithuania has violated its obligation to accord a *fair and equitable treatment* by frustrating its legitimate expectations. The standard of fair and equitable treatment requires the host State to treat international investments in a way that does not affect the basic expectations that were taken into account by the foreign investor in making its investment. Parkerings was therefore entitled to expect that Lithuania maintain a stable and

⁶¹ See CE 13, Article 7.3. of the Agreement.

⁶² See Gintautas Barktkus, Tr. 908.

⁶³ See Expert Report of Carlos Lapuerta, p. 4.

⁶⁴ See Bjorn Havnes, Tr. 1072.

predictable legal and business framework, as well as act transparently in a consistent manner free from any ambiguity.

321. The Claimant principally alleges that:

- a) *“Lithuania frustrated Parkerings’s legitimate expectation that it would respect and protect the legal integrity of the Agreement*

The Municipality of Vilnius did not inform the Claimant of the existence of the “Sorainen memo” that questioned the consistency of a hybrid parking fee with the Lithuanian Laws⁶⁵;

Moreover, modification of law had the effect to invalidate several decisive provisions of the Agreement. The Municipality did not object to the new law “even though it had contractually undertaken to use its best efforts to ensure that the Government’s laws and decrees furthered the successful development of the parking system”;

Claimant emphasizes that it “had a legitimate expectation that Lithuania would not employ its municipal and national instrumentalities to first induce investment by Parkerings on the false promise of a contractual armor for its investment, and then deliberately to perforate that legal armor to expose Parkerings to the arbitrariness of the Municipal authorities⁶⁶;

- b) *“Lithuania frustrated Parkerings’s legitimate expectation that it would respect and protect the economic integrity of the Agreement”*:

Notwithstanding the modification of law, the Municipality continued to require the full performance of the Agreement by BP and notably the payment of the Clause 5.1.15;

The Municipality failed to deliver to BP the design conditions of MSCP and changed several times the site of the construction, but pretended that BP had breached the Agreement;

The Municipality refused to renegotiate in good faith the Agreement;

The Municipality repudiated unlawfully the Agreement.⁶⁷

322. The Claimant alleges that it was “entitled to expect that Lithuania maintain a stable and predictable legal and business framework,”⁶⁸ and that “Lithuania was required to act in a consistent manner, free from ambiguity and totally transparently in its relation with Parkerings.”⁶⁹ The Claimant asserts that by frustrating its legitimate expectations, the Respondent violated Article III of the BIT.

323. The Respondent alleges that not every regulatory action that creates a business problem amounts to a treaty violation.⁷⁰ For the Respondent, the Claimant should prove that “the Government’s conduct frustrated the investor’s investment-backed

⁶⁵ See Claimant’s Memorial, ¶ 215.

⁶⁶ *Idem*, ¶ 216.

⁶⁷ *Idem*, ¶ 217

⁶⁸ *Idem*, p. 68.

⁶⁹ *Idem*, ¶ 216.

⁷⁰ See Respondent Counter-Memorial, p. 65.

*expectations that the State created or reinforced through its own acts.*⁷¹ The Respondent alleges that neither the City nor the Government of Lithuania induced Parkerings to invest by making representations as to the stability of the legal regime applicable to the Agreement.⁷² On the contrary, Parkerings was aware that the arrangements set out in the Agreement were untested and could be subject to legal challenge.⁷³ Parkerings should have known the potential modification of law and the legal challenges of certain provisions of the Agreement.⁷⁴

324. The Respondent noted that the Agreement does not contain a provision stabilizing the legal regime applicable to the Agreement, but contains a provision exempting the City from responsibility for actions taken by the Lithuanian Government.⁷⁵

325. Finally, the Respondent argues that the claims consist only of possible breaches of the Agreement and therefore that the Claimant should have acted before the Lithuanian Courts.⁷⁶

8.1.4.2 Discussion

326. The Tribunal notes that in this case a difference has to be made between: **a)** the obligations of the Republic of Lithuania not to modify the law, and **b)** the obligations of the Municipality of Vilnius to inform and protect the Claimant against the potential economic impact of such modification on the Agreement.

a) Did Lithuania frustrate Parkerings' legitimate expectation that it would respect and protect the legal integrity of the Agreement?

327. In 2000, subsequent to the signing of the Agreement of 29 December 1999, the Lithuanian Parliament amended several laws which affected the Agreement. The Law on Local Fees and Charges was modified on 13 June 2000,⁷⁷ the Decree on Clamping was amended on 5 September 2000⁷⁸ and finally, the Law on Self-Government was modified on 12 October 2000.⁷⁹

328. The Agreement provided that the Consortium was granted the right to collect the parking fees and the clamping fees. The parties agree that the modification of the Law on Local Fees and Charges and the amendment of the Decree on Clamping prevented the Consortium from receiving an important part of its income.

⁷¹ *Ibidem.*

⁷² See Respondent Post-Hearing Brief, p. 18.

⁷³ See Respondent Counter-Memorial, p. 68.

⁷⁴ *Ibidem.*

⁷⁵ *Idem*, ¶¶ 189-200.

⁷⁶ *Idem*, ¶¶ 201-206.

⁷⁷ See Exhibit CE 136.

⁷⁸ See Exhibit CE 41.

⁷⁹ See Exhibit CE 47.

329. The questions to be resolved are whether Parkerings had any legitimate expectation in the stability of the *legal system* and whether its expectation has been frustrated.
330. In order to determine whether an investor was deprived of its legitimate expectations, an arbitral tribunal should examine “[...] *the basic expectation that were taken into account by the foreign investor to make investment* [...]”⁸⁰. In other words, the *Fair and Equitable Treatment* standard is violated when the investor is deprived of its legitimate expectation that the conditions existing at the time of the Agreement would remain unchanged.
331. The expectation is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment. Finally, in the situation where the host-State made no assurance or representation, the circumstances surrounding the conclusion of the agreement are decisive to determine if the expectation of the investor was legitimate.⁸¹ In order to determine the legitimate expectation of an investor, it is also necessary to analyse the conduct of the State at the time of the investment.
332. It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a *stabilisation* clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.
333. In principle, an investor has a right to a certain stability and predictability of the legal environment of the investment. The investor will have a right of protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in light of the circumstances. Consequently, an investor must anticipate that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of legal environment.
334. In the present case, various modifications of laws occurred in Lithuania. It is not contested that these amendments had an impact on the investment expectations of the Claimant, as it was deprived of its right to receive part of its expected income.⁸²

⁸⁰ See *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, *reprinted in 19 ICSID Rev.—FILJ* 158 (2004), ¶ 154.

⁸¹ See *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, April 30, 2004, *supra* note 60. See also, *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, *supra* note 80, ¶¶ 152 *et seq.*; *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, May 12, 2005, *supra* note 39.

⁸² See *The Republic of Lithuania Counter-Memorial*, ¶ 81: « *the Lithuanian Government had taken actions that, with respect to the On-Street parking Concession, prevented (or would eventually prevent) the concessionaire, VPK, from collecting the fee as provided under the Agreement and from penalizing drivers who failed to pay the fees provided under the Agreement* ».

Neither is it contested that the Republic of Lithuania gave no specific assurance or guarantee to Parkerings that no modification of law, with possible incidence on the investment, would occur. The legitimate expectations of the Claimant that the legal regime would remain unchanged are not based on or reinforced by a particular behaviour of the Respondent. In other words, the Republic of Lithuania did not give any explicit or implicit promise that the legal framework of the Agreement would remain unchanged.

335. In 1998, at the time of the Agreement, the political environment in Lithuania was characteristic of a country in transition from its past being part of the Soviet Union to candidate for the European Union membership. Thus, legislative changes, far from being unpredictable, were in fact to be regarded as likely. As any businessman would, the Claimant was aware of the risk that changes of laws would probably occur after the conclusion of the Agreement. The circumstances surrounding the decision to invest in Lithuania were certainly not an indication of stability of the legal environment. Therefore, in such a situation, no expectation that the laws would remain unchanged was legitimate.
336. By deciding to invest notwithstanding this possible instability, the Claimant took the *business risk* to be faced with changes of laws possibly or even likely to be detrimental to its investment. The Claimant could (and with hindsight should) have sought to protect its legitimate expectations by introducing into the investment agreement a stabilisation clause or some other provision protecting it against unexpected and unwelcome changes.
337. The record does not show that the State acted unfairly, unreasonably or inequitably in the exercise of its legislative power. The Claimant has failed to demonstrate that the modifications of laws were made specifically to prejudice its investment.
338. Consequently, in the case at hand, the Tribunal is not persuaded that the Claimant had any legitimate expectation that the Government of the Republic of Lithuania would not pass legislation and regulatory measures which could harm its investment. In that respect, the Tribunal considers that the Respondent did not violate Article III of the BIT.
- b) Did Lithuania, by the action and omission of the Municipality, frustrate Parkerings' legitimate expectation that it would respect and protect the economic and legal integrity of the Agreement?**
339. The Claimant contends that the City of Vilnius was aware of the existence of the proposals to amend the Law on Fees and Charges, the Decree on Clamping and the Law of Self-Government, but never informed the Claimant during the negotiation and prior to the signing of the Agreement
340. Concerning the amendment of the Decree on Clamping and the modification of the Law on Self-Government, the record confirms that Mayor Zuokas was a member of the

Board of the Association of Local Authorities in Lithuania.⁸³ On 22 October 1999, the Board of the Association of Local Authorities in Lithuania had to “*submit comments and proposals to the Seimas, Government and any other state authorities on the improvement of the legal base of local self-government and other laws related to the operation of the local authorities.*”⁸⁴

341. Consequently, the City of Vilnius was in possession of information, prior to the conclusion of the Agreement, concerning possible modifications of the Law on Self-Government and omitted to advise the Claimant. It is evident that the Respondent, as mentioned above (see ¶ 335), had the contractual obligation to act and negotiate in good faith prior to the conclusion of the Agreement. By failing to do so, it may have breached the Agreement but that is not a matter for this Tribunal.
342. However, first, the record does not show that the Respondent deliberately neglected to advise the Claimant of the possible amendment of the law. Second, as described above (see ¶ 335), the political environment was changing at the time of the negotiation of the Agreement and the Claimant should have known that the legal framework was unpredictable and could evolve. Third, the fact that the City of Vilnius knew the intention of the legislator to modify certain laws, does not mean that the City of Vilnius knew the substance of the modification. Indeed, the record does not show that the City of Vilnius was in possession of any specific information which indicated that the Agreement would be affected by a modification of the law. Fourth, the Claimant failed to demonstrate that any investor or at least a qualified law firm was unable to get the information about the amendment process. Therefore, the Tribunal sees no reason why, in the circumstances, the alleged contractual obligation of the Municipality to inform BP of the future modification of the law is constitutive of a *legitimate expectation* for the Claimant.
343. The Claimant alleges a violation by the Municipality of Vilnius of its obligation to use its best efforts to ensure that the Government’s laws and decrees furthered the successful development of the parking system. The Claimant alleges that following the different modifications of laws, it was deprived of various sources of income in violation of the Agreement. Moreover, the Claimant accuses the Representative of the Municipality and notably the Mayor of failing to act in good faith to protect and respect the Agreement and especially the economic interest of the Claimant in the performance of the Agreement.
344. It is evident that not every hope amounts to an expectation under international law. The expectation a party to an agreement may have of the regular fulfilment of the obligation by the other party is not necessarily an expectation protected by international law. In other words, contracts involve intrinsic expectations from each party that do not amount to expectations as understood in international law. Indeed, the party whose *contractual expectations* are frustrated should, under specific conditions, seek redress before a national tribunal. As stated by the Tribunal in Saluka, “[t]he Treaty cannot be

⁸³ See Exhibit CE 256, p. 3084.

⁸⁴ *Idem*, p. 3077.

*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.*⁸⁵

345. In the case at hand, the Claimant alleges that the Municipality of Vilnius frustrated its legitimate expectation in violation of Article III of the Treaty (see ¶¶ 321 *et seq.*). However, the Tribunal considers that the Claimant's expectations are, in substance, of a contractual nature. The acts and omissions of the Municipality of Vilnius, in particular any failure to advise or warn the claimant of likely or possible changes to Lithuanian law, may be breaches of the Agreement but that does not mean they are inconsistent with the Treaty.
346. In conclusion, the Arbitral Tribunal finds that the Claimant has not been deprived of any legitimate expectation in violation of Article III of the Treaty.

8.2 CLAIMS FOR VIOLATION OF THE OBLIGATION OF PROTECTION (ARTICLE III OF THE TREATY)

347. Pursuant to Article III of the BIT the contracting States also agreed to accord *protection* to the investor.

8.2.1 Position of the parties

348. The Claimant alleges that the Respondent failed to protect its investment.⁸⁶
- (a) When parking meters owned by VPK were destroyed, the Police did not identify any suspects, did not find any evidence.
 - (b) Claimant sought the protection of the Prime Minister against the action and omission of the Municipality but no such protection was given. Claimant alleged that *“the Government Representative failed to disclose that the Municipality was treating BP unfairly and engaging in discrimination by refusing to enter into a Cooperation Agreement”*.
 - (c) Claimant reproaches the Government Representative for its passiveness when the Municipality refused to sign a Cooperation Agreement with BP and then repudiated the Agreement.
349. The Claimant argues that the Republic of Lithuania, in order to comply with its obligation, *“must show that it took all measure of precaution to protect Parkerings’ investment and met the standard of due diligence. [...] Lithuania’s duty of protection extends to guarding against the action of both non-state actors and organs of government. [...] a state has a duty to protect aliens and their investment against unlawful acts committed by some of its citizens. If such acts are committed with the active assistance of state-organs a breach of International Law occurs. [...] If the wrong has been committed by a private individual or a state organ, Lithuania is under an obligation to punish the wrongdoer.”*⁸⁷

⁸⁵ See *Saluka Investment BV (The Netherlands) v. The Czech Republic*, UNICITRAL Case, ¶ 442.

⁸⁶ See Claimant's Memorial, p. 72 *et seq.* and Claimant's Post-Hearing Brief, p. 117.

⁸⁷ See Claimant's Memorial, ¶ 222.

350. The Claimant alleges that, by its failure to protect the investment, the Respondent has breached its obligation under Article III of the Treaty.
351. The Respondent contends that it granted the Claimant the *full protection and security* as provided by the Treaty. Under International Law, the guarantee of protection is characterized by the standard of due diligence. This standard requires “*the state to take reasonable steps to prevent hostile acts toward investors that it knew or should have known were about to take place.*”⁸⁸
352. In the Respondent’s view, “*the guarantee of protection and security is not absolute and does not impose strict liability on the State that grants it.*”⁸⁹ “*The simple fact that Claimant is not pleased with the result of a state action does not constitute a basis for a claim under the protection clause, provided the state exercised due diligence.*”⁹⁰
353. The Respondent alleges that Lithuania reacted reasonably within the parameter of due diligence of a democratic state to the various complaints lodged by Claimant and BP.⁹¹ For the Respondent, the non-intervention of the Government’s Representative concerning the termination of the Agreement and the refusal of the City of Vilnius to sign a Cooperation Agreement do not amount to a violation of the Treaty. Indeed, the termination was not wrongful and, therefore, did not merit any legal challenge; Lithuania had no obligation to challenge an alleged breach of the Agreement if the contracting party had the right and the opportunity to challenge the breach itself.⁹²

8.2.2 Discussion

354. Article III of the Treaty only mentions the term *protection*. In a number of decisions, Tribunals make reference to the standard of “*full protection and security.*” It is generally accepted that the variation of language between the formulation “*protection*” and “*full protection and security*” does not make a significant difference in the level of protection a host State is to provide.⁹³ Moreover, *in casu*, the Parties make systematically reference to the standard of “*full protection and security.*” Therefore, the Arbitral Tribunal intends to apply the standard of “*full protection and security.*”
355. A violation of the standard of *full protection and security* could arise in case of failure of the State to prevent the damage, to restore the previous situation or to punish the author of the injury.⁹⁴ The injury could be committed either by the host State, or by its agencies or by an individual.

⁸⁸ See Respondent Counter-Memorial, p. 86.

⁸⁹ *Idem*, ¶ 228.

⁹⁰ See Respondent Counter-Memorial, ¶ 230.

⁹¹ *Idem*, ¶ 232.

⁹² *Idem*, ¶ 235.

⁹³ See for instance Rubins N., Kinsella S., *International Investment, Political Risk and Dispute Resolution*, New-York, 2005.

⁹⁴ See *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, December 8, 2000, reprinted in 41 *ILM* 896 (2002), ¶¶ 84-95.

356. The Claimant alleges damages to its materials due to vandalism. However, the Claimant does not show that such vandalism would have been prevented if the authorities had acted differently. The Claimant only contends that the police did not find the authors of this offence. Both parties agree that Lithuanian authorities started an investigation to find the authors of the vandalism.
357. The Arbitral Tribunal finds that the record does not show in which way the process of investigation amounted to a violation of the Treaty. In *Tecmed*, the Tribunal underlined that “*the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it.*”⁹⁵
358. The Claimant criticized the alleged failure of the Prime Minister to protect its investment against the action and omission of the municipality. However, the record does not show that the Prime Minister did not act in any manner that should be incompatible with his function and duties. The Claimant failed also to demonstrate a negligence of the Prime Minister that could amount to a breach of the BIT.
359. The Claimant also criticized the Respondent for its passivity when the City of Vilnius breached the Agreement. However, the Arbitral Tribunal considers that the investment Treaty created no duty of due diligence on the part of the Respondent to intervene in the dispute between the Claimant and the City of Vilnius over the nature of their legal relationships.
360. The Respondent’s duty under the Treaty was, first, to keep its judicial system available for the Claimant to bring its contractual claims and, second, that the claims would be properly examined in accordance with domestic and international law by an impartial and fair court. There is no evidence - not even an allegation – that the Respondent has violated this obligation.
361. The Claimant had the opportunity to raise the violation of the Agreement and to ask for reparation before the Lithuanian Courts. The Claimant failed to show that it was prevented to do so. As a result, the Arbitral Tribunal considers that the Respondent did not violate its obligation of protection and security under the Article III of the BIT.

8.3 CLAIMS FOR VIOLATION OF THE OBLIGATION TO ACCORD TREATMENT NO LESS FAVORABLE THAN THE TREATMENT ACCORDED TO INVESTMENTS BY INVESTORS OF A THIRD STATE (ARTICLE IV OF THE TREATY)

362. Article IV of the Treaty provides that

1. *[I]nvestments made by investors of one contracting party in the territory of the other contracting party, as also the returns therefrom, shall be accorded treatment no less favourable than that accorded to investments made by investors of any third state.*

⁹⁵ See *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, *supra* note 80, ¶¶ 177.

8.3.1 Position of the parties

363. In substance, the Claimant alleges that the Respondent violated Article IV of the Treaty as follows:⁹⁶

- (a) the City of Vilnius rejected the project of MSCP proposed by BP on the Gedimino site for cultural heritage concerns, because the project was situated in the Old Town of the City of Vilnius. However, the Municipality authorized another company (Pinus Proprius) to build a MSCP on the same site;
- (b) the City of Vilnius refused to sign a Joint Activity Agreement (JAA) with BP for the Gedimino MSCP and for the Pergales MSCP for legal reason, but signed a JAA with the Company Pinus Proprius;
- (c) Once the JAA signed with the Company Pinus Proprius has been declared unlawful, the City of Vilnius transformed it into a Cooperation Agreement. However, the City of Vilnius refused to conclude a similar Cooperation Agreement with BP as a substitute of the JAA.

364. In the Claimant's view, the Companies Pinus Proprius and BP were facing similar circumstances. The refusal of the City of Vilnius to sign a JAA or a Cooperation Agreement prevented BP from the construction of any MSCP in Vilnius and thus deprived it of the opportunity to carry out its investment as it was entitled to do under the Agreement.

365. The Respondent alleges that the situation of the MSCP built by Pinus Proprius on the Gedimino site was clearly different from the project proposed by the Claimant on the Gedimino site and the Pergales site.⁹⁷

- (a) The MSCP built by Pinus Proprius on the Gedimino site was smaller than the MSCP project proposed by the Claimant. The proposed MSCP designed by the Claimant extended to the Odiminiu Square, which is part of the Old Town area as defined by the Annex No. 5 of the Agreement, but the one constructed by Pinus Proprius was not. The Respondent underlines that a construction in the Old Town needed the approval of the Government's Cultural heritage Commission.
- (b) The Joint Activity Agreement could not be signed with BP since the modification of the Article 9(2) of the Law on Self-Government which prohibited the conclusion of such agreement with private entities. The Respondent alleges that the Cooperation Agreement signed with Pinus Proprius was not a JAA. However, the conclusion of a similar Cooperation Agreement with BP was not possible for various reasons:
 - A transfer of land was necessary for the MSCP proposed by BP and not for the MSCP built by Pinus Proprius, as the latter was already the owner of part of the land where the MSCP was built. Consequently, a Public Auction was necessary for the transfer of state-owned land to BP⁹⁸;
 - Pinus Proprius had the contractual obligation to transfer its own land to the State when the building would be achieved. Pinus Proprius also agreed to sell the MSCP to the City. On the contrary, BP could remain the owner of the MSCP built on the Gedimino site and on Pergales site and would have the possibility to lease the state-owned land or to buy it⁹⁹.

⁹⁶ See Claimant's memorial, p. 74 and Claimant's Post-Hearing Brief, p. 99.

⁹⁷ See Respondent Counter-Memorial, p. 90 and Respondent Post-Hearing Brief, p. 5

⁹⁸ See Respondent Counter-Memorial, ¶ 248.

⁹⁹ See Respondent Post-Hearing Brief, p. 6.

- The MSCP built by Pinus Proprius was under state-owned land that was not delineated by a land plot and, therefore, could never be owned or leased by Pinus Proprius. On the contrary, the project of MSCP on Pergales site proposed by BP was situated on a state-owned land delineated as a land plot and therefore required a Public Auction.¹⁰⁰

366. Article IV of the Treaty is known as the standard of the “*Most-favoured-nation Treatment*”. *Most-favoured-nation (MFN)* clauses are by essence very similar to “*National Treatment*” clauses. They have similar conditions of application and basically afford indirect advantages to their beneficiaries, namely a treatment no less favourable than the one granted to third parties. Tribunals’ analyses of the *National Treatment* standard will therefore also be useful to discuss the alleged violation of the *MFN* standard.

367. *National treatment* and *Most-Favoured-Nation treatment* are treaty clauses that have the same substantive effect as the international treatment standard: foreigners should be afforded treatment no less favourable than the one granted to local citizens. The international law requirement in fact acts as a minimum requirement as it would be useless for the States party to a treaty to grant benefits less sweeping than customary law. In other words, all the requirements, be they national treatment, most favoured-nation-treatment or non-discrimination at large, will in effect bar discrimination against foreign national investing in the country concerned. All investors benefiting from a treaty will benefit of a treatment identical or better than nationals or third countries persons. There is, thus, no reason discretely to address the issue of non-discrimination: the two aspects, under most-favoured-nation requirements (Article IV of the Treaty) on the one hand and under international customary law on the other.

368. Discrimination is to be ascertained by looking at the circumstances of the individual cases. Discrimination involves either issues of law, such as legislation affording different treatments in function of citizenship, or issues of fact where a State unduly treats differently investors who are in similar circumstances. Whether discrimination is objectionable does not in the opinion of this Tribunal depend on subjective requirements such as the bad faith or the malicious intent of the State: at least, Article IV of the Treaty does not include such requirements. However, to violate international law, discrimination must be unreasonable or lacking proportionality, for instance, it must be inapposite or excessive to achieve an otherwise legitimate objective of the State. An objective justification may justify differentiated treatments of similar cases. It would be necessary, in each case, to evaluate the exact circumstances and the context.

369. The essential condition of the violation of a *MFN* clause is the existence of a different treatment accorded to another foreign investor in a similar situation.¹⁰¹ Therefore, a

¹⁰⁰ *Idem*, pp. 5-6.

¹⁰¹ See Goetz and others v. Burundi, ICSID Case No. ARB/95/3, Award, February 10, 1999, *supra* note 40, ¶ 121.

comparison is necessary with an investor in *like circumstances*. The notion of *like circumstances* has been broadly analyzed by Tribunals¹⁰².

370. For example, in *Pope and Talbot Inc. v. Government of Canada*, the Tribunal held that:

*[i]n evaluating the implication of the legal context, the Tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected [...] should be compared with that accorded domestic investment in the same business or economic sector.*¹⁰³ [...]

*Once it is established that a foreign and domestic investor are in the same business or economic sector, "[d]ifference in treatment will presumptively violate [the principle] unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or de facto, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing of NAFTA. [...] A formulation focusing on the like circumstances [...] will require addressing any difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign-owned investment.*¹⁰⁴

371. In order to determine whether Parkerings was in *like circumstances* with Pinus Proprius, and thus whether the MFN standard has been violated, the Arbitral Tribunal considers that three conditions should be met:

- (i) Pinus Proprius must be a foreign investor;
- (ii) Pinus Proprius and Parkerings must be in the same economic or business sector;
- (iii) The two investors must be treated differently. The difference of treatment must be due to a measure taken by the State. No policy or purpose behind the said measure must apply to the investment that justifies the different treatments accorded. *A contrario*, a less favourable treatment is acceptable if a State's legitimate objective justifies such different treatment in relation to the specificity of the investment.

372. With regard to the first condition **(i)**: The parties are not disputing the fact that the company Pinus Proprius is an investor in Lithuania. As Pinus Proprius is owned by the Dutch company Litprop Holding BV, it is a foreign investor within the meaning of the BIT.¹⁰⁵

373. With regard to the second condition **(ii)**: BP and Pinus Proprius are engaged in similar activities. Both Pinus Proprius and BP are companies acting in the construction and management of parking garages. Both are competitors for the same MSCP project in

¹⁰² See for instance: Occidental Exploration and Production Company v. Republic of Ecuador, UNICITRAL Case No. UN 3467, Final Award, July 1, 2004, ¶¶ 173-176; Marvin Roy Feldman Karpa v. United Mexican States, ICSID Case No. AB(AF)/99/1, Award, December 16, 2002, *reprinted in* 18 *ICSID Rev.—FILJ* 488 (2003), ¶¶ 170 *et seq*; S.D. Myers, Inc v. The Government of Canada, NAFTA UNICITRAL Arbitration, First Partial Award, November 13, 2000, ¶¶ 248-250.

¹⁰³ See *Pope & Talbot Inc. v. The Government of Canada*, NAFTA Case, Award on the merits of phase 2, April 10, 2001, ¶ 78.

¹⁰⁴ *Idem*, ¶¶ 78-79.

¹⁰⁵ See Exhibit CE 249.

Gedimino. Thus, the Arbitral Tribunal finds that Pinus Proprius and BP are in a similar economic and business sector.

374. With regard to the last condition (iii): The Claimant alleges that Pinus Proprius has been treated differently than BP, because, first, Pinus Proprius has been authorised to construct its MSCP in Gedimino, but BP's project also situated in Gedimino has been refused. Second, the Municipality of Vilnius refused to conclude a JAA or a Cooperation agreement with BP but accepted such a conclusion with Pinus Proprius.
375. However, the situation of the two investors will not be in *like circumstances* if a justification of the different treatment is established.
376. The Arbitral Tribunal will discuss separately the two alleged discriminatory measures, namely whether the Municipality wrongfully granted Pinus and denied BP an authorisation to build a MSCP under Gedimino Avenue (see below *the situation of the Gedimino MSCP*, section 8.3.2.1); and whether the Municipality wrongfully refused to enter into a Cooperation Agreement with BP, whilst it had concluded such a Cooperation Agreement with Pinus (see below *The Situation of the Pergales MSCP*, section 8.3.2.2).

8.3.1.1 The situation of the Gedimino MSCP

377. In order to determine if the two investors were *in like circumstances*, or if the measure taken by the Municipality was justified, the Arbitral Tribunal analyses below the situation of the two investors.
378. In substance, the Respondent argues that BP's MSCP project in Gedimino was *fundamentally different* from the MSCP built by Pinus Proprius. First, the MSCP project proposed by the Claimant was clearly bigger than the MSCP built by Pinus Proprius. Second, the proposed MSCP designed by the Claimant extended to the Odiminiu Square, which is part of the Old Town area as defined by Annex No. 5 of the Agreement, but the one constructed by Pinus Proprius did not. Finally, BP's project reached the Vilnius' historic Cathedral Square. The Respondent underlines that a construction in the Old Town needed the approval of the Government's Cultural Heritage Commission.
379. The record confirms that Claimant's proposed project on the Gedimino site and the MSCP built by Pinus Proprius were almost identically located in the sense that they are both situated in the Old Town. Indeed, the maps produced by the Respondent¹⁰⁶ show that the Pinus Proprius MSCP is partly superimposed with the MSCP project of BP.
380. However, the Claimant's project is considerably bigger than the MSCP constructed by Pinus Proprius¹⁰⁷. All the maps clearly show that BP's MSCP extended under Gedimino Street as far as the Cathedral Square.¹⁰⁸ The Claimant's project involved the

¹⁰⁶ See Exhibits RE 97, RE 102-103.

¹⁰⁷ See Respondent Counter-Memorial, p. 93; Exhibits RE 97 and RE 102-103.

¹⁰⁸ See Exhibits RE 97, RE 102-103.

construction of a garage comprising over 500 parking slots by comparison; the MSCP constructed by Pinus Proprius consists of only 233 parking slots.¹⁰⁹

381. However, notwithstanding the difference of size, both Pinus Proprius MSCP and BP's MSCP project in Gedimino show obvious similarities. They are located in the Old Town district of the City of Vilnius as defined by the Administrative borders.¹¹⁰ The Old Town as defined by the Administrative borders is protected territory as defined by the applicable laws and regulations.¹¹¹ The Old Town of Vilnius as defined by its administrative borders is considered to be practically the same as the area defined by UNESCO.¹¹²
382. The territory of the Old Town as defined by UNESCO is a protected area which requires the approval of various administrative Commissions in order, notably, to make any construction.¹¹³ Mr Robertas Staskevicius agreed that "[t]he Department of Cultural Heritage Protection, their concern was over the administrative region in Vilnius designated by UNESCO as being the protected administrative region."¹¹⁴ And that "they [the Department of Cultural Heritage Protection] would be concerned about an activity that took place within that zone [the administrative region in Vilnius designated by UNESCO]."¹¹⁵
383. The Tribunal understands that inside the Old Town as defined by UNESCO is located the Old Town as defined by Annex 5 of the Agreement.¹¹⁶ Annex 5 of the Agreement supplies the contractual definition of the Old Town. Mr. Robertas Staskevicius confirmed that "the reason why that zone was identified in the contract with the consortium was to make sure that the consortium focused on solving the traffic and parking problems in that specific zone."¹¹⁷ Mr. Robertas Staskevicius confirmed also that "as far as this department [the Department of Cultural Heritage Protection] within the Ministry of Culture of the Lithuanian Government was concerned, it didn't matter how the parties had defined a part of the Old Town in annex 5 of the Contract."¹¹⁸ It is not immediately apparent why Annex 5, clearly a contractual document binding the Municipality of Vilnius and BP, should be relevant, as argued by the Respondent, in assessing whether Pinus Proprius was *in like circumstances* with Parkerings.
384. Nevertheless, *ex abundanti cautela*, it appears that after analysis of the maps furnished by the Respondent,¹¹⁹ neither the MSCP built by Pinus Proprius nor the MSCP

¹⁰⁹ See CE 39, CE 40 and CE 95.

¹¹⁰ See Exhibits RE 97, RE 102, RE 103; See also Exhibit CE 294.

¹¹¹ See Exhibit CE 75 and CE 294 ; See Robert Staskevicius, TR 1350:19.

¹¹² See Robert Staskevicius, TR 1348:13.

¹¹³ See for instance CE 81, CE 60, CE 69, CE 84.

¹¹⁴ See Robert Staskevicius, TR 1348:13

¹¹⁵ See Robert Staskevicius, TR 1348:20.

¹¹⁶ See Exhibits CE 13, RE 97, RE 102, RE 103.

¹¹⁷ See Robert Staskevicius, TR 1352:12.

¹¹⁸ *Idem*, TR 1350:9.

¹¹⁹ See Exhibits RE 97, RE 102-103

proposed by BP are situated in the Old Town District, as defined by Annex 5 of the Agreement.¹²⁰ The most recent maps furnished by the Respondent established that BP's project did not extend into the Annex 5 area¹²¹. Consequently, this argument is not useful for the Tribunal's determination.

385. Another feature does however call the Tribunal attention: the MSCP planned by BP extends significantly in the Old Town as defined by UNESCO and especially near the historical site of the Cathedral. The record shows that various administrative Departments and Commissions in Lithuania were opposed to the MSCP as planned by BP. On 20 October 2000, the State Monument Protection Commission of the Republic of Lithuania objected to the parking plan for the following reason:

*Projects of such type and scale like the project of the construction of planned underground garages in the Old Town of Vilnius should be developed concurrently taking into consideration the possible direct and indirect environmental impact of planned works and also the impact on cultural properties. In the opinion of the State Monumental Protection Commission, the planned garages [...] would change the character of the Old Town of global value; destroy large areas of unexplored cultural layer. Also, the intensity of traffic and air pollution in the Old Town is likely to increase. The Old Town might become less attractive in terms of tourism and to the residents and visitor, and this would be a great loss. [The State Monumental Protection Commission] resolves: to object the project of construction of the underground garages in the Old Town of Vilnius [...]*¹²².

386. On 4 December 2000, the Urban Development Department of the Vilnius Municipality stated its objection to BP's MSCP project under Gedimino:

*The city's humanitarian community would psychologically not accept this proposal. The final conclusions concerning the feasibility of construction of this garage would have to be supplied by detailed exploratory archaeological works, because this square [Odminiu] is a supposed site of the defensive installations of Vilnius Castle. In terms of the townscape, the site of the square is very important in the formation of the area of Cathedral Square. Clearance of the trees and extension and distortion of the Cathedral area is not architecturally acceptable. This site also remains the subject of the debate on the feasibility of construction – for the purpose of better formation of the area of Cathedral Square and creation of a site of particular public significance. Therefore, it would be purposeful to design the garage only together with a structure that would occupy the square, provided that construction of such a structure would be permitted. Currently, such construction is irrelevant*¹²³.

387. On 22 December 2000, the Vilnius Territorial Division underlined:

*the solutions presented in the referred documents directly affect a cultural monument old city of Vilnius [...]*¹²⁴.

388. Finally, on 12 March 2001, the State Monument Protection Commission of the Republic of Lithuania stated, concerning the MSCP project filed by BP:

¹²⁰ See Exhibits RE 103 and RE 104.

¹²¹ See Exhibits RE 97, RE 99, RE 100, RE 102, RE 103;

¹²² Exhibit CE 49

¹²³ Exhibit CE 60.

¹²⁴ Exhibit CE 61.

In case construction of underground garages in the old city of Vilnius embarked now, it can be stated that Lithuania failed to perform obligation undertaken upon signing in November 1999 of the Convention for the Protection of the Architectural heritage of Europe and the European Convention on the Protection of the Archaeological heritage. All legal acts concerning regulation of territorial planning, land relationship, heritage protection, environment protection and construction would be infringed [...].

Upon installation of garages, a big portion of archaeological heritage of the old city of Vilnius will be destroyed; use of multiple up-to-date materials and technologies will damage the authenticity of the old city of Vilnius¹²⁵.

389. In a letter to the City Development Committee dated 25 July 2001, Mr. Jonas Tamulis, member of the board of BP, wrote that

[g]iven the suspension of solution in the Old Town territories (in the boundaries within which it is inscribed in the UNESCO List of World Heritage) for stage two we do not propose any sites in this territory. The second step should involve construction of parking areas in such sites according to the parking plan which should necessarily be independent form solution regarding the Old Town¹²⁶.

390. The Arbitral Tribunal considers, as described above (see ¶ 383), that the difference based on the alleged encroachment in the Old Town as defined by the Annex 5 of the Agreement is not relevant.
391. The difference in size of the two MSCPs also is, in and by itself, not decisive either to establish that the two investors were not *in like circumstances* but it may be one of the factors to take into consideration.
392. On the other hand, the fact that BP's MSCP project in Gedimino extended significantly more into the Old Town as defined by the UNESCO, is decisive. Indeed, the record shows that the opposition raised against the BP projected MSCP were important and contributed to the Municipality decision to refuse such a controversial project. The historical and archaeological preservation and environmental protection could be and in this case were a justification for the refusal of the project. The potential negative impact of the BP project in the Old Town was increased by its considerable size and its proximity with the culturally sensitive area of the Cathedral. Consequently, BP's MSCP in Gedimino was not similar with the MSCP constructed by Pinus Proprius.
393. That being said the Claimant failed to show that Pinus Proprius benefited of a more favourable treatment regarding the administrative requirements, *i.e.* that is was exempt of such requirements or obtained a clearance more easily. It is the Claimant's burden of proof to show that the foreign investor has been treated more favourably.
394. The Tribunal notes that the Pinus Proprius project was also situated in the Old Town as defined by the UNESCO and should have likely met the same administrative requirements as BP's. Indeed, the project had to be approved by, among others, the State Monument Protection Commission of the Republic of Lithuania, the Urban Development Department of the Vilnius Municipality and the Vilnius Territorial Division.

¹²⁵ Exhibit CE 81.

¹²⁶ Exhibit CE 89.

However, there is no evidence that Pinus Proprius has been treated differently from BP in the discharge of the administrative requirements. For instance there is no evidence that Pinus Proprius failed to apply or did not receive the permission, from the State Monument Protection Commission of the Republic of Lithuania or the Urban Development Department of the Vilnius Municipality or the Vilnius Territorial Division, to construct its MSCP in the Old Town.

395. Moreover, the record does not evidence that Pinus Proprius faced the same objections and that its project had the same potential impact on the Old Town. On the contrary, the record shows that the Pinus Project did not extend near the Cathedral area which may have meant it was less controversial.
396. Nonetheless, despite similarities in objective and venue, the Tribunal has concluded, on balance, that the differences of size of Pinus Proprius and BP's projects, as well as the significant extension of the latter into the Old Town near the Cathedral area, are important enough to determine that the two investors were not *in like circumstances*. Furthermore, the Municipality of Vilnius was faced with numerous and solid oppositions from various bodies that relied on archaeological and environmental concerns. In the record, nothing convincing would show that such concerns were not determinant or were built up to reject BP's project. Thus the City of Vilnius did have legitimate grounds to distinguish between the two projects. Indeed, the refusal by the Municipality of Vilnius to authorize BP's project in Gedimino was justified by various concerns, especially in terms of historical and archaeological preservation and environmental protection. These concerns are peculiar to the extension of BP's project in the Old Town and thus could justify different treatment with Pinus Proprius. In the absence of convincing evidence that Pinus Proprius benefited from a more favourable treatment in terms of administrative requirement, the Arbitral Tribunal finds that the Claimant failed to demonstrate a discrimination concerning the Gedimino car park.
397. Finally, the Tribunal notes that, in April 2001, the Municipality of Vilnius ordered the Consortium to abandon the Gedimino project and to study the MSCP on the Pergales site.¹²⁷ BP accepted to start the planning for the site of Pergales and also agreed that the site of Gedimino was uncertain due to its location in the Old Town (see above ¶ 392)¹²⁸. The record is insufficient to show that the Municipality of Vilnius unduly rejected the Gedimino project of MSCP proposed by BP. On the contrary, the Gedimino site was only one possibility among several other locations. The refusal of one site did not deprive BP of the possibility to propose other locations and finally to construct its ten MSCPs as agreed.¹²⁹

8.3.1.2 The situation of the Pergales MSCP

398. As set out above (see ¶¶ 363-364) the Claimant alleges, first, that the Municipality refused to sign a Joint Activity Agreement (JAA) with BP but concluded a JAA with

¹²⁷ See Exhibits R 63 and CE 89.

¹²⁸ See Exhibits CE 89.

¹²⁹ *Ibidem*

Pinus Proprius, and second, that once the JAAs had been declared unlawful under the Law on Self-Government, the Municipality refused to transform the JAA envisioned by BP into a Cooperation Agreement as it did with Pinus Proprius.

399. JAAs are used in Lithuania to embody private-public partnerships for construction, if the project is situated on state-owned land and if the constructor is neither the owner nor the lessee of the land.¹³⁰

400. In his statement, Mr. Sigitas Burnickas explained that:

Under Lithuanian law, much of the land available for infrastructure development within the city of Vilnius was formally owned by the national government, and not the Municipality. This necessitated a two step process for each car park – first, the Municipality had to obtain the land from the State; second, the Municipality had to transfer that land to the consortium member responsible for developing that particular car park.

In accordance with applicable construction regulations the permits for the construction of car parks could be issued only if the developer had possession of the relevant land plot by proprietary right, by lease (or sublease), or by right of use. Under the land lease law of 1998, however, the state-owned land plots could only be leased to the consortium through an auction procedure. [...]

In the consortium's case, the joint activity agreement would work as follows. First, the Municipality would obtain the state-owned land plots by right of trust and apply, on its behalf or on behalf of the consortium member, for the construction permit. Second, the consortium member would finance and carry out the construction works on the state-owned land. Because of the joint activity agreement, there was no requirement for a lease of transfer of any kind during construction. Third, upon completion of construction, each of the parties received a defined share in the joint property. The division of property was agreed to in the model joint activity agreement: the consortium member would own the car park and the Municipality would receive the associated public infrastructure that the consortium member had constructed. Under the provision of the land lease law, the consortium member who owned the car park on the state-owned land could lease that land without having to go through an auction¹³¹.

401. In summary, the Tribunal understands that a JAA or Cooperation Agreement is necessary to start the construction and permits to avoid the public auction as defined by Article 7 section 1 of the Law on leasing of Land.¹³² Indeed, pursuant to Article 7 section 1 of the Law on leasing of Land:

*State-owned land, save for the case stipulated in paragraph 2 of this article, in the procedure set by the Government shall be leased in an auction for the person, whose bid for land lease fee is the highest. [...]*¹³³

402. However, Article 7 section 2 of the same law provides that if the prospective lessee already owns a building on the said land, no public auction is necessary:

In case state-owned land is developed with buildings owned or rented by natural or legal persons, it shall be leased without an auction in the procedure set by the Government.

¹³⁰ See Lithuania TR. 375:24-376:5.

¹³¹ See Burnickas Stmt. ¶ 11.

¹³² See Lithuania, Tr. 375:24-376:5.

¹³³ See Exhibits RE 11.

403. In the case at hand, it is not disputed that Pinus Proprius was the owner of a small part of the land on its MSCP building site.¹³⁴ BP was not the owner of the land on the MSCP building site and, consequently it needed a JAA in order to construct its MSCP. This was also the case for Pinus Proprius, at least for the part of the land it did not own.
404. However, on 12 October 2000, the Amendment of the Law on Self-Government precluded the public authorities from concluding JAA with a private entity. In substance, Article 9 Section 2 of the Law on Self-Government provides that “[f]or general purposes a municipality may conclude joint activity contracts or public procurement contracts with State institutions and (or) other municipalities.”¹³⁵ It is common ground that a municipality is thus authorized to enter into JAAs but exclusively with State constituent divisions to the exclusion of private entities.
405. On 24 October 2001, the Vilnius City Council decided to conclude a JAA with the Company Pinus Proprius.¹³⁶ However, on 18 December 2001, the Representative of the Government for Vilnius Region, Mr Gintautas Jakimavicius, suspended the enforcement of the decision of the Vilnius City Council pursuant to the Law on Local Self-Government,¹³⁷ and on 18 January 2002, requested the Vilnius District Administrative Court to revoke the decision of the Vilnius City Council. In substance, the Representative of the Government for Vilnius Region stated:

*a conclusion should be made that the Law does not provide for the right for municipalities to conclude joint venture agreement with private persons and that Vilnius City Municipality Council having passed the decision No.417 of 24 October 2001 and by Clause 1 thereof approved the draft joint venture agreement with Pinus Proprius UAB exceeded the scope of competence of public authorities*¹³⁸.

406. On 27 March 2002, the Vilnius City Council agreed to modify the controversial JAA into a *Cooperation Agreement*.¹³⁹ Thus, the Representative of the Government for the Vilnius Region, Mr. Gintautas Jakimavicius, wrote to the Vilnius District Administrative Court:

*[t]he Vilnius City Council on March 27, 2002, issued decision No. 530 “on the Approval of the Cooperation Agreement” whereby item 1 approved the Cooperation Agreement between the Municipality of the City of Vilnius and the Joint Stock Company “Pinus Proprius.” By this decision the Vilnius City Council actually changed decision No. 417 of 10/24/01 “On approval of the Partnership Agreement,” i.e. it became out of force. Since the decision became out of force, the legal issue also disappeared. Consequently, the case was dismissed.*¹⁴⁰

¹³⁴ See Letter from Counsel for Respondent dated 9 November 2006; Rukstele 1517:6-23.

¹³⁵ Exhibit CE 47.

¹³⁶ Exhibit CE 95.

¹³⁷ Exhibit CE 99.

¹³⁸ Exhibit CE 104.

¹³⁹ See Exhibit CE 112 and CE 128.

¹⁴⁰ See Exhibit CE 117.

407. Finally, on 20 August 2002, the Vilnius City Municipality concluded a *Cooperation Agreement* with Pinus Proprius.¹⁴¹ The record shows that the *Cooperation Agreement* and the JAA signed between Pinus Proprius and the City of Vilnius are in every respect similar.¹⁴²
408. BP's situation evolved differently. Indeed, in March 2002, the Mayor of the Municipality of Vilnius, Mr. Zuokas, sent to BP a draft Joint Activity Agreement¹⁴³ and, in April 2002, BP sent a revised draft of the JAA.¹⁴⁴ However, the City of Vilnius never concluded the JAA with BP for the Construction of the MSCP on Pergales site.¹⁴⁵ It is not contested that the City of Vilnius also refused to conclude a *Cooperation Agreement* with BP similar to the one concluded with Pinus Proprius.
409. The Claimant alleges that BP and Pinus Proprius were *in like circumstances* and that by refusing to conclude a JAA or a Cooperation Agreement with BP, the Municipality of Vilnius gave a treatment more favourable to Pinus Proprius.
410. However, the Tribunal finds that in order to determine whether the claiming investor and another (most favoured) investor used as benchmark were in like circumstances, at least two elements were significantly different between the BP and Pinus Proprius projects and therefore different treatment could be justified.
411. Before addressing such two differences, the Tribunal wishes to comment on a significant difficulty the Claimant is facing. Entering into agreements is subject to party autonomy and no one may be forced to contract. Under conditions changing from one law to another, parties may conclude framework agreements and define conditions under which they will have to enter into such agreement. Even when the legislation recognizes the enforceability of such obligation to contract, party autonomy will still play its part in the negotiation and conclusion of the agreements. *In casu*, the City of Vilnius is a public entity and thus has to act with the defence of public interests as its main yardstick. Public interest does, of course, depend on the policy of the administration running the public entity at any particular time. Thus, it is a difficult endeavour to show discrimination in a public entity entering into an agreement with a certain person and refusing to conclude a similar agreement with another party. Apart from factors applying to individuals or companies (timing, financing, opportunities,...) a public entity may have legitimate motivation of its own at the time to exercise its discretion to contract or not to contract.
412. The two differences which the Tribunal considers relevant are (i) the substantive differences to the content of the agreements, and (ii) the existence and non-existence of a signed JAA with Pinus Proprius and BP respectively. These two differences are reviewed below.

¹⁴¹ See Exhibit CE 128.

¹⁴² Exhibit CE 95 and CE 128.

¹⁴³ See Exhibit CE 110.

¹⁴⁴ See Exhibit CE 113.

¹⁴⁵ See for instance CE 116, CE 126,

413. **With regard to the first difference between the projects:** The substance of the Cooperation Agreement signed with Pinus Proprius was different from the proposed JAA with BP. Indeed, pursuant to Article 7.2 of the *Cooperation Agreement* between the City of Vilnius and Pinus Proprius, the parties

agree on the following principles of apportionment in kind of their joint property, i.e. the Infrastructure Unit:

(a) title to the Underground Car Park A (including the internal service lines necessary for the operation of the car park) shall be vested in PINUS PROPRIUS;

(b) title to the remaining part of the Infrastructure (i.e. the service lines, transport communication, pavement, minor architectural structures, collectors to house service lines of the city, etc.) save the part indicated in paragraph (a) above, shall be vested in the Municipality.¹⁴⁶

414. This part of the Pinus Proprius Agreement was similar to the one contained in the BP draft JAA.

415. However, pursuant to Article 10.4.3. of the same Cooperation Agreement:

Should the Municipality receive the Lithuanian Government's consent for purchase from the sole source of the Underground Car Park A or fulfil other requirements prescribed by laws as applicable in the event of purchase to this particular transaction, the parties undertake to enter into a leasing contract with respect to the Underground Car park A subject to the requisite conditions set forth below:

(i) transfer by PINUS PROPRIUS of the Underground Car Park A into the Municipality's possession and use on the stipulation that once the price quoted for the Underground Car Park A has been paid the Underground Car Park A will become the ownership of the Municipality;

(ii) the period of payment for the Underground Car Park A being 10 years as the of the date of signing the leasing contract;

(iii) PINUS PROPRIUS giving its consent to transfer by the Municipality against payment of the Underground Car park A to other third parties to be used for business needs;

(iv) no payment for use of the Underground Car Park A being effected to PINUS PROPRIUS¹⁴⁷.

416. In brief, Pinus Proprius had the contractual obligation to sell the MSCP to the Municipality of Vilnius upon completion of the construction.

417. On the other hand, pursuant to the form of JAA annexed to the Concession Agreement between the Municipality of Vilnius and BP:

3.2.1. the multi-storey car park would belong by the right of ownership to the consortium or the consortium Member only;

3.2.2. the remaining part the Object if Infrastructure (engineering services, transport, communications, etc.), except those specified in sub-item 3.2.1. of part 3 of this Article, would belong by the right of ownership to the Municipality¹⁴⁸.

¹⁴⁶ See Exhibit CE 128; see also Rukstele Tr. 1523:2-3.

¹⁴⁷ Exhibit CE 128.

¹⁴⁸ See Exhibit CE 13 and also project of Joint Activity Agreement, Articles 3.3.2.1. and 3.3.2.2., CE 113.

418. Neither the draft JAA annexed to the Concession Agreement, nor the draft JAA proposed by the Mayor Zuokas on 9 April 2002 contained a provision that obliged BP to sell the MSCP to the Municipality. Mr. Rukstele explained that:

after BP-Egapris constructed car park, according to the condition of the joint activity agreements with them, particularly which is different from agreement of cooperation with Pinus Proprius. They [BP-Egapris] had the right to register even the beginnings of the construction to separate it from--to make it their own property and to apply for lease to purchase the land plot on which that construction is built. And this is not the case with Pinus Proprius¹⁴⁹.

[...] there was an obligation on behalf of Pinus Proprius to sell the car park to municipality. It was not intending to be the owner of that car park to municipality¹⁵⁰.

419. The Claimant accepts that “[u]nlike Pinus, BP would lease the land on which it built its MSCPs. That was possible because of the above cited provision of Article 7(2) of the Land Lease Law that allows a private company to acquire a lease interest in publicly owned land if it already owns building on the land – clearly BP’s case.”¹⁵¹
420. In summary, BP’s draft JAA provided that the investor will be the owner of the MSCP and will lease or buy the publicly-owned land after completion of works. Unlike BP’s JAA, Pinus Proprius’ Cooperation Agreement provided that the investor will sell its MSCP to the Municipality (subject to the Lithuanian Government authorizing such a purchase) and therefore will not lease or buy the publicly-owned land. This dissimilarity is significant. It may very well be that the economic difference is limited or even non-existent. The record does not evidence that it is the case. Nevertheless, the legal situation is different: one investor remains the owner of the investment while the other must return it to the City. Whatever the compensation paid, the two situations are not the same.
421. Both BP and Pinus Proprius needed a JAA in order to construct the car parks. Once the construction would be completed, both investors would be the owners of the MSCP. On that matter, they are similar. However, Pinus Proprius would be obliged, subsequently, to sell its MSCP to the Municipality, if the latter was authorized to buy it. Therefore, the JAA or the Cooperation Agreement signed with Pinus Proprius was useful for the construction process but had neither the purpose nor the effect of avoiding the public auction (Article 7(1) of the Land Lease Law). BP needed a JAA or a Cooperation Agreement for the construction process, but more fundamentally, to avoid the public auction. This is a further difference.
422. In substance, a public auction has several objectives, and especially gives the assurance to the State that the highest price will be paid for the lease of the publicly-owned land. Moreover, the public auction guarantees the equality of treatment as all entities interested have the opportunity to apply for the lease.

¹⁴⁹ See Rukstele Tr. 1527:2-14.

¹⁵⁰ *Idem*, Tr. 1527:20-24.

¹⁵¹ Claimant’s Post-Hearing Brief, p.114.

423. In the case of Pinus Proprius, the public auction was not necessary because the investor was not to keep the MSCP and would not need to enter into a lease of the land. The Municipality would be the owner of the MSCP and the publicly-owned land would not be leased by another private entity.
424. On the other hand, BP had a right to own the MSCP and therefore to lease the publicly-owned land. Consequently, the public auction was an obligation, unless the Municipality and BP concluded a JAA. In the context of the legal uncertainty of the JAA and the Cooperation Agreement with regard to the Law on Self-Government, the Municipality of Vilnius could refuse the conclusion of such Agreement with BP and thus dispense with the obligation to organize a public auction.
425. In addition, the Cooperation Agreement concluded with Pinus Proprius afforded full power of self-determination to the Municipality of Vilnius after the construction of the MSCP. Indeed, the Municipality - once properly authorized by superior authorities - could decide, at its sole discretion, to buy the MSCP after completion of works. The consequences of the conclusion of JAA or Cooperation Agreement were, therefore, limited to the time of the construction process. The Agreement had no impact in this regard after the construction.
426. It was not the case with BP, which was contractually entitled to remain the owner of the MSCP and therefore had the right to lease the land. It is evident that the consequences of the conclusion of a Cooperation Agreement with Pinus Proprius were limited in terms of time and importance, while the conclusion of a JAA or Cooperation Agreement with BP had wider ranging effects.
427. BP and Pinus Proprius situations were different enough to justify a different treatment. Therefore, the Tribunal on balance has concluded that both investors were not *in like circumstances*.
428. **With regard to the second difference between the projects:** As described above (see ¶¶ 405-407) in October 2001, the City of Vilnius concluded a JAA with Pinus Proprius. A few months later, the Representative of the Government for the Vilnius Region challenged the validity of the JAA. Thus, the JAA was withdrawn and a Cooperation Agreement was concluded in its place. The Cooperation Agreement concluded in March 2002 was nothing more than a change of title of the existing JAA in order to avoid the decision of the Vilnius District Administrative Court on the legality of the JAA. In other words, the Municipality wanted to avoid that its decision to conclude a JAA be declared in violation of the Law on Self-Government.
429. In the case of BP, the situation was clearly different; BP never concluded any JAA with the Municipality of Vilnius. The conclusion of a Cooperation Agreement with BP would have required the conclusion of a new agreement and not the modification of an existing, possibly binding and enforceable agreement. It is therefore at least credible and understandable that the Municipality of Vilnius refused to conclude a new agreement with BP due to the uncertainty of the legality of JAA or Cooperation Agreements.

430. Under the circumstances, the Arbitral Tribunal concludes that Pinus Proprius' situation differed from BP's situation. As a result, the decision of the Municipality of Vilnius to refuse the conclusion of a JAA or a Cooperation Agreement with BP could be justified by the difference.

8.4 EXPROPRIATION

431. Article VI of the Treaty provides that:

Investments made by investors of one contracting party in the territory of the other contracting party cannot be expropriated, nationalized or subjected to other measures having a similar effect (all such measure hereinafter referred to as "expropriation") except when the following conditions are fulfilled:

- (I) The expropriation shall be done for public interest and under domestic legal procedures;*
- (II) It shall not be discriminatory;*
- (III) It shall be done only against compensation. [...]*

8.4.1 Position of the parties

432. The Claimant alleges that pursuant to Article VI of the Treaty, the investment cannot be expropriated, nationalized or subjected to measures having a similar effect except for a public purpose, in a non-discriminatory manner, upon payment of compensation and in accordance with domestic laws.
433. Claimant argues that by repudiating the Agreement, the Republic of Lithuania destroyed the value of BP and VPK. Moreover, the Claimant contends that the "Government's litigious, legislative, and administrative interference with the Agreement deprived BP of the legal security afforded by the Agreement."¹⁵² By preventing the execution and demanding full performance of the Agreement at the same time, and then repudiating the Agreement, the Municipality of Vilnius destroyed BP. Thus, by taking the asset that was the sole purpose of BP's existence, Lithuania indirectly expropriated Parkering's ownership interest in BP.¹⁵³ BP became a "company with assets, but without business." By failing to provide compensation for this expropriation, Lithuania breached its obligation under Article VI of the Treaty.¹⁵⁴
434. The Claimant contends that whether Lithuania benefited or not from the expropriation is irrelevant. On the contrary, whether the investor continues to enjoy the benefit of ownership is decisive.¹⁵⁵
435. The Respondent alleges that the termination of a contract only amounts to an expropriation in limited cumulative circumstances. First, the termination must be wrongful; second, there must be no remedy under the contract for the wrongful

¹⁵² See Claimant's Memorial ¶ 237.

¹⁵³ *Idem*, ¶ 238

¹⁵⁴ *Idem* ¶ 239 and Claimant's Post-Hearing Brief, p. 123.

¹⁵⁵ *Idem* ¶ 235.

termination; and third the termination must give rise to a substantial deprivation of the investor's enjoyment of the property in question.¹⁵⁶

436. The Respondent contends that the termination was lawful under the terms of the Agreement¹⁵⁷ and that, in any case, the Claimant never brought a claim before the contractually agreed forum, *i.e.* Lithuanian Courts. The Respondent underlines that the Lithuanian Courts were in position to give a fair and impartial hearing of the Claimant's case.¹⁵⁸ Finally, the Respondent alleges that the Claimant was not deprived of its property since it still owns and controls BP and because BP and VPK continue to develop their activities in Lithuania.¹⁵⁹

8.4.2 Discussion

437. The Treaty expressly contemplates *de facto* expropriation besides the formal or direct expropriation. *De facto* expropriation (or indirect expropriation) is not clearly defined in treaties, but can be understood as the negative effect of government measures on the investor's property rights, which does not involve a transfer of property but a deprivation of the enjoyment of the property.

438. As indicated in *Metalclad v. Mexico*, the Tribunal stated that

*expropriation [...] 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.*¹⁶⁰

439. The parties are not challenging the fact that the expropriation can be direct or indirect and that, in the case at hand, the expropriation alleged by the Claimant is indirect. There is no mention of any direct expropriation.
440. In the present case, the expropriation results, according to the Claimant, of the wrongful termination of the Agreement between the City of Vilnius and BP. Undoubtedly, wrongful termination of an agreement amounts to a breach thereof. Whether contract rights may be expropriated is widely accepted by the case law and the legal authors. However, under limited circumstances, three cumulative conditions (which will be addressed below ¶¶ 443-456) should be met to elevate a breach of an agreement to the level of an indirect expropriation within the meaning of the Treaty.
441. Having said that, an expropriation does not necessarily amount to a violation of the Treaty. Indeed, pursuant to Article VI of the Treaty, the expropriation is *legitimate* if

¹⁵⁶ See Respondent Counter-Memorial, p. 81.

¹⁵⁷ *Idem*, ¶¶ 210-212.

¹⁵⁸ *Idem*, ¶ 214.

¹⁵⁹ *Idem*, ¶ 218 and ¶¶ 220-224

¹⁶⁰ See *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARF (AF)/97/1, Award, August 30, 2000, reprinted in 16 *ICSID Rev.—FILJ* 168 (2001), ¶ 103.

done for public interest and under domestic legal procedures; if not discriminatory; and if done against compensation.

442. Therefore, the Arbitral Tribunal will first determine if an indirect expropriation occurred (see ¶¶ 443-456). If the answer is positive, it will analyse if the expropriation is *legitimate*.
443. **First**, a breach of an agreement will amount to an expropriation only if the State acted not only in its capacity of party to the agreement, but also in its capacity of sovereign authority, that is to say using its *sovereign power*. The breach should be the result of this action. A State or its instrumentalities which simply breach an agreement, even grossly, acting as any other contracting party might have done, possibly wrongfully, is therefore not expropriating the other party.
444. The Tribunal agrees with the tribunal in *Azurix Corp. v. the Argentine Republic* which held that:

contractual breaches by State party or one of its instrumentalities would not normally constitute expropriation. Whether one or series of such breaches can be considered to be measures tantamount to expropriation will depend on whether the State or its instrumentality has breached the contract in the exercise of its sovereign authority, or as a party to a contract. As already noted, a State or its instrumentalities may perform a contract badly, but this will not result in a breach of treaty provisions “unless it be proved that the state or its emanation has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign.”¹⁶¹

445. In the present case, on 27 January 2004, Mr. Artūras Zuokas, Mayor of the City of Vilnius, informed the Consortium that the Agreement dated 30 December 1999 was terminated. The reason invoked was a “*material breach on the part of the Consortium formed by UAB Baltijos Parkingas and UAB Egapris of [...] provisions of the Agreement.*”¹⁶² The record does not show that the State, *i.e.* the Municipality, acted differently than another contracting party would have done. In other words, assuming that the Municipality of the City of Vilnius breached the Agreement, there is no evidence that it used its sovereign power in that respect.
446. It is thus unnecessary and irrelevant to ascertain whether the termination breached the Agreement.
447. Therefore, the termination of the Agreement by the City of Vilnius cannot be considered as an expropriation under the BIT due to the fact that the City of Vilnius did not act as a sovereign authority and did not use that authority to expropriate the rights of BP.
448. **Second**, a breach of contract, if there should be one is, in itself, not always sufficient to amount to an indirect expropriation within the meaning of the BIT. An investor faced with a breach of an agreement by the State counter-party should, as a general rule, sue that party in the appropriate forum to remedy the breach. Therefore, as already

¹⁶¹ See *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, July 14, 2006, *supra* note 59, ¶ 314.

¹⁶² Exhibit CE 210.

stated (see ¶ 316), a preliminary determination of the existence of a contractual breach under domestic law is, in most cases, a prerequisite.

449. If the investor is deprived, legally or practically, of the possibility to seek a remedy before the appropriate domestic court, then the Arbitral Tribunal might decide on the basis of the BIT if international rights have been violated (see above ¶ 317). That would be the case, for instance, if a party is denied the possibility to complain about the wrongful termination of the agreement before the forum contractually chosen.

450. For instance, in the Waste Management case, the Tribunal concluded that:¹⁶³

it is one thing to expropriate a right under a contract and another to fail to comply with the contract. Non-compliance by a government with contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation. In the present case, the Claimant did not lose its contractual rights, which it was free to pursue before the contractually chosen forum.

451. In Azinian and others v. the United Mexican States, the Tribunal noted that:

[t]he problem is that Claimants' fundamental complaint is that they are the victims of a breach of the Concession Contract. NAFTA does not, however, allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes.

The Tribunal added that “the Claimants have raised no complaints against the Mexican courts; they do not allege a denial of justice.”¹⁶⁴

452. In Generation Ukraine v. Ukraine, the Tribunal held that:

*an international tribunal may deem that the failure to seek redress from national authorities disqualifies the international claim, not because there is a requirement of exhaustion of local remedies but because the very reality of conduct tantamount to expropriation is doubtful in the absence of a reasonable – not necessarily exhaustive – effort by the investor to obtain correction.*¹⁶⁵

453. In the case at hand, BP and possibly the Claimant had the opportunity to bring the case before the forum contractually chosen, *i.e.* Lithuanian Courts, in order to complain of the breach of the Agreement (see above ¶ 316). The record does not show any objective reason to question the Lithuanian Courts' ability to dispose of the case fairly, competently, impartially and within a reasonable period of time.¹⁶⁶ Nevertheless, neither BP nor the Claimant challenged the termination before the forum contractually chosen, *i.e.* the Lithuanian Courts.¹⁶⁷

¹⁶³ See Waste Management, Inc. v. United Mexican States, ICSID Case No. ARB (AF)/00/3, Award, April 30, 2004, *supra* note 60, ¶ 175.

¹⁶⁴ See Robert Azinian and others v. United Mexican States, ICSID Case No. ARB(AF)/97/2, Award, November 1, 1999, *reprinted in* 14 *ICSID Rev.—FILJ* 538 (1999), ¶ 87 and ¶ 100.

¹⁶⁵ See Generation Ukraine Inc. v. Ukraine, ICSID Case No. ARB/00/9, Award, September 16, 2003, *supra* note 16, p. 91.

¹⁶⁶ See Gintautas Barktkus, Tr. 908 and Expert Report of Carlos Lapuerta, p. 4.

¹⁶⁷ See Article 7.3 of the Agreement between the Municipality of Vilnius and the Consortium, CE 13.

454. It is not the mission of the present Arbitral Tribunal to decide on the alleged breach of the Agreement, entered into by a company which acted as vehicle of the investment of the Claimant. In the absence of any objective reason not to bring the case before national tribunals, it cannot be concluded, on the basis of the facts at hand, that the Claimant's investment has been indirectly expropriated.
455. **Third**, the breach of the Agreement, *in casu* the termination of the agreement, must give rise to a substantial decrease of the value of the investment.¹⁶⁸
456. In the case at hand, the Arbitral Tribunal finds that it is not worth analysing the existence of a decrease of the value of the Claimant's investment as no other conditions for the existence of an expropriation developed above are met (see above ¶¶ 443-454). Thus it can be concluded that Parkerings has not been expropriated within the meaning of Article VI of the Treaty. Accordingly, the question whether the expropriation was *legitimate* is not relevant and does not need to be discussed here either.

9. THE ISSUE OF COSTS

457. Both parties sought the costs of this arbitration in the event that they were successful.
458. By letter dated 22 December 2006, Parkerings presented the Tribunal with a statement of costs and expenses of € 2,655,584.75 which included the sum of € 196,591.42 paid to ICSID as deposit towards the fees and expenses of the Arbitral Tribunal. By letter of 9 May 2007, Parkerings amended its statement of costs and expenses to € 2,655,584.75.
459. On the same date, the Republic of Lithuania presented the Tribunal with a submission of costs and expenses of € 1,340,716.10 which included the sum of € 196,591.42 paid to ICSID as deposit towards the fees and expenses of the Arbitral Tribunal.
460. The parties filed no additional comments on statements of costs.
461. It is unambiguous from Article 61(2) of the ICSID Convention and Rule 28 of the ICSID Arbitration Rules that the Arbitral Tribunal has discretion with regard to costs.
462. There is no rule in international arbitration that costs must follow the event. Thus, the question of costs is within the discretion of the Tribunal with regard, on the one hand, to the outcome of the proceedings and, on the other hand, to other relevant factors.
463. In the Tribunal's view, the proceedings were expeditiously and efficiently conducted by the representatives of both parties.

¹⁶⁸ See *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003, *supra* note 80, ¶ 115; see also *Telenor Mobile Communications AS v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award, September 13, 2006, *available online at* www.worldbank.org/icsid, ¶¶ 65 *et seq.*

464. Even if no violation of the BIT or international law occurred, the conduct of the City of Vilnius was far from being without criticism. In such circumstances, the Arbitral Tribunal concludes that an equitable result would be that each party bears its own costs and expenses, and that the costs and expenses of the Tribunal be paid equally by both parties.

10. THE AWARD

465. Having heard and read all the submissions and evidence in this arbitration, and for the reasons set out above, the Tribunal unanimously decides that:

- a) the Tribunal has jurisdiction to hear and consider all the claims made by the Claimant in this case;
- b) the conduct of the Republic of Lithuania, which is the subject of the claims in this arbitration, did not involve a violation of the duty of equitable and reasonable Treatment (Article III of the Treaty);
- c) the conduct of the Republic of Lithuania as claimed in this arbitration did not involve a violation of the obligation of protection (Article III of the Treaty);
- d) the conduct of the Republic of Lithuania as claimed in his arbitration did not involve a violation of the obligation to accord treatment no less favorable than the Treatment accorded to investment by investor of a third State (Article IV of the Treaty);
- e) the conduct of the Republic of Lithuania as claimed in this arbitration did not involve a violation of the prohibition of expropriation (Article VI of the Treaty);
- f) Parkerings' claims are accordingly dismissed in their entirety;
- g) Each party shall bear its own costs and half of the costs and expenses of these proceedings.

[signature]

Dr. Julian Lew

Arbitrator

Date: August 13, 2007

[signature]

Dr. Laurent Lévy

President

Date: August 14, 2007

[signature]

The Hon. Marc Lalonde

Arbitrator

Date: August 9, 2007

The Due Diligence Principle Under International Law

ROBERT P. BARNIDGE, JR.*

Abstract.

This article explores the interface of state responsibility, non-state actors, and the due diligence principle. It begins by examining the various principles of responsibility under international law. After doing so, it closely considers the deliberations of the International Law Commission on the topic of state responsibility. In light of these developments, attention is then paid to exactly what has been expected of states with regard to the activities of non-state actors during the last century. This overview focuses on the due diligence principle, a principle which, it is argued, can be restrictively or expansively interpreted, as the particular facts and circumstances require, to hold states responsible for their actions or omissions related to non-state actors.

1. Introduction

There has been much talk in recent years of the role of non-state actors in a historically state-centric international legal order. Although much progress has been made on the law of state responsibility, particularly thanks to James Crawford's special rapporteurship on the project at the International Law Commission (ILC), there does not yet exist a corresponding comprehensive framework for the international responsibility of non-state actors. This may lead one to conclude that a lacuna exists in the law of responsibility.

This article explores the interface of state responsibility, non-state actors, and the due diligence principle. It begins by examining the various principles of responsibility under international law. After doing so, it closely considers the deliberations of the ILC on the topic of state responsibility. In light of these developments, attention is then paid to exactly what has been expected of states with regard to the activities of non-state actors during the last century. This overview focuses on the due diligence principle, a principle which, it is argued, can be restrictively or expansively interpreted, as the

* BA, *summa cum laude*, University of Notre Dame, 1999; JD, University of North Carolina, 2003; LLM Public International Law, University of Amsterdam, 2004; PhD Candidate, School of Law, Queen's University Belfast, research commenced October 2004. The author would like to acknowledge the generous financial support of the Overseas Research Students Awards Scheme and Queen's University Belfast to his current research. While accepting full responsibility for this article's content, the author would like to thank Prof. Phil Scraton and Dr. Jean Allain of the School of Law, Queen's University Belfast, for their valuable comments. A much less exhaustive study of the due diligence principle under international law appears in Robert P. Barnidge, Jr., *States' Due Diligence Obligations with Regard to International Non-State Terrorist Organizations Post-11 September 2001: The Heavy Burden That States Must Bear*, 16 *IR. STUD. INT'L AFF.* 103, 106–10 (2005).

particular facts and circumstances require, to hold states responsible for their actions or omissions related to non-state actors.

2. Principles of Responsibility

It should come as little surprise that a legal regime as complex as international law should contain principles of responsibility as varied as they are fundamental.¹ While many of these principles have counterparts in domestic law contexts, they assume a unique character and personality at the level of international law.

Pisillo Mazzeschi identifies four main principles of responsibility.² First, there is fault-based responsibility.³ Fault here is defined in subtly varied ways. Fault-based responsibility has historically required a finding of “psychological fault (wilful or negligent conduct) of the organs of the State accused of the wrongful act.”⁴ This historical formulation examines negligence, or *culpa*, or intent, or *dolus*.⁵

A more nuanced way of defining fault-based responsibility focuses on the underlying rules within a “regime of responsibility for breach of due diligence obligations (considering due diligence as an objective and international standard of behaviour).”⁶ Cassese describes fault with reference to intent or recklessness.⁷ It is also possible to think of *culpa* to “describe types of blameworthiness based upon reasonable foreseeability, or foresight without desire of consequences (recklessness, *culpa lata*).”⁸

Iwasawa and Nishimura present separate theories based on subjective fault and objective fault.⁹ While the former theory “understands fault as an intention or choice on the part of the State in connection with actions or omissions that are involved in a breach of obligation, and this intention or choice is that of the State itself as an entity and not of an individual person operating as a State organ”¹⁰ and while the latter theory understands fault as the “inappropriate or non-diligent nature of the acts judged in light of the standards that can be set forth *a posteriori* only under particular circum-

¹ For the varied types of responsibility in the context of non-state terrorism, see Bertrand G. Ramcharan, *Terrorism and Non-State Organizations*, in *TOWARDS WORLD CONSTITUTIONALISM: ISSUES IN THE LEGAL ORDERING OF THE WORLD COMMUNITY* 681, 691 (Ronald St. John Macdonald & Douglas M. Johnston eds., 2005).

² See Riccardo Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, in *INTERNATIONAL RESPONSIBILITY FOR ENVIRONMENTAL HARM* 15, 16–17 (Francesco Francioni & Tullio Scovazzi eds., 1991). See also F. V. García Amador, *State Responsibility: Some New Problems*, in 94(2) *ACADÉMIE DE DROIT INTERNATIONAL DE LA HAYE: RECUEIL DES COURS* 365, 382–92 (1958) (providing a helpful overview of the topic).

³ See Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 16.

⁴ *Ibid.*

⁵ See MALCOLM N. SHAW, *INTERNATIONAL LAW* 698 (5th ed. 2003).

⁶ Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 16.

⁷ See ANTONIO CASSESE, *INTERNATIONAL LAW* 250–51 (2d ed. 2005).

⁸ IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 425 (6th ed. 2003).

⁹ See Yuji Iwasawa & Yumi Nishimura, *A Review of Japanese Legal Literature on State Responsibility* 9, available at <http://www.law.cam.ac.uk/rcil/ILCSR/rt/JapanRev.rtf> (1999).

¹⁰ *Ibid.*

stances of each case,”¹¹ both theories are rooted in fundamental similarities.¹² Indeed, theories that base themselves on subjective fault and objective fault, such as those that Iwasawa and Nishimura discuss, present subjective fault and objective fault as not the same but, rather, as “two faces of the same coin.”¹³ The subjective fault theory and the objective fault theory are not so much distinct as they are descriptions of a common phenomenon.

Pisillo Mazzeschi’s second and third main principles of responsibility share in common the fact that they are based not on fault but, rather, on an objective assessment of responsibility, or responsibility premised on the “mere breach of an international obligation.”¹⁴ Shaw equates the objective principle of responsibility with strict liability: “[o]nce an unlawful act has taken place, which has caused injury and which has been committed by an agent of the state, that state will be responsible in international law to the state suffering the damage irrespective of good or bad faith.”¹⁵

The basic distinction between the two types of objective responsibility identified by Pisillo Mazzeschi is that one form allows for the raising of circumstances precluding wrongfulness as a defence while the other does not.¹⁶ These two principles of objective responsibility could be characterized as relative or absolute responsibility for breach of obligations of result rather than relative or absolute objective responsibility.¹⁷

Former Judge of the International Court of Justice (ICJ) Mohammed Bedjaoui characterizes Pisillo Mazzeschi’s framework of fault-based responsibility and the two types of objective responsibility slightly differently.¹⁸ What Pisillo Mazzeschi describes as fault-based responsibility, Bedjaoui refers to as “‘liability for fault’ or ‘subjective responsibility,’”¹⁹ and what the former states as the two types of objective responsibility, Bedjaoui describes as “‘causal liability’ or ‘objective responsibility.’”²⁰ Bedjaoui’s explanation and further discussion are interesting because they seem to challenge the traditional notion that the main subjective and objective principles of

¹¹ *Ibid.*

¹² See *ibid.* (asserting these similarities as foreseeability, acknowledgement of obligations, capability of prevention, and means to prevent injuries).

¹³ *Ibid.*

¹⁴ Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 16.

¹⁵ SHAW, *supra* note 5. For a similar definition of objective responsibility, see TIM HILLIER, SOURCEBOOK ON PUBLIC INTERNATIONAL LAW 338 (1998) (stating that “[p]rovided that the acts complained of can be attributed to the state then it will be liable if those acts constitute a breach of international law regardless of any question of fault or intention.”).

¹⁶ See Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 16. See also Riccardo Pisillo Mazzeschi, *The Due Diligence Rule and the Nature of the International Responsibility of States*, 35 GERM. Y.B. INT’L L. 9, 9 (1992) (noting that, “[i]n the regime of objective responsibility, responsibility arises as a sole consequence of conduct contrary to an international obligation, but in the case of objective and relative responsibility the State may be exonerated from responsibility by invoking one of the defenses allowed by international law.”).

¹⁷ See Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 16.

¹⁸ See Mohammed Bedjaoui, *Responsibility of States: Fault and Strict Liability*, in 10 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 358 (1987).

¹⁹ *Ibid.* at 359.

²⁰ *Ibid.*

responsibility exist as polar opposites.²¹ In large part, this is due to an objectified understanding of fault.²²

The fourth main principle of responsibility identified by Pisillo Mazzeschi fundamentally differs from his earlier principles of responsibility in that it does not require an unlawful act and because it can be established based solely on a finding of causation to damage.²³ Bedjaoui justifies a framework of responsibility that does not require a wrongful act as inevitably resulting from modern technologies, such as nuclear energy, the use of gaseous and liquid hydrocarbons, and the exploration of space, that states see as necessary yet acknowledge as extremely dangerous.²⁴

Having thus described fault-based responsibility, objective responsibility, and liability without a wrongful act, a few observations can be made. Nollkaemper correctly stresses that inquiry into what in the criminal law would be described as the *mens rea* is in the state responsibility context “generally [. . .] either irrelevant or manifests itself in a different, objectified, form in the determination of state responsibility.”²⁵

While acknowledging the existence of four main principles of responsibility, one should recognize that these regimes do not necessarily function in a hermetically sealed manner. In the responsibility discourse, for example, fault’s role should not be underestimated, even when the responsibility regime at issue would seem, at first glance, to completely exclude fault.²⁶ As Former President of the Inter-American Court of Human Rights Antônio Augusto Cançado Trindade has stated, the subjective element may aggravate a state’s responsibility.²⁷ Goodwin-Gill has noted that, particularly under international human rights law, “[c]onduct and result overlap; torture, ill-treatment, arbitrary deprivation of life, and *refoulement*, are all examples of forbidden conduct; but due process and accountability mechanisms are necessary, linked, but still separate bases for determining whether ‘protection’ is available or effective.”²⁸

Which responsibility regime applies, whether subjective or objective responsibility or responsibility without a wrongful act, serves particular policy ends and in large part

²¹ See *ibid.*

²² See *ibid.*

²³ See Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2. See also Bedjaoui, *supra* note 18, at 360–61. On abuse of rights, see BROWLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW*, *supra* note 8, at 429–30.

²⁴ See Bedjaoui, *supra* note 18, at 360 (asserting a “necessity of reconciling the greatest possible freedom of action for States with the justified fear that undisciplined use of technological and industrial power might spell the ruin of mankind.”).

²⁵ André Nollkaemper, *Concurrence Between Individual Responsibility and State Responsibility in International Law*, 52(3) *INT’L & COMP. L.Q.* 615, 633 (2003).

²⁶ See Iwasawa & Nishimura, *supra* note 9, at 9–10. See also Antônio Augusto Cançado Trindade, *Complementarity Between State Responsibility and Individual Responsibility for Grave Violations of Human Rights: The Crime of State Revisited*, in *INTERNATIONAL RESPONSIBILITY TODAY* 253, 258 (Maurizio Ragazzi ed., 2005) (stating that, “even if one admits the principle of the objective or absolute responsibility of the State, this does not mean that the responsibility based on fault or guilt is entirely dismissed in every and any hypothesis or circumstance.”).

²⁷ See Trindade, *supra* note 26.

²⁸ Guy S. Goodwin-Gill, *State Responsibility and the “Good Faith” Obligation in International Law*, in *ISSUES OF STATE RESPONSIBILITY BEFORE INTERNATIONAL JUDICIAL INSTITUTIONS* 75, 78 (Malgosia Fitzmaurice & Dan Sarooshi eds., 2004).

determines the extent to which a party can be held accountable for its acts or omissions.²⁹ A regime of strict liability, for example, forces states to exert more control over the organs of their state apparatus than under a fault-based responsibility framework.³⁰ Brownlie asserts that a regime of objective responsibility “provides a better basis for maintaining good standards in international relations and for effectively upholding the principle of reparation.”³¹ Particular facts and circumstances may make it impossible to find a failure of the due diligence principle under a fault-based responsibility regime in some situations but not in others, although special regimes of protection may impose more exacting due diligence obligations than ordinary regimes of protection.³² Finally, while a fault-based responsibility regime makes more difficult a finding of state responsibility, either of the two objective responsibility regimes identified by Pisillo Mazzeschi makes such a finding considerably easier.³³ This is another way of stating that the international obligation requires more of the party bearing the obligation under the latter responsibility regimes.

Shaw, although recognizing a split in the case law and in academia, has noted a tendency favouring strict liability.³⁴ Brownlie has also advanced evidence of the dominance of the regime of objective responsibility.³⁵ According to Cassese, international courts normally do not concern themselves with subjective questions of intent on the part of state actors.³⁶

²⁹ See Ian Brownlie, *State Responsibility and the International Court of Justice*, in ISSUES OF STATE RESPONSIBILITY BEFORE INTERNATIONAL JUDICIAL INSTITUTIONS 11, 12 (Malgosia Fitzmaurice & Dan Sarooshi eds., 2004).

³⁰ See SHAW, *supra* note 5, at 700.

³¹ BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, *supra* note 8.

³² See Horst Blomeyer-Bartenstein, *Due Diligence*, in 10 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 138, 142 (1987) (arguing that “[t]he classic standard of due diligence may thus not suffice, it may require, depending upon the circumstances, a standard more exacting than its own as part of a special régime of protection. In this sense, the régime of absolute liability in the case of damage caused by space objects may be looked upon as ‘evidence of the standard of care which the authors of the Convention believed to be reasonable in relation to that particular treaty.’”). See also BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, *supra* note 8, at 423 (asserting that, “in municipal systems of law, the precise mode of applying a *culpa* doctrine, especially in the matter of assigning the burden of proof, may result in a regime of objective responsibility.”).

³³ See Pisillo Mazzeschi, *The Due Diligence Rule and the Nature of the International Responsibility of States*, *supra* note 16, at 10. See also Gaetano Arangio-Ruiz, *State Fault and the Forms and Degrees of International Responsibility: Questions of Attribution and Relevance*, in LE DROIT INTERNATIONAL AU SERVICE DE LA PAIX, DE LA JUSTICE ET DU DÉVELOPPEMENT 25, 35 (Mélanges Michel Virally ed., 1991) (stating that, “[c]onsidering therefore the far greater difficulty which any determination of intent or motivation presents, as compared with the determination of the so-called ‘objective’ conduct, attribution of any degree of fault to a State may be frequently more problematic than attribution of ‘objective conduct.’”).

³⁴ See SHAW, *supra* note 5.

³⁵ See BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, *supra* note 8, at 423–25. See also James Crawford & Simon Olleson, *The Nature and Forms of International Responsibility*, in INTERNATIONAL LAW 445, 459 (Malcolm D. Evans ed., 2003). According to Brownlie, “[a]s a matter of positive law the position is clear. Both the practice of States and the preponderance of the decisions of international tribunals adopt the concept of objective responsibility.” Brownlie, *State Responsibility and the International Court of Justice*, *supra* note 29.

³⁶ See CASSESE, *supra* note 7, at 251.

3. The International Law Commission and State Responsibility

Given the disparate nature of the principles of responsibility under international law, it should not come as a surprise that the law implicates elements of both fault-based responsibility and objective responsibility. Consider the Truth and Reconciliation Commission of South Africa (TRC). The TRC, although unique as a body and operating within a particular context, dealt with the principle of state responsibility in examining the acts and omissions of state and non-state actors under apartheid. According to it, state responsibility for the gross violation of human rights exists according to the following framework: “a It [i.e., the state] is strictly responsible for the acts of its organs or agents or persons acting under its control. b It is responsible for its own failure to prevent or adequately respond to the commission of gross human rights violations.”³⁷ While both of these scenarios trigger state responsibility, the second scenario raises the issue of due diligence.³⁸

An examination of the ILC’s work provides some insight into the role that the due diligence principle plays within this framework. Since its creation at the end of the Second World War, the ILC has deliberated on varied issues of international law. Created by the General Assembly as part of that body’s mandate under the Charter of the United Nations to “initiate studies and make recommendations for the purpose of [. . .] encouraging the progressive development of international law and its codification,”³⁹ it had on its agenda since its inception the issue of state responsibility.⁴⁰ The journey of this important agenda item through the ILC, from its initial placement on the agenda to the completion of the 2001 *Articles on Responsibility of States for Internationally Wrongful Acts (Articles on State Responsibility)*,⁴¹ had been, in its ups and downs, much like a roller coaster.

It is clear from the decades long work of the ILC on the perplexing issue of state responsibility that the nature of the due diligence obligation is a matter to be resolved by the underlying primary rules, not the secondary rules of state responsibility, which Crawford and Olleson refer to as the “framework for the application of these [primary]

³⁷ TRUTH AND RECONCILIATION COMMISSION OF SOUTH AFRICA REPORT 602, available at <http://www.info.gov.za/otherdocs/2003/trc/rep.pdf> (released 21 Mar. 2003).

³⁸ For an explanation of state responsibility and the due diligence principle within the context of small arms used by non-state actors, see Barbara A. Frey, *Small Arms and Light Weapons: The Tools Used to Violate Human Rights*, (3) DISARMAMENT FORUM: HUMAN RIGHTS, HUMAN SECURITY AND DISARMAMENT 37, 41–43 (2004), available at <http://www.unidir.ch/pdf/articles/pdf-art2140.pdf>.

³⁹ U.N. CHARTER art. 13, para. 1(a).

⁴⁰ See James Crawford, *Introduction*, in JAMES CRAWFORD, *THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES* 1, 1 (2003). On state responsibility deliberations by the League of Nations and the ILC, see Shabtai Rosenne, *State Responsibility: Festina Lente*, 75 BRIT. Y.B. INT’L L. 363, 363–66 (2004).

⁴¹ International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts*, in JAMES CRAWFORD, *THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES* 61 (2003) (2001). Since they are no longer in draft form, this article simply makes reference to them in the text as the *Articles on Responsibility of States for Internationally Wrongful Acts (Articles on State Responsibility)*.

obligations, whatever they may be.”⁴² On the difference between the primary and secondary rules of international law, Cassese notes:

It is now generally acknowledged that a distinction can be made between ‘*primary rules*’ of international law, that is, those customary or treaty rules laying down substantive obligations for States (on State immunities, treatment of foreigners, diplomatic and consular immunities, respect for territorial sovereignty, etc.), and ‘*secondary rules*’, that is, rules establishing (i) on what conditions a breach of a ‘primary rule’ may be held to have occurred and (ii) the legal consequences of this breach.⁴³

Assuming that the primary rules at issue impose a due diligence standard of conduct on the state, then the nature of the rights and interests at issue, as well as a number of other factors, will determine whether the conduct breaches the state’s international obligation.

Under F. V. García Amador’s special rapporteurship, the question of state responsibility initially focussed on the traditional concept of diplomatic protection, but a combination of several other agenda items and fundamental disagreement within the ILC on the question of state responsibility prevented any significant progress from being made.⁴⁴ It remained for subsequent special rapporteurs to guide the ILC in a more fruitful direction.⁴⁵

Roberto Ago dominated the next phase of the debate. In an inter-sessional subcommittee which he chaired, an ambitious plan was set, one that would broadly apply across international law but that would focus exclusively on the secondary, as opposed to the primary, rules of international law.⁴⁶ Thus, Ago’s “focus was to be on the framework or matrix of rules of responsibility, identifying whether there has been a breach by a State and what were its consequences.”⁴⁷ The inter-sessional subcommittee’s plan was approved by the ILC, Ago was made special rapporteur, and a prolific period of article drafting began.⁴⁸ Ago’s special rapporteurship more than made up for what García Amador’s special rapporteurship had failed to achieve.⁴⁹

⁴² James Crawford & Simon Olleson, *The Continuing Debate on a UN Convention on State Responsibility*, 54(4) INT’L & COMP. L.Q. 959, 968 (2005).

⁴³ CASSESE, *supra* note 7, at 244. See HILLIER, *supra* note 15, at 321.

⁴⁴ See Crawford, *Introduction*, *supra* note 40, at 1–2.

⁴⁵ García Amador delivered a comprehensive overview of state responsibility at the Hague Academy of International Law in 1958. His lectures explored international responsibility’s legal nature, elements, and subjects, the law of diplomatic protection, including its exercise and the doctrine of exhaustion of local remedies, and the international claim and extent and nature of reparation. See García Amador, *supra* note 2.

⁴⁶ See Crawford, *Introduction*, *supra* note 40, at 2. For a critique of the distinction between the primary and secondary rules of international law, see Daniel Bodansky & John R. Crook, *Introduction and Overview*, 96(4) AM. J. INT’L L. 773, 780–81 (2002). “[T]his distinction,” according to Bodansky and Crook, “has proved elusive and in any event is unnecessary. To some degree, classifying an issue as part of the rule of conduct (the primary rule) or as part of the determination of whether that rule has been violated (the secondary rule) is arbitrary.” *Ibid.* at 780.

⁴⁷ Crawford, *Introduction*, *supra* note 40, at 2.

⁴⁸ See *ibid.* at 2–3.

⁴⁹ On the separation of the primary and secondary rules, see Blomeyer-Bartenstein, *supra* note 32, at 141–42.

Further progress was made on the question of state responsibility under the subsequent special rapporteurships of Willem Riphagen and Gaetano Arangio-Ruiz.⁵⁰ Sufficient progress was made such that 1996 saw the completion of the *Draft Articles on State Responsibility Provisionally Adopted by the International Law Commission on First Reading (Draft Articles on State Responsibility Provisionally Adopted on First Reading)*.⁵¹ While not the conclusion of the agenda item, it represented significant progress over several decades.

It is important to examine the *Draft Articles on State Responsibility Provisionally Adopted on First Reading* to arrive at a better understanding of the interface of state responsibility, non-state actors, and the due diligence principle. Article 3, which Gattini describes as its “centrepiece,”⁵² is the key article in the *Draft Articles on State Responsibility Provisionally Adopted on First Reading*. It defines an internationally wrongful act of state as occurring when “(a) conduct consisting of an action or omission is attributable to the State under international law; and (b) that conduct constitutes a breach of an international obligation of the State.”⁵³ Attribution and breach are classic requirements of state responsibility under international law,⁵⁴ and international case law supports this.⁵⁵

Taking Article 3 as a starting point, it is possible to make a number of observations about the *Draft Articles on State Responsibility Provisionally Adopted on First Reading*. There is no preference expressed *per se* as to whether state responsibility is essentially fault-based or based on intent.⁵⁶ According to Crawford, who was special rapporteur at the conclusion of the state responsibility project in 2001, attribution and breach act as the *sine qua non* of an internationally wrongful act of state, “no secondary rule or principle of responsibility imposing any such requirements, over and above those contained in the primary rule.”⁵⁷ Arangio-Ruiz, writing before the completion of the *Draft Articles on State Responsibility Provisionally Adopted on First Reading*, recognized that fault was not necessarily indispensable, yet questioned the assertion that the “legal consequences of an act which passes that threshold [of unlawfulness] are the same whether or not any fault is present in any degree.”⁵⁸

⁵⁰ See Crawford, *Introduction*, *supra* note 40, at 3–4.

⁵¹ International Law Commission, *Draft Articles on State Responsibility Provisionally Adopted by the International Law Commission on First Reading (1996)*, in JAMES CRAWFORD, *THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES* 348 app. (2003) (1996).

⁵² Andrea Gattini, *Smoking/No Smoking: Some Remarks on the Current Place of Fault in the ILC Draft Articles on State Responsibility*, 10(2) EUR. J. INT’L L. 397, 398 (1999).

⁵³ International Law Commission, *Draft Articles on State Responsibility Provisionally Adopted by the International Law Commission on First Reading (1996)*, *supra* note 51, at 348, art. 3.

⁵⁴ See Rüdiger Wolfrum, *Internationally Wrongful Acts*, in 10 *ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW* 271, 272 (1987).

⁵⁵ See International Law Commission, *Commentaries, Articles on Responsibility of States for Internationally Wrongful Acts*, in JAMES CRAWFORD, *THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES* 74, 81 (2003) (2001).

⁵⁶ See Crawford, *Introduction*, *supra* note 40, at 12.

⁵⁷ *Ibid.*

⁵⁸ Arangio-Ruiz, *supra* note 33, at 25.

The “essentially neutral position”⁵⁹ of the *Draft Articles on State Responsibility Provisionally Adopted on First Reading* on the question of fault ensured that it would not operate under a fixed, rigid regime of responsibility but, rather, that it would have a more comprehensive effect and applicability under international law.⁶⁰ Because the secondary rules of state responsibility have nothing to say on the matter, questions of fault must be resolved with reference to the underlying primary rules. Put differently, “[i]f the primary rules require fault (of a particular character) or damage (of a particular kind) then they do; if not, then not.”⁶¹ The ILC wisely removed itself from the fray.⁶²

As already noted, the ILC completed its decades’ long study of state responsibility in 2001 when it adopted the *Articles on State Responsibility*. The *Articles on State Responsibility* were subsequently noted by the General Assembly and forwarded to states.⁶³ Debate among states continues, however, as to what should happen to the *Articles on State Responsibility* in future, with questions arising such as to whether they should be codified and, if so, whether this should take place in the short, medium, or long term, the extent to which they reflect customary international law at present also being raised.⁶⁴ Reflecting on the situation in late-2005, Crawford and Olleson argue for “keeping the possibility of a convention open while perpetually postponing a decision on the conclusion of such a convention.”⁶⁵

The formulation of an internationally wrongful act of state in what became the central article, Article 2, is very similar to the 1996 equivalent, Article 3, and only differs in minor ways. According to Article 2 in the final version, an internationally wrongful act of state is defined as “conduct consisting of an action or omission [that]: (a) is attributable to the State under international law; and (b) constitutes a breach of an international obligation of the State.”⁶⁶

⁵⁹ Crawford, *Introduction*, *supra* note 40, at 13.

⁶⁰ See *ibid.* at 13–14 (identifying this as a “more subtle approach, more appropriate to a general set of articles dealing with all international obligations and no longer focusing on the specific field of diplomatic protection. It corresponded to the wider range of possibilities, but it did not go further than that.”).

⁶¹ James Crawford, *Revising the Draft Articles on State Responsibility*, 10(2) EUR. J. INT’L L. 435, 438 (1999).

⁶² See *ibid.* (stating that “the long-standing argument about fault might seem to be a false debate; but whether or not this is so, it is not a debate into which the ILC is compelled to enter, at a general level, in relation to this topic.”).

⁶³ See G.A. Res. 56/83, U.N. GAOR, at para. 3, U.N. Doc. A/RES/56/83 (2001).

⁶⁴ See Crawford & Olleson, *The Continuing Debate on a UN Convention on State Responsibility*, *supra* note 42 (exploring this debate). For an overview of developments since 2001, see Rosenne, *supra* note 40, at 366–67. According to an ICSID Tribunal, “[w]hile [. . . they] are not binding, they are widely regarded as a codification of customary international law.” *Noble Ventures, Inc. (Noble) v. Rom.*, ICSID Case No. ARB/01/11, 69, available at <http://ita.law.uvic.ca/documents/Noble.pdf> (2005). Although the ICSID Tribunal likely meant to state “not binding as a matter of international treaty law” instead of “not binding,” because customary international law is binding, it may have underestimated the degree of progressive development.

⁶⁵ Crawford & Olleson, *The Continuing Debate on a UN Convention on State Responsibility*, *supra* note 42, at 971.

⁶⁶ International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts*, *supra* note 41, at 61, art. 2.

Article 2 of the *Articles on State Responsibility* seems to support the conclusion that the legal consequences arising from active state conduct that satisfies the attribution and breach requirements and omissive state conduct that satisfies the attribution and breach requirements are, or at least should be, the same. The *Commentary* to Article 2 supports this interpretation and, once it can be established that particular facts and circumstances qualify as “conduct consisting of an action or omission” that satisfy the attribution and breach requirements, acknowledges the essentially non-discriminatory position of the law with regard to state action and omission for purposes of finding an internationally wrongful act of state. Specifically, “[c]ases in which the international responsibility of a State has been invoked on the basis of an omission are at least as numerous as those based on positive acts, and no difference in principle exists between the two.”⁶⁷ Further on this point, state responsibility may be based on a combination of state action and omission.⁶⁸

As with the 1996 version, the *Articles on State Responsibility* dodge the issue when it comes to the underlying nature of responsibility. The *Commentaries* make clear that the final version does not concern itself with subjective, or fault-based, responsibility or objective responsibility.⁶⁹ Put differently, “[s]uch standards vary from one context to another for reasons which essentially relate to the object and purpose of the treaty provision or other rule giving rise to the primary obligation.”⁷⁰ Italian jurist Dionisio Anzilotti, stressing the importance of the underlying primary rule, advanced this view decades earlier.⁷¹ While Rosenne is correct that “the concept of absolute responsibility balanced by circumstances precluding wrongfulness is now firmly implanted in international law,”⁷² this absoluteness of responsibility must be understood as such in the sense that once the primary rule at issue imposes responsibility, which can base itself on any of the diverse responsibility regimes, the state is absolutely responsible unless wrongfulness is precluded by consent, self-defence, countermeasures related to an internationally wrongful act, *force majeure*, distress, necessity, and conflict with norms of *jus cogens*.⁷³

⁶⁷ International Law Commission, *Commentaries, Articles on Responsibility of States for Internationally Wrongful Acts*, *supra* note 55, at 82. See also Crawford & Olleson, *The Nature and Forms of International Responsibility*, *supra* note 35 (stating that “[o]f course conduct attributable to a State may consist of both actions and omissions; breach of international obligations by omissions is relatively common.”).

⁶⁸ See International Law Commission, *Commentaries, Articles on Responsibility of States for Internationally Wrongful Acts*, *supra* note 55, at 82.

⁶⁹ See *ibid.* at 81–82.

⁷⁰ *Ibid.* at 82. See also Crawford & Olleson, *The Nature and Forms of International Responsibility*, *supra* note 35, at 460 (noting that “[e]verything depends on the specific context and on the content and interpretation of the obligation said to have been breached.”).

⁷¹ See García Amador, *supra* note 2, at 385 (stating that “Anzilotti himself, in a later reconsideration of his own original position, suggested that whenever there is a rule providing for State responsibility it is necessary to ascertain whether such rule, tacitly or expressly, makes its imputation dependent on the fault or *dolus* on the part of the organ, or, on the contrary, points only to the existence of a fact objectively contrary to international law. To him, in most cases international law does not make the *animus* of the organ a condition of responsibility.”).

⁷² Rosenne, *supra* note 40, at 368.

⁷³ On these, see International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts*, *supra* note 41, at 65–66, arts. 20–26.

Despite the silence of the *Articles on State Responsibility* on the underlying regime of responsibility, it is possible to make some general observations. Crawford and Olleson assert that affirmative state action tends to attract objective responsibility, while a state's failure to act, or omission, typically triggers subjective responsibility.⁷⁴ This view was also advanced decades earlier by García Amador, despite his acknowledgement of a lack of overall clarity on the issue:

For instance, in cases of omissions relating to acts of private individuals, the subjective element is so closely linked to the wrong imputable to the organ or official that, if it would not exist, no imputation could be made. In this sense, malicious or culpable negligence constitutes by itself the wrongful omission. On the other hand, in cases of positive acts and even of some omissions which originate the direct responsibility of the State, the subjective elements (*culpa* or *dolus*) that might be found behind the conduct of the organ or official play, if any, a very small rôle; that is to say, fall into the background.⁷⁵

As a general rule, then, affirmative state action and a state's failure to act, or omission, tend to attract different principles of responsibility.

4. State Responsibility, Non-State Actors, and the Due Diligence Principle

Accepting, as one must, that certain primary rules impose a due diligence standard on state conduct, it is useful to examine arbitral decisions, international environmental law,⁷⁶ decisions of the ICJ,⁷⁷ diplomatic correspondence,⁷⁸ and other activity during the last century to understand exactly what is expected of states with regard to the activities

⁷⁴ See Crawford & Olleson, *The Nature and Forms of International Responsibility*, *supra* note 35, at 460. On a state's omission and due diligence, see Blomeyer-Bartenstein, *supra* note 32, at 140.

⁷⁵ García Amador, *supra* note 2, at 388 (continuing by noting that "[t]his second submission is made without prejudice to those acts or omissions involving the violation of a rule which, expressly or tacitly, makes responsibility dependent on *culpa* or on any other subjective element. Further submissions, if not made in these general and flexible terms, could fail to reflect actual realities.").

⁷⁶ The role played by due diligence within the corporate context with emphasis on environmental factors is not explored in this article. On this, however, see Carsten Corino, *Environmental Due Diligence*, 9(4) EUR. ENVTL. L. REV. 120 (2000).

⁷⁷ For general overviews of state responsibility and the ICJ, see Brownlie, *State Responsibility and the International Court of Justice*, *supra* note 29; Rosalyn Higgins, *Issues of State Responsibility Before the International Court of Justice*, in ISSUES OF STATE RESPONSIBILITY BEFORE INTERNATIONAL JUDICIAL INSTITUTIONS 1 (Malgosia Fitzmaurice & Dan Sarooshi eds., 2004). Brownlie argues that, "[w]hilst courts of arbitration may make a contribution, it is the [International] Court [of Justice] which, as a mainstream interpreter of general international law, has produced the most important decisions on State responsibility." Brownlie, *State Responsibility and the International Court of Justice*, *supra* note 29, at 11.

⁷⁸ Fitzmaurice fleshes out the importance of diplomatic correspondence to international law. According to him, "if State practice [. . .] is a source of law, it would be incorrect to regard such things as documents embodying diplomatic representations, notes of protest, etc., as constituting sources of law. They are evidences of it because they demonstrate certain attitudes on the part of States, but it is the State practice so evidenced which is the source of law." Gerald G. Fitzmaurice, *Some Problems Regarding the Formal Sources of International Law*, in SYMBOLAE VERZIJL: PRÉSENTÉES AU PROFESSEUR J. H. W. VERZIJL À L'OCCASION DE SON LXX-IÈME ANNIVERSAIRE 153, 153 (1958).

of non-state actors.⁷⁹ That this examination explores disparate areas of the law in different fora does not preclude the drawing of conclusions.⁸⁰

It makes most sense to approach this from the standpoint of *lex posterior derogat priori* because a chronological approach reveals the evolution of these obligations and provides the proper context. To that end, this section examines arbitral decisions in the early twentieth century dealing with the duty to protect and apprehend and punish and state action or omission in the context of insurrectional movements, activity during the Second World War and during the post-war era, movement during the Cold War, and activity at the end of the Cold War and more recently. The due diligence principle having been accepted in theory, it remains to flesh out the contents of this well-established principle of international law.

4.1 *The Beginning of a New Century: Arbitral Decisions in the Early Twentieth Century*

It is useful to examine arbitral decisions in the early twentieth century to understand exactly what kind of behaviour international law demands of states with regard to the activities of non-state actors. The arbitral decisions relevant for present purposes base themselves in agreed-upon treaty frameworks between states. Classically, the arbitral decisions on this subject deal with the law of diplomatic protection and state action or omission in contexts in which non-state actors inflict harm upon foreign nationals.⁸¹

4.1.1 *The Duty to Protect and Apprehend and Punish*

Although state responsibility will generally not arise when non-state actors commit wrongs against foreign nationals, it will be triggered “if the state can be shown to have connived at or failed to take adequate measures to prevent injuries to foreigners, or if, after the event, the foreign authorities fail to make an adequate attempt to provide justice.”⁸² Brownlie cites the *Janes*,⁸³ *Youmans*,⁸⁴ and *Massey*⁸⁵ claims before the United

⁷⁹ For a helpful digest prepared by the United Nations Secretariat of international tribunals’ decisions relating to various aspects of state responsibility that was compiled in the early 1960s, see *Digest of the Decisions of International Tribunals Relating to State Responsibility, Prepared By the Secretariat*, U.N. Doc. A/CN.4/169 (1964), in 2 Y.B. Int’l L. Comm’n 132, U.N. Doc. A/CN.4/SER.A/1964/ADD.1 (1964).

⁸⁰ See Andrea Bianchi, *Enforcing International Law Norms Against Terrorism: Achievements and Prospects*, in ENFORCING INTERNATIONAL LAW NORMS AGAINST TERRORISM 491, 505 (Andrea Bianchi ed., 2004) (arguing that “[t]he availability of numerous multilateral fora in which States may assert their claims and express themselves makes the task of establishing general *opinio juris* less burdensome than in the past and provides evidence of emerging trends in State practice.”).

⁸¹ On the conduct of insurrectional movements and other movements, see International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts*, *supra* note 41, at 62, art. 10.

⁸² HILLIER, *supra* note 15, at 355. For a similar point of view, see G.A. Res. 60/147, U.N. GAOR, Annex, at 5, U.N. Doc. A/RES/60/147 (2005) (stating that, “[i]n cases of gross violations of international human rights law and serious violations of international humanitarian law constituting crimes under international law, States have the duty to investigate and, if there is sufficient evidence, the duty to submit to prosecution the person allegedly responsible for the violations and, if found guilty, the duty to punish her or him.”).

⁸³ *Janes* (U.S. v. Mex.), 4 R.I.A.A. 82 (1926).

⁸⁴ *Youmans* (U.S. v. Mex.), 4 R.I.A.A. 110 (1926).

⁸⁵ *Massey* (U.S. v. Mex.), 4 R.I.A.A. 155 (1927).

States/Mexico General Claims Commission established in the early-1920s (General Claims Commission) as representative of the rule that a state must act with due diligence in carrying out its duties to protect and apprehend and punish when non-state actors commit injuries against foreign nationals.⁸⁶

Before proceeding further, it should be stressed that the General Claims Commission's jurisdiction and ability to maneuver were restricted by and necessarily had to operate within the parameters established by the 1923 General Claims Convention signed by the United States and Mexico.⁸⁷ According to Article 1 of that treaty, relevant claims were to be decided by a "Commission consisting of three members for decision in accordance with the principles of international law, justice and equity."⁸⁸

The *Janes* claim "may be considered as the prototype of over forty [sic] claims of its kind presented to the commission, all based on the failure of Mexican authorities, to prosecute, apprehend, condemn or punish effectively the murderers of American citizens killed in Mexico."⁸⁹ In that arbitral decision, the General Claims Commission addressed states' obligations under international law to apprehend those who commit wrongs against foreign nationals and provided a theoretical framework for distinguishing between damages caused by non-state actors and damages caused by states.

The foreign national in *Janes*, American Byron Everett Janes, managed a mining company in Mexico, and Pedro Carbajal, a Mexican, had worked for the same company.⁹⁰ During the summer of 1918, Carbajal shot Janes twice, killing him.⁹¹ The local police, although informed of the shooting within minutes, delayed for approximately one half hour before searching for Carbajal, who had fled up a canyon.⁹² This search ended in failure, as did a similar search the next day.⁹³ Evidence suggested that Carbajal had hid in a nearby ranch for a week and that he had actually returned to El Tigre, the town of the shooting, twice during the same week.⁹⁴ Mexican authorities failed to follow up on a lead that Carbajal was seventy-five miles away from El Tigre until the mining company offered a reward for Carbajal's capture, and when they did finally search for Carbajal, he could not be found.⁹⁵

The General Claims Commission found that "there was clearly such a failure on the part of the Mexican authorities to take prompt and efficient action to apprehend the slayer as to warrant an award of indemnity."⁹⁶ Thus, it found that Mexico had breached its obligation to apprehend those who commit wrongs against foreign nationals.

⁸⁶ See IAN BROWNLIE, *SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY (PART I)* 161 (1983). For an overview of the General Claims Commission, see JACOBUS GUSBERTUS DE BEUS, *THE JURISPRUDENCE OF THE GENERAL CLAIMS COMMISSION, UNITED STATES AND MEXICO UNDER THE CONVENTION OF SEPTEMBER 8, 1923 1-9* (1938).

⁸⁷ See DE BEUS, *supra* note 86, at 10.

⁸⁸ *Ibid.*

⁸⁹ *Ibid.* at 159.

⁹⁰ See *Janes*, *supra* note 83, at 83-84.

⁹¹ See *ibid.* at 84.

⁹² See *ibid.*

⁹³ See *ibid.*

⁹⁴ See *ibid.* at 85.

⁹⁵ See *ibid.*

⁹⁶ *Ibid.*

According to the General Claims Commission, Mexico's responsibility rested on its failure to "take proper steps to apprehend and punish the slayer."⁹⁷ The "proper steps" language here is the equivalent of a due diligence obligation. Crawford and Olleson cite *Janes* for the proposition that "[p]urely private acts will not engage the State's responsibility, although the State may in certain circumstances be liable for its failure to prevent those acts, or to take action to punish the individuals responsible."⁹⁸

In *Janes*, the General Claims Commission provided a theoretical framework for distinguishing between damages caused by non-state actors and damages caused by states.⁹⁹ One view, which might be termed the "presumed complicity"¹⁰⁰ theory of state responsibility, asserts that a state can be held responsible in cases of serious failure of diligence in apprehension, punishment, or both as a matter of "derivative liability, assuming the character of some kind of complicity with the perpetrator himself and rendering the State responsible for the very consequences of the individual's misdemeanor."¹⁰¹ The General Claims Commission acknowledged that this view may apply where the state has knowledge of an intended injury and could have prevented it but failed to do so.¹⁰²

The General Claims Commission, however, rejected the "presumed complicity" theory of state responsibility and adopted the view, which might be termed the "nonrepression"¹⁰³ theory of state responsibility, which distinguishes between the injury caused by the non-state actor and the injury caused by the state.¹⁰⁴ Unlike the "presumed complicity" theory, the "nonrepression" theory explicitly acknowledges separate injuries and apportions them appropriately between the non-state actor and the state.¹⁰⁵ Applying the "nonrepression" theory of state responsibility to *Janes*, the General Claims Commission concluded that "[t]he damage caused by the culprit is the damage caused to Janes' relatives by Janes' death; the damage caused by the Government's negligence is the damage resulting from the non-punishment of the murderer."¹⁰⁶

Acknowledging the distinct nature of the injury caused by the non-state actor and by the state when measuring damages forms the basis of the modern rule.¹⁰⁷ According

⁹⁷ *Ibid.* at 86.

⁹⁸ Crawford & Olleson, *The Nature and Forms of International Responsibility*, *supra* note 35, at 455.

⁹⁹ On this distinction generally, see García Amador, *supra* note 2, at 401–05 (exploring "direct" state responsibility, "vicarious" state responsibility, and "indirect" state responsibility).

¹⁰⁰ *Janes*, *supra* note 83, at 87.

¹⁰¹ *Ibid.* at 86.

¹⁰² *See ibid.* at 87.

¹⁰³ *Ibid.*

¹⁰⁴ *See ibid.* For a useful visual sketch of this theory of state responsibility, see DE BEUS, *supra* note 86, at 165–66.

¹⁰⁵ *See* Wolfrum, *supra* note 54, at 275 (arguing that the state is "responsible only for the act or omission of its organs where they are guilty of not having done everything within their power to prevent the injurious act of the private individual or to punish if it has occurred. The State is responsible for having breached not the international obligation with which the individual's act might be in conflict, but the general or special obligation imposed on its organs to provide for protection.").

¹⁰⁶ *Janes*, *supra* note 83, at 87.

¹⁰⁷ On acknowledging the distinct nature of the injury caused by the non-state actor and by the state, see CASSESE, *supra* note 7, at 250 (stating that, "in the case of violence and other unlawful acts against foreigners,

to United Nations Special Rapporteur on the Prevention of Human Rights Violations Committed with Small Arms and Light Weapons Barbara A. Frey, “under a due diligence standard, it is the omission on the part of the state, not the injurious act by the private actor, for which the state may be responsible.”¹⁰⁸

In the *Youmans* claim, the General Claims Commission explored the issue of state responsibility for failure to act with due diligence in the context of a mob uprising against foreign nationals in Mexico. The incident arose out of a labour dispute between American John A. Connelly, Managing Engineer of the San Hilario Tunnel construction project in Mexico, and local labourer Cayetano Medina.¹⁰⁹ Medina, angered over a dispute that had not been settled to his liking, threw stones at Connelly and threatened him with a machete.¹¹⁰ Connelly responded by firing a warning shot in Medina’s direction and after Medina persisted shot his legs.¹¹¹ A mob of approximately one thousand people soon converged on Connelly’s house, where Connelly and two other Americans, Henry Youmans and Justin Arnold, found themselves trapped.¹¹² The local mayor attempted to restore order but could not, and when Mexican soldiers arrived to defuse the situation, they shot at the house and killed Arnold.¹¹³ The soldiers and the mob then proceeded to kill Connelly and Youmans, and “[t]heir bodies were dragged through the streets and left under a pile of stones by the side of the road so mutilated as scarcely to be recognizable.”¹¹⁴ The central issue that the General Claims Commission faced was “the failure of the Mexican Government to exercise due diligence to protect [. . . Youmans] from the fury of the mob at whose hands he was killed, and the failure to take proper steps looking to the apprehension and punishment of the persons implicated in the crime.”¹¹⁵

In concluding that Mexico bore responsibility, the General Claims Commission found that the state had acted negligently with regard to its duty to protect Connelly, Youmans, and Arnold and that it had violated its obligation to apprehend and punish

the State is not responsible for the acts of the individuals; it is accountable only if its own ‘conduct by omission’ may be proved, that is it failed to act in conformity with international legal standards.”). *See also* Gilbert Guillaume, *Terrorism and International Law*, 53(3) INT’L & COMP. L.Q. 537, 544 (2004) (asserting that, “[a]ccording to the case law which has thus developed, a careful distinction should be drawn between those acts which are imputable to the individual perpetrators and those acts or omissions for which public authorities are responsible.”); Giuseppe Sperduti, *Responsibility of States for Activities of Private Law Persons*, in 10 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 373, 374 (1987) (noting that, in denial of justice cases, “[t]he State is called upon to answer for an injury that it has itself caused, be this a moral damage which has been inflicted by disregarding the lawful expectation of having the offender punished, or be it an injury arising from a person having been prevented from obtaining from a court a remedy for the damage suffered, as assessable in economic terms.”).

¹⁰⁸ Frey, *supra* note 38, at 42. This resembles Reinisch’s concept of “vicarious state responsibility for non-state acts.” August Reinisch, *The Changing International Legal Framework for Dealing with Non-State Actors*, in NON-STATE ACTORS AND HUMAN RIGHTS 37, 79 (Philip Alston ed., 2005).

¹⁰⁹ *See Youmans*, *supra* note 84, at 111.

¹¹⁰ *See ibid.*

¹¹¹ *See ibid.*

¹¹² *See ibid.*

¹¹³ *See ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.* at 114.

for failure to make “proper efforts.”¹¹⁶ Mexico’s knowledge of the unrest at Connelly’s house, combined with the affirmative action that it took to protect Connelly, Youmans, and Arnold, namely Mexico’s unsuccessful attempt by the mayor to restore order and its decision to dispatch Mexican soldiers to the scene, evidenced the state’s acknowledgement of a duty to protect.¹¹⁷ While a state does not bear responsibility for the actions of non-state actors when it acts with due diligence, that Mexico had knowledge and had taken affirmative action, albeit action that was woefully inadequate under the particular facts and circumstances, likely figured into the General Claims Commission’s calculus in reaching a finding of state responsibility.

The General Claims Commission in *Youmans* also found that Mexico had breached its duty to apprehend and punish those responsible for killing the three Americans. Once order had been restored, Mexico arrested eighteen people, but some of these were freed on minimal bail.¹¹⁸ Those who received capital sentences had their sentences reduced.¹¹⁹ Due to failures in the Mexican criminal justice system, all of those who had received capital sentences and had had them reduced, except for one who had died, fled the jurisdiction, and charges against six others were dropped.¹²⁰ Given that a mob of approximately one thousand people had converged on Connelly’s house, the inability of Mexico to hold anyone accountable for the killings demonstrated a breach of the state’s due diligence obligation to apprehend and punish those who commit criminal offences against foreign nationals.

Less than a year after *Youmans*, the General Claims Commission again addressed the contours of the “rule of international law which requires a government to take proper measures to apprehend and punish nationals who have committed wrongs against aliens.”¹²¹ Joaquín R. Saenz, a Mexican, had shot his American boss, William B. Massey, six times, resulting in his death.¹²² Mexican authorities jailed Saenz after he had killed Massey and fled for a brief time.¹²³ However, with the permission of a prison guard, Saenz simply left jail one evening, never to return.¹²⁴

The General Claims Commission found that the United States had successfully made its case for denial of justice.¹²⁵ According to it, “[t]here is no proper arrest and there can be no prosecution in the case of a man who is permitted by police authorities to leave prison.”¹²⁶ The General Claims Commission cited correspondence between American diplomats in early 1904 in language that summarizes the legal rule reinforced in *Massey*:

¹¹⁶ *Ibid.* at 112.

¹¹⁷ On *ultra vires* acts of state and state responsibility, see Noble, *supra* note 64, at 74.

¹¹⁸ See *Youmans*, *supra* note 84, at 112.

¹¹⁹ See *ibid.*

¹²⁰ See *ibid.*

¹²¹ Massey, *supra* note 85, at 156.

¹²² See *ibid.*

¹²³ See *ibid.*

¹²⁴ See *ibid.* at 160–61.

¹²⁵ See *ibid.* at 162; *ibid.* at 164.

¹²⁶ *Ibid.* at 160.

“While a State is not ordinarily responsible for injuries done by private individuals to other private individuals in its territory, it is the duty of the State to diligently prosecute and properly punish such offenders, and for its refusal to do so it may be held answerable in pecuniary damages.”¹²⁷

It was for its failure to “diligently prosecute and properly punish” Saenz that the General Claims Commission held Mexico responsible.

Summing up the due diligence principle as it applies in the context of the duty to prevent injury to foreign nationals by non-state actors and the duty to punish those responsible for causing such injury, one may make certain conclusions.¹²⁸ The first duty, the duty to prevent injury to foreign nationals by non-state actors, contains two parts, namely the duty to permanently have “a legal and administrative apparatus normally able to guarantee respect for the international norm on prevention”¹²⁹ and the duty to employ this state apparatus “with the diligence that the circumstances require.”¹³⁰ Only the second part of this duty of protection is governed by the due diligence rule.¹³¹ The Inter-American Court of Human Rights’ description of the investigation duty, which requires a serious undertaking that is “not [done] as a mere formality preordained to be ineffective [. . . but, rather, with] an objective [. . . that is] assumed by the State as its own legal duty,”¹³² applies in this context.

4.1.2 *State Action or Omission in the Context of Insurrectional Movements*

Insurrectional movements fundamentally challenge the viability of regimes and may require that a state dedicate its entire apparatus to maintain its hold on power. Given the seriousness of the situation, international law extends a degree of deference to the state and presumes that it will not be held responsible for actions with regard to the insurrection.¹³³ The underlying idea is that, “even in a regime of objective responsibility, there must exist a normal capacity to act, and a major internal upheaval is tantamount to *force majeure*.”¹³⁴

In the 1903 *Sambiaggio* decision,¹³⁵ the Italy-Venezuela Mixed Claims Commission (Mixed Claims Commission)¹³⁶ addressed the question whether Venezuela bore responsibility for injury inflicted by revolutionaries on Salvatore Sambiaggio, an Italian national living in Venezuela.¹³⁷ According to the Mixed Claims Commission, revolutionaries commanded by Colonel Guevara coerced Sambiaggio to give them advances of money and took property from him and caused damage.¹³⁸

¹²⁷ *Ibid.* at 159.

¹²⁸ See Pisillo Mazzeschi, *The Due Diligence Rule and the Nature of the International Responsibility of States*, *supra* note 16, at 25–30.

¹²⁹ *Ibid.* at 26.

¹³⁰ *Ibid.*

¹³¹ See *ibid.* at 27.

¹³² Velásquez Rodríguez, Ser. C, Case No. 4, Inter-Am. Ct.H.R. 1988, para. 177.

¹³³ See BROWNIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW*, *supra* note 8, at 437.

¹³⁴ *Ibid.*

¹³⁵ *Sambiaggio (Italy v. Venez.)*, 10 R.I.A.A. 499 (1903).

¹³⁶ For the historical and legal background, see 9 R.I.A.A. 99–110; 10 R.I.A.A. 477–84.

¹³⁷ See *Sambiaggio*, *supra* note 135, at 512.

¹³⁸ See *ibid.*

Italy, basing its argument on factual considerations, equitable principles, a bilateral treaty with Venezuela and its relevant protocols, general international law principles, relevant arbitral decisions, and special legislation,¹³⁹ asserted that Venezuela bore responsibility for Sambiaggio's injury even though Guevara's revolutionaries were the perpetrators.¹⁴⁰ Venezuela argued that, as a general rule, a state could only be held responsible for the illegal acts of state actors, not for the illegal acts of revolutionaries.¹⁴¹ However, Venezuela did acknowledge that a state could bear responsibility when, in case of revolution, "it had been negligent in the protection of individuals: but in such case the responsibility would arise from the fact that the government, by its conduct, had laid itself open to the charge of complicity in the injury."¹⁴²

Venezuela wisely noted that a commission such as the one deciding *Sambiaggio* operates within a particular context and under particular facts and circumstances and that it "gives its decision in each case and with especial reference to all its circumstances."¹⁴³ Since such commissions generally decide claims within a particular treaty context, claims' usefulness outside the particular treaty regime at issue is often limited to the extent that they accurately reveal the state of international law generally. Thus, *Sambiaggio's* relevance lies in its clarification of international law as it relates to potential state responsibility in the context of revolutionary non-state actors who cause injury to foreign nationals.

In finding that Venezuela did not bear responsibility for Sambiaggio's damage on the basis of the equitable application of the "well-established principles of justice, not permitting sympathy for suffering to bring about a disregard for law,"¹⁴⁴ the Mixed Claims Commission looked at the issue from the "standpoint of abstract rights,"¹⁴⁵ relevant decisions made by commissions and courts, and scholarly commentary.¹⁴⁶ The Mixed Claims Commission noted the general rule of international law that a state can only bear responsibility for the acts of its organs or when the state expressly assumes responsibility.¹⁴⁷ A state cannot be held responsible for the actions of revolutionary non-state actors "unless it clearly appear[s] that the government has failed to use promptly and with appropriate force its constituted authority."¹⁴⁸

As applied to *Sambiaggio*, the reality that "for six months previous to the taking complained of in the present case a bloody and determined revolution demanding the entire resources of the Government to quell it had been raging throughout the larger part of Venezuela"¹⁴⁹ protected Venezuela from responsibility for Sambiaggio's

¹³⁹ See *ibid.* at 501.

¹⁴⁰ See *ibid.* at 500–01.

¹⁴¹ See *ibid.* at 507.

¹⁴² *Ibid.*

¹⁴³ *Ibid.* at 508.

¹⁴⁴ *Ibid.* at 524.

¹⁴⁵ *Ibid.* at 512 (stating "[l]et us treat the matter first from the standpoint of abstract right, reserving examination of precedents, the treaties between the two countries, and the question whether there be anything to exempt Venezuela from the operation of such general rule as may be found to exist.").

¹⁴⁶ See *ibid.* at 512–17.

¹⁴⁷ See *ibid.* at 512.

¹⁴⁸ *Ibid.* at 513.

¹⁴⁹ *Ibid.*

damage.¹⁵⁰ In its examination of relevant decisions made by commissions and courts, the Mixed Claims Commission cited numerous cases in which states were not held responsible for damage caused to individuals by revolutionaries.¹⁵¹ The examined scholarly commentary supported the general rule of states' non-responsibility for damage under such facts and circumstances.¹⁵²

The Mixed Claims Commission seemed to have agreed with Venezuela's argument that potential state responsibility in the context of revolutionary non-state actors could only be assessed "in proportion to [. . . the state's] ability to avoid an evil."¹⁵³ In such a context, Venezuela contended that a state only needed to afford security and protection "in so far as is permitted by the means at its disposal and according as the circumstances may be verified."¹⁵⁴

Sambiaggio's main contribution lies in its reaffirmation that the general notion that states "should be held responsible for the acts of revolutionists [. . . is] in derogation of the general principles of international law."¹⁵⁵ While the Mixed Claims Commission clearly deferred to Venezuela because the state had been involved in an intense assault on the revolutionaries at the time that they inflicted injury on *Sambiaggio*, it acknowledged, in principle, that Venezuela could have been held responsible had it not acted with due diligence.¹⁵⁶

4.2 *The Second World War and the Post-War Dispensation*

One of the most important arbitral decisions within the context of environmental law, *Trail Smelter*,¹⁵⁷ was decided during the middle of the Second World War. It has contributed greatly to international law as relates not only to the law of state responsibility for transboundary harm to the environment, which the ICJ has stated "represents the living space, the quality of life and the very health of human beings, including generations unborn,"¹⁵⁸ but also, and perhaps more importantly, to the law of state responsibility for transboundary harm generally.¹⁵⁹

¹⁵⁰ See *ibid.*

¹⁵¹ See *ibid.* at 513–15.

¹⁵² See *ibid.* at 515–17. The Mixed Claims Commission, for example, cited Wharton's Digest of International Law, at section 223's headnotes, for the principle that "[a] sovereign is not ordinarily responsible to alien residents for injuries they receive on his territory from belligerent action, or from insurgents whom he could not control or whom the claimant government had recognized as belligerents." *Ibid.* at 515.

¹⁵³ *Ibid.* at 509.

¹⁵⁴ *Ibid.* at 510.

¹⁵⁵ *Ibid.* at 521.

¹⁵⁶ See *ibid.* at 524. On the prosecution obligation and the due diligence principle in the context of injuries caused by armed opposition groups, see LIESBETH ZEGVELD, ACCOUNTABILITY OF ARMED OPPOSITION GROUPS IN INTERNATIONAL LAW 201–04 (2002).

¹⁵⁷ *Trail Smelter Arbitral Tribunal, Decision*, Reported on March 11, 1941, to the Government of the United States of America and to the Government of the Dominion of Canada, Under the Convention Signed April 15, 1935, 35 AM. J. INT'L L. 684 (1941).

¹⁵⁸ *Legality of the Threat or Use of Nuclear Weapons (Advisory Opinion)*, 1996 I.C.J. 226, 241.

¹⁵⁹ See Luke T. Lee, *The Right to Compensation: Refugees and Countries of Asylum*, 80(3) AM. J. INT'L L. 532, 554 n.92 (1986) (noting that "[i]t has been pointed out that 'to compare the flow of refugees with the flow of, for example, noxious fumes may appear invidious; the basic issue, however, is the

While the controversy could be succinctly summarized as alleged transboundary environmental harm caused by a non-state actor in Canada to the territory of the United States,¹⁶⁰ it is helpful to provide a bit more detail. As the name of the arbitral decision suggests, the dispute involved a smelter of lead and zinc in Trail, British Columbia.¹⁶¹ The smelter significantly expanded, so much so that it became “one of the best and largest equipped smelting plants on the American continent.”¹⁶² With the expansion of the Trail Smelter came increased sulphur dioxide fumes and a higher concentration of them being released into the air.¹⁶³ According to the *ad hoc* arbitral Tribunal, these increased levels of released sulphur dioxide caused damage for at least ten years.¹⁶⁴ While it is unnecessary to unduly focus on statistics for present purposes, suffice it to say that the amount of sulphur released from the Trail Smelter was significant, with about 10,000 tons being released monthly in 1930 and a rise from a decade-low 3,250 tons being released monthly in 1939 to 3,875 tons being released monthly in 1940.¹⁶⁵

After having determined that the Trail Smelter had caused transboundary environmental damage for a number of years since early 1932,¹⁶⁶ the Tribunal explored whether, pursuant to Article III of the relevant treaty in force, the Trail Smelter should be estopped from causing further transboundary environmental harm in future and, if so, the extent to which it should be so estopped.¹⁶⁷

The Tribunal began by stating the general rule that “[a] State owes at all times a duty to protect other States against injurious acts by individuals from within its jurisdiction.”¹⁶⁸ Neither the United States nor Canada disputed this general rule, although its content and application to particular facts and circumstances were at the core of the dispute, thus exposing difficulties in applying the rule to concrete cases.¹⁶⁹ Indeed, the Tribunal itself noted “the relativity of the rule.”¹⁷⁰

Because the Tribunal faced the reality that international tribunals to date had not reached decisions on facts and circumstances of either transboundary air pollution or transboundary water pollution,¹⁷¹ it examined by analogy decisions reached by the

responsibility which derives from the fact of control over territory.’ See G. GOODWIN-GILL, *THE REFUGEE IN INTERNATIONAL LAW* 228 n.49 (1983). Thus, it has been held that the *Trail Smelter* rule extends beyond ecological/pollution damage to any damage to other states. Garvey, *TOWARD A REFORMULATION OF INTERNATIONAL REFUGEE LAW*, 26 HARV. INT’L L.J. 483, 495 (1985).” But see Kevin J. Madders, *Trail Smelter Arbitration*, in 2 *ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW* 276, 279–80 (1981) (challenging the precedential value of the case); Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 29 (stating that, “[i]n spite of the fact that it is so well known, the *Trail Smelter* case is not really very significant, since in the compromise between the US and Canada the question of Canada’s responsibility had already been resolved affirmatively.”).

¹⁶⁰ See *Trail Smelter*, *supra* note 157, at 685.

¹⁶¹ See *ibid.* at 688.

¹⁶² *Ibid.* at 692.

¹⁶³ See *ibid.*

¹⁶⁴ See *ibid.* at 693.

¹⁶⁵ See *ibid.* at 695.

¹⁶⁶ See *ibid.* at 696–712.

¹⁶⁷ See *ibid.* at 712.

¹⁶⁸ *Ibid.* at 713.

¹⁶⁹ See *ibid.* at 713–14.

¹⁷⁰ *Ibid.* at 714.

¹⁷¹ See *ibid.*

United States Supreme Court on transboundary air pollution and transboundary water pollution.¹⁷² The Tribunal famously concluded that

under the principles of international law, as well as of the law of the United States, no State has the right to use or permit the use of its territory in such a manner as to cause injury by fumes in or to the territory of another or the properties or persons therein, when the case is of serious consequence and the injury is established by clear and convincing evidence.¹⁷³

As a matter of international law, the Tribunal held Canada responsible for the transboundary environmental harm caused by the Trail Smelter to the territory of the United States.¹⁷⁴ While Cassese may be correct that *Trail Smelter* represents “the first time an international tribunal propounded the principle that a State may not use, or allow its nationals to use, its own territory in such a manner as to cause injury to a neighbouring country,”¹⁷⁵ the issue of states’ obligations with regard to non-state actors under the non-interference principle had already enjoyed a long pedigree at the time of the decision.¹⁷⁶

While often cited, and with good reason, the language of what might be termed the *Trail Smelter* rule begs many questions. To suggest but a few, what is a “case [. . .] of serious consequence”? When can an injury be considered to be “established by clear and convincing evidence”? With reference to which criteria are these determinations to be made? Presumably, individual states make these decisions at first instance, through a balancing of rights and interests, guided by an international law rule of reasonableness.

It is significant that the *Trail Smelter* Tribunal deliberately included the caveat “when the case is of serious consequence and the injury is established by clear and convincing evidence.” This highlights the significant nature of the injury at issue and makes clear that the *Trail Smelter* rule excludes *de minimis* injuries.¹⁷⁷ In this context,

¹⁷² See *ibid.* at 714–16.

¹⁷³ *Ibid.* at 716. For statements of a similar principle, see Legality of the Threat or Use of Nuclear Weapons, *supra* note 158, at 241–42 (stating that “[t]he existence of the general obligation of States to ensure that activities within their jurisdiction and control respect the environment of other States or of areas beyond national control is now part of the corpus of international law relating to the environment.”); Request for an Examination of the Situation in Accordance with Paragraph 63 of the Court’s Judgment of 20 December 1974 in the Nuclear Tests (N.Z. v. Fr.) Case, 1995 I.C.J. 288, 378 (Koroma, J., dissenting) (asserting that, “[u]nder contemporary international law, there is probably a duty not to cause gross or serious damage which can reasonably be avoided, together with a duty not to permit the escape of dangerous substances.”); P. W. BIRNIE & A. E. BOYLE, *INTERNATIONAL LAW AND THE ENVIRONMENT* 265 (2d ed. 2002) (stating that “[i]f states are responsible for their failure to control soldiers and judges abroad, they may likewise be held responsible for their failure to control transboundary pollution and environmental harm caused by activities within their own territory.”).

¹⁷⁴ See *Trail Smelter*, *supra* note 157, at 716–17.

¹⁷⁵ CASSESE, *supra* note 7, at 484. Cassese notes that “[l]egally the issue was not viewed as different from damage caused to private or public property, for instance by the inadvertent penetration of a foreign State’s territory by armed forces.” *Ibid.*

¹⁷⁶ See, e.g., R. Y. Jennings, *The Caroline and McLeod Cases*, 32 AM. J. INT’L L. 82 (1938). On the *Caroline* case, see Bianchi, *supra* note 80, at 506–07.

¹⁷⁷ Highlighting the significant nature of the injury contemplated by the *Trail Smelter* rule, the Tribunal made clear to state that the “damage herein referred to and its extent [. . . must be] such as would be

Koskenniemi stresses that transboundary pollution cases raise issues that require the balancing of contrasting liberties.¹⁷⁸

It is also necessary to understand which of the four main principles of responsibility, subjective and objective responsibility for a wrongful act and liability without a wrongful act, are implicated by the *Trail Smelter* rule. While Pisillo Mazzeschi argues that the rule stands for a form of subjective or objective responsibility for a wrongful act but insist that the rule is confusing as to which exact form of responsibility applies,¹⁷⁹ the established law is that the *Trail Smelter* rule grounds itself in strict liability.¹⁸⁰ Certainly, the rule's plain meaning, with no mention of, for example, an examination into the reasonableness of a state's actions or omissions with regard to transboundary harm to the environment, supports a regime of responsibility based other than on fault.

Even though *Trail Smelter* speaks to a regime of responsibility based other than on fault, it is vitally important in understanding the relationship between the law of state responsibility and transboundary harm. International law frowns on transboundary harm and seeks to construct rules to minimize it or, if possible, to eliminate it altogether.¹⁸¹ As the ICJ has stated, "[t]he existence of the general obligation of States to ensure that activities within their jurisdiction and control respect the environment of other States or of areas beyond national control is now part of the corpus of international law relating to the environment."¹⁸² That the *Trail Smelter* rule supports a regime of responsibility based other than on fault does not detract from this general rule, nor does it make it any less applicable or relevant when the particular facts and circumstances present a regime of responsibility based on fault.¹⁸³

recoverable under the decisions of the courts of the United States in suits between private individuals." *Trail Smelter*, *supra* note 157, at 717. It is likely that the Tribunal was influenced by the International Joint Commission's definition of "damage" that excluded "occasional damage that may be caused by SO₂ fumes being carried across the international boundary in air pockets or by reason of unusual atmospheric conditions," as far, at least, as the duty of the Smelter to reduce the presence of that gas in the air was concerned." *Ibid.* at 713.

¹⁷⁸ See Martti Koskenniemi, *The Politics of International Law*, 1(1–2) EUR. J. INT'L L. 4, 19 (1990).

¹⁷⁹ See Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 29–30.

¹⁸⁰ See Thomas W. Merrill, *Golden Rules for Transboundary Pollution*, 46(5) DUKE L.J. 931, 950–51 (1997). *But see* Gunther Handl, *State Liability for Accidental Transnational Environmental Damage by Private Persons*, 74(3) AM. J. INT'L L. 525, 537 (1980).

¹⁸¹ See International Law Commission, *Articles on Prevention of Transboundary Harm from Hazardous Activities*, in REPORT OF THE INTERNATIONAL LAW COMMISSION ON THE WORK OF ITS FIFTY-THIRD SESSION 370, 372, art. 3, U.N. Doc. A/56/10 Supp. No. 10 (2001).

¹⁸² Legality of the Threat or Use of Nuclear Weapons, *supra* note 158, at 241–42. According to the ILC, "[p]revention 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." International Law Commission, *Commentaries, Articles on Prevention of Transboundary Harm from Hazardous Activities*, in REPORT OF THE INTERNATIONAL LAW COMMISSION ON THE WORK OF ITS FIFTY-THIRD SESSION 377, 379 U.N. Doc. A/56/10 Supp. No. 10 (2001).

¹⁸³ Pisillo Mazzeschi identifies the due diligence principle as the crux of international environmental law. See Pisillo Mazzeschi, *The Due Diligence Rule and the Nature of the International Responsibility of States*, *supra* note 16, at 36–41.

Another case worth exploring during this time period involved a dispute between the United Kingdom and Albania, the *Corfu Channel* case.¹⁸⁴ As background, four British warships, the *Mauritius*, *Saumarez*, *Leander*, and *Volage*, sailed in October 1946 from Corfu north in the direction of a channel in the North Corfu Strait that had previously been swept for mines.¹⁸⁵ Despite the previous minesweeping operation, a mine near the Bay of Saranda exploded and severely damaged *Saumarez*.¹⁸⁶ A mine subsequently struck *Volage*, which had been ordered to tow *Saumarez*, and severely damaged it.¹⁸⁷

Putting the incident in context, the ICJ summarized the recent history of minesweeping operations in the North Corfu Channel. The British Navy had swept for mines in the channel during October 1944 and, having found no mines, declared the channel safe for shipping during the next month.¹⁸⁸ Negative results from further minesweeping operations in early 1945 confirmed this declaration of safety.¹⁸⁹ While the ICJ failed to indicate whether any minesweeping operations had been done between 15 May 1946, when British ships successfully sailed through the channel, and the incident in October 1946, British minesweepers did conduct minesweeping operations in the channel soon after the damage to the *Saumarez* and *Volage* and discovered a number of mines.¹⁹⁰ The ICJ summarized the established facts as follows: “[t]he two ships were mined in Albanian territorial waters in a previously swept and check-swept channel just at the place where a newly laid minefield consisting of moored contact German GY mines was discovered three weeks later.”¹⁹¹

The ICJ, per the Special Agreement between the two states, addressed whether Albania had incurred international responsibility for the explosions in its waters in October 1946 and the resulting fatalities and damage.¹⁹² It took as its starting point the three possible grounds of responsibility mentioned in the United Kingdom’s second submission, namely “that the minefield which caused the explosions was laid between May 15th, 1946, and October 22nd, 1946, by or with the connivance or knowledge of the Albanian Government.”¹⁹³ The ICJ dealt with each possible ground of responsibility in turn.

First, as to the possible ground of responsibility that the minefield had been laid by the Albanian state, the ICJ noted that the United Kingdom raised this argument only at a superficial level and did not provide evidence to substantiate its position on this point.¹⁹⁴ Further, Albania responded to the argument rather convincingly in stating that, as it did not have a navy, it would have been unable to have laid the minefield.¹⁹⁵ The ICJ easily dismissed this possible ground of responsibility.¹⁹⁶

¹⁸⁴ *Corfu Channel* (U.K. v. Alb.), 1949 I.C.J. 4.

¹⁸⁵ *See ibid.* at 12.

¹⁸⁶ *See ibid.*

¹⁸⁷ *See ibid.* at 12–13.

¹⁸⁸ *See ibid.* at 13.

¹⁸⁹ *See ibid.* at 13–14.

¹⁹⁰ *See ibid.*

¹⁹¹ *Ibid.* at 15.

¹⁹² *See ibid.* at 12. The issue of a compensation obligation was also raised. *See ibid.*

¹⁹³ *Ibid.* at 15.

¹⁹⁴ *See ibid.* at 15–16.

¹⁹⁵ *See ibid.* at 15.

¹⁹⁶ *See ibid.* at 16.

The second possible ground of responsibility, that the minefield had been laid with the connivance of the Albanian state, involved an implied theory of collusion between Albania and Yugoslavia, “consisting either of a request by the Albanian Government to the Yugoslav Government for assistance, or of acquiescence by the Albanian authorities in the laying of the mines.”¹⁹⁷ Evidence by former Lieutenant-Commander of the Yugoslav Navy Karel Kovacic alleging that he had seen mines being loaded onto two Yugoslav minesweepers in Sibenik that left around 18 October 1946 and returned shortly after 22 October 1946 fell below the standard of “decisive legal proof.”¹⁹⁸ The ICJ also rejected British arguments based on circumstantial evidence.¹⁹⁹ As it had done with the first possible ground of responsibility, the ICJ found no merit on the connivance ground of responsibility.²⁰⁰

Having rejected the first two possible grounds of responsibility put forward by the United Kingdom, the ICJ assessed whether the mines had been laid with the knowledge of Albania.²⁰¹ At the outset, it stated a rule pertaining to state knowledge of unlawful conduct that can be applied in a much wider context: “it cannot be concluded from the mere fact of the control exercised by a State over its territory and waters that that State necessarily knew, or ought to have known, of any unlawful act perpetrated therein, nor yet that it necessarily knew, or should have known, the authors.”²⁰² Knowledge cannot be attributed to a state for all unlawful acts that occur within its territory, and this extends to the unlawful acts of non-state actors. The ICJ noted, however, that the reality of “exclusive territorial control”²⁰³ meant that the complaining state could benefit from a more lenient standard of proof regarding circumstantial evidence and factual inferences.²⁰⁴ Nonetheless, a finding of knowledge requires that factual inferences leave “no room for reasonable doubt.”²⁰⁵ Of course, people may dispute whether certain factual inferences leave “no room for reasonable doubt,” but like all courts, the ICJ assesses the evidence and ultimately reaches conclusions based on its mandate.

In assessing whether the mines had been laid with Albania’s knowledge, the ICJ examined Albania’s attitude prior to and after the incident in October 1946 and explored whether it would have been feasible for it to have observed mine-laying from its coast.²⁰⁶ As to the first point, the ICJ, noting evidence demonstrating that Albania

¹⁹⁷ *Ibid.*

¹⁹⁸ *Ibid.*

¹⁹⁹ *See ibid.* at 17.

²⁰⁰ *See ibid.* at 16–17.

²⁰¹ *See ibid.* at 17–22.

²⁰² *Ibid.* at 18.

²⁰³ *Ibid.*

²⁰⁴ *See ibid.* For an application of this principle in the context of counterterrorism and human rights, see HELEN DUFFY, THE “WAR ON TERROR” AND THE FRAMEWORK OF INTERNATIONAL LAW 305 (2005) (asserting that “[l]inked to the foregoing positive obligations is the onus that lies with the state, in certain circumstances, to demonstrate that it has met those obligations, as opposed to the onus resting with the individual to prove the violation. This is particularly so where – as is not infrequently the situation in human rights cases, and all the more so in the shrouded world of counter-terrorism – the facts lie wholly, or in large part, within the exclusive knowledge of the authorities.”).

²⁰⁵ *Corfu Channel*, *supra* note 184, at 18.

²⁰⁶ *See ibid.*

closely watched the channel, occasionally would employ force in the area, and required permission for foreign vessels to sail through its territorial waters, concluded that the mines must have been laid while Albania had been closely watching the channel.²⁰⁷ The ICJ, based partly on an experts' report, also found that it was feasible for Albania to have observed mine-laying from its coast and that, given the ICJ's findings as to Albania's attitude prior to and after the incident in October 1946, the mines at issue could not have been laid without Albania's knowledge.²⁰⁸ Knowledge having been found, the ICJ held Albania internationally responsible for the explosions and the resulting fatalities and damage.²⁰⁹

The ICJ assessed Albania's conduct based on fault responsibility, or due diligence.²¹⁰ It found that Albania was under a duty to have notified the maritime community about the mines and the danger that they posed, this duty being based on "elementary considerations of humanity, even more exacting in peace than in war; the principle of the freedom of maritime communication; and every State's obligation not to allow knowingly its territory to be used for acts contrary to the rights of other States."²¹¹

Brownlie's objection, that the ICJ's decision was rooted in objective responsibility and that, "in the light of the subject matter, knowledge was [simply] the prerequisite of the legal duty of the territorial sovereign to give warning of the existence of the mines,"²¹² is correct, but only if one bears in mind Nollkaemper's contribution that inquiry into what in the criminal law would be described as the *mens rea* is in the state responsibility context "generally [. . .] either irrelevant or manifests itself in a different, objectified, form in the determination of state responsibility." The ICJ did inquire into Albania's knowledge, and this is crucial. It would not have had to do this had it only been operating within an exclusively objective responsibility regime, a regime which, by definition, does not concern itself with knowledge.

The last element forming the basis of a state's duty of notification in the *Corfu Channel* case, "every State's obligation not to allow knowingly its territory to be used for acts contrary to the rights of other States," has become one of the decision's most lasting contributions to international law, in part because, as a legal rule, it raises so many interesting issues of state responsibility. Dinstein, for example, concludes "from this general principle that a State must not permit its territory to be used as a springboard for operations of armed bands bent on sowing terror in another country."²¹³ It also raises questions of proving knowledge through control. For example, how does the more lenient standard of proof regarding circumstantial evidence and factual inferences

²⁰⁷ See *ibid.* at 18–19.

²⁰⁸ See *ibid.* at 20–22.

²⁰⁹ See *ibid.* at 23. The ICJ also found an obligation to compensate. See *ibid.*

²¹⁰ See Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 30. But see BROWNIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW*, *supra* note 8, at 427 (stating that the majority's approach "fails to correspond neatly with either the *culpa* doctrine or the test of objective responsibility."); García Amador, *supra* note 2, at 387–88 (expressing a split of authority on the role that knowledge played in the case); SHAW, *supra* note 5, at 700 (stating that the case "cannot be taken as proof of the acceptance of the fault theory.").

²¹¹ *Corfu Channel*, *supra* note 184, at 22.

²¹² Brownlie, *State Responsibility and the International Court of Justice*, *supra* note 29.

²¹³ Yoram Dinstein, *Terrorism as an International Crime*, 19 *Isr. Y.B. H.R.* 55, 66 (1989).

apply in varied contexts, such as those involving international terrorist acts committed by non-state actors? Furthermore, what exactly is meant by a “series of facts linked together and leading logically to a single conclusion,”²¹⁴ which triggers the more lenient standard of proof?

4.3 *The Cold War*

A review of arbitral decisions, international environmental law, the ICJ’s jurisprudence, and diplomatic correspondence during the Cold War also provides a perspective on the interface of state responsibility, non-state actors, and the due diligence principle. *Lake Lanoux*,²¹⁵ for example, addressed the relationship between territorial sovereignty and the rights and interests of other states and contributes to an understanding of international law on the subject.

In *Lake Lanoux*, Electricité de France’s planned diversion of water from Lake Lanoux was the central fact on the ground in the arbitration between France and Spain.²¹⁶ According to the French plan, a dam would be built at Lake Lanoux to more than triple the lake’s water capacity, and hydroelectric power would be produced from water diverted from Lake Lanoux to the River Ariège.²¹⁷ The diverted water, which had theretofore emptied into the Mediterranean Sea, would then empty into the Atlantic Ocean.²¹⁸ To ensure that Spain would not experience a decrease in water flow because of the French plan, the construction of an underground tunnel to transport an amount of water equal to the amount of water diverted would ensure that the River Carol would not experience a net decrease in water.²¹⁹ The French plan included safeguards, such as a double set of cocks as a backup mechanism, to ensure that the River Carol would not experience a net decrease in water.²²⁰

Despite France’s contention that the “complete restoration of the volume of water diverted will take place well above the head of the Puigcerda Canal and, *a fortiori*, above the Spanish frontier [. . . and that on] Spanish territory [. . .] neither the course nor the flow of the Carol will suffer the slightest change,”²²¹ Spain argued that the French plan would violate the 1866 Treaty of Bayonne and its Additional Act, signed by France and Spain, because of its adverse effect on Spanish rights and interests, or alternatively, even if the French plan would not violate the 1866 Treaty of Bayonne and its Additional Act, that Spanish consent to the French plan was required.²²² Thus, Spain argued that the French plan would violate treaty law or, in the alternative, that treaty law required Spanish consent to the French plan. France contended that Spain’s posi-

²¹⁴ Corfu Channel, *supra* note 184, at 18.

²¹⁵ *Lake Lanoux (Spain v. Fr.)*, I.L.R. 100 (1961) (1957).

²¹⁶ *See ibid.* at 107.

²¹⁷ *See ibid.* at 109.

²¹⁸ *See ibid.*

²¹⁹ *See ibid.* at 109–10.

²²⁰ *See ibid.* at 110.

²²¹ *Ibid.* at 117.

²²² *See ibid.* at 101.

tion was too rigid and that a dynamic interpretation of treaty law was required to account for modern facts and circumstances and would permit the French plan.²²³

The Arbitral Tribunal agreed with France.²²⁴ In doing so, it addressed the relationship between territorial sovereignty and the rights and interests of other states. The Arbitral Tribunal examined restrictions on France's territorial sovereignty in the Additional Act's Article 8.²²⁵ Playing as it does the part of a rebuttable presumption, territorial sovereignty, or the right of a state to do what it will within its territory,²²⁶ "must bend before all international obligations, whatever their origin, but only before such obligations."²²⁷

The Arbitral Tribunal addressed Spain's argument that treaty law required Spanish consent to the French plan. According to the Arbitral Tribunal, another state's consent as a limitation to territorial sovereignty could only be justified based on "clear and convincing evidence."²²⁸ Although the Arbitral Tribunal admitted that cases meeting this standard did exist, they were "exceptional, and international judicial decisions are slow to recognize their existence, especially when they impair the territorial sovereignty of a State, as would be the case in the present matter."²²⁹ Put differently, international law is predisposed against limiting the right of states to do what they will within their territory.²³⁰

As Lefeber has noted, despite the fact that the principle of territorial sovereignty acts as a rebuttable presumption, a state's exclusive jurisdiction within its territory is limited when the rights of another state are involved.²³¹ When the interests, something less important than rights, are involved, however, the state whose actions may affect another state "has the right to give preference to the solution contained in its own scheme provided that it takes into consideration in a reasonable manner the interests of the downstream State."²³² While transboundary environmental changes rooted in rights may require the affected state's consent, transboundary environmental changes

²²³ See *ibid.* at 114.

²²⁴ See *ibid.* at 142.

²²⁵ See *ibid.* at 119–20.

²²⁶ See *Island of Palmas*, 2 R.I.A.A. 829, 838 (1928) (defining territorial sovereignty as "[i]ndependence in regard to a portion of the globe[. . .] the right to exercise therein, to the exclusion of any other State, the functions of a State.").

²²⁷ *Lake Lanoux*, *supra* note 215, at 120.

²²⁸ *Ibid.* at 127.

²²⁹ *Ibid.*

²³⁰ *But see* Legality of the Threat or Use of Nuclear Weapons, *supra* note 158, at 505 (Weeramantry, J., dissenting) (stating that the "principle of good neighbourliness [. . .] is one of the bases of modern international law, which has seen the demise of the principle that sovereign States could pursue their own interests in splendid isolation from each other. A world order in which every sovereign State depends on the same global environment generates a mutual interdependence which can only be implemented by co-operation and good neighbourliness."); *IN LARGER FREEDOM: TOWARDS DEVELOPMENT, SECURITY AND HUMAN RIGHTS FOR ALL: REPORT OF THE SECRETARY-GENERAL, U.N. GAOR*, at 34, U.N. Doc. A/59/2005 (2005) (asserting that "even harder experience has led us to grapple with the fact that no legal principle – not even sovereignty – should ever be allowed to shield genocide, crimes against humanity and mass human suffering.").

²³¹ See RENÉ LEFEBER, *TRANSBOUNDARY ENVIRONMENTAL INTERFERENCE AND THE ORIGIN OF STATE LIABILITY* 23 (1996).

²³² *Lake Lanoux*, *supra* note 215, at 140. See LEFEBER, *supra* note 231, at 24 (noting that "the source state is not free in such cases to disregard a third state's interests altogether.").

rooted in interests do not require the affected state's consent but, rather, simply reasonable consideration of its interests.

Although the Arbitral Tribunal spent the greater part of its analysis addressing Spain's argument that the French plan would violate treaty law or, in the alternative, that treaty law required Spanish consent to the French plan, it did engage in a limited discourse that informs an understanding of the due diligence principle, particularly in the context of possible transboundary environmental harm. The French plan, according to the Arbitral Tribunal, did not "entail an abnormal risk in neighbourly relations or in the utilization of the waters,"²³³ the safeguards provided were "as satisfactory as possible,"²³⁴ and the risk of the River Carol somehow experiencing a decrease in water could be safely regarded as "only occasional."²³⁵ Pisillo Mazzeschi, commenting, concludes that *Lake Lanoux* stands for a negligence standard of responsibility for transboundary environmental harm, a standard that simply requires a state's taking of "all necessary measures to prevent transboundary damage."²³⁶

Diplomatic correspondence between states during the Cold War also contributes to an understanding of exactly what international law expects of states with regard to the activities of non-state actors. While one should place diplomatic correspondence in proper context and guard against considering it in isolation, diplomatic correspondence clarifies the rule that states can be held internationally responsible for actions or omissions with respect to non-state actors. By revealing the expectations of states on particular facts and circumstances, it reflects norms of state responsibility. Diplomatic correspondence also exposes the legal views of states, mixed with political considerations, when they face urgent, time-sensitive disputes on the ground and is an example of state practice.²³⁷

As an example of relevant diplomatic correspondence between states during the Cold War, consider the Soviet Union's lodgement of a protest note with the United States after a Soviet merchant ship filled with sugar was shelled at Caibarien, Cuba, during the night of 26–27 March 1963.²³⁸ Coming in the wake of an attack on a Soviet motorship less than two weeks earlier, the incident constituted, according to the Soviet Union, a "fresh criminal act committed by groups of Cuban counter-revolutionaries who are acting with the approval and under the protection of the American authorities."²³⁹ The Soviet complaint alleged that the United States had supplied anti-Castro

²³³ *Lake Lanoux*, *supra* note 215, at 123.

²³⁴ *Ibid.*

²³⁵ *Ibid.*

²³⁶ Pisillo Mazzeschi, *Forms of International Responsibility for Environmental Harm*, *supra* note 2, at 30. According to the ICJ, "in the field of environmental protection, vigilance and prevention are required on account of the often irreversible character of damage to the environment and of the limitations inherent in the very mechanism of reparation of this type of damage." *Gabčíkovo-Nagymaros (Hung. v. Slov.)*, 1997 I.C.J. 7, 78.

²³⁷ Dinstein defines state practice as "primarily [. . .] actual conduct (acts of commission or omission), but additionally of declarations and statements (often explaining the conduct of the acting State or challenging the conduct of another State)." YORAM DINSTEIN, *THE CONDUCT OF HOSTILITIES UNDER THE LAW OF INTERNATIONAL ARMED CONFLICT* 6 (2004).

²³⁸ See BROWNLIE, *SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY (PART I)*, *supra* note 86, at 116.

²³⁹ *Ibid.*

Cubans with ships, arms, and “other forms of support”²⁴⁰ and that these Cubans had acted with the support and knowledge of the United States.²⁴¹

At the heart of the Soviet complaint was the charge that the United States knew of the activities of the “Cuban counter-revolutionary scum”²⁴² but failed to intervene and had “not taken the necessary measures to prevent similar dangerous provocations.”²⁴³ Although the Soviet Union’s protest note partly alleged American collusion with the anti-Castro Cubans, it also asserted that the United States had not acted reasonably in controlling the anti-Castro Cubans and by failing to take “effective measures”²⁴⁴ to thwart such “gangster attack[s].”²⁴⁵ According to the Soviet Union, the United States bore responsibility because its alleged acts and omissions with respect to the anti-Castro Cubans failed to fulfil its international obligations.²⁴⁶ This protest note demonstrates that an alleged breach of the due diligence obligation can form an integral part of a claim for state responsibility.

China lodged a protest note with Indonesia in December 1965 alleging “serious outrages of persecution of overseas Chinese.”²⁴⁷ The complaint asserted a complex combination of state collusion with non-state actors and failure to control non-state actors that amounted to breaches of Indonesia’s international obligations.²⁴⁸ One incident in the protest note that involved Indonesia’s alleged failure to act with due diligence involved Chinese national Oei Tjong Kwi, who after having had his house searched and been taken into custody and interrogated was later proved innocent by presentation of an unspecified document.²⁴⁹ Under cover of police escort, “a gang of hooligans, with weapons in their hands, blocked his way, knocked him down, and then poured kerosene on him and burnt him to death.”²⁵⁰ Only a few days later, a “gang of hooligans”²⁵¹ abducted another Chinese national and his son during a curfew and murdered them.²⁵²

While the facts of the Chinese protest note suggest that the perpetrators of both crimes were non-state actors, both incidents reflect the position that a state that enters into a special relationship with an individual, such as by providing a police escort, or that imposes a curfew but, presumably, does not adequately enforce it can be held to a higher standard. That China had apparently informed Indonesia of its concerns on a number of occasions previously, imploring Indonesia to protect Chinese nationals and “urging it to put a speedy and effective stop to the persecution of Chinese nationals in

²⁴⁰ *Ibid.* at 117.

²⁴¹ *See ibid.*

²⁴² *Ibid.*

²⁴³ *Ibid.*

²⁴⁴ *Ibid.*

²⁴⁵ *Ibid.*

²⁴⁶ *See ibid.* (maintaining that “[i]t goes without saying that the entire responsibility for the consequences of the Cuban counter-revolutionaries’ piratical actions rests wholly with the United States government.”).

²⁴⁷ *Ibid.* at 100.

²⁴⁸ *See ibid.* at 100–01.

²⁴⁹ *See ibid.*

²⁵⁰ *Ibid.* at 101.

²⁵¹ *Ibid.*

²⁵² *See ibid.*

various parts of Indonesia”²⁵³ and that Indonesia had failed to provide “any effectual reply”²⁵⁴ would strengthen the case that Indonesia may have borne some degree of responsibility in the context of the crimes that had been committed against the Chinese nationals.

Another piece of diplomatic correspondence during the Cold War worth exploring is the Soviet protest of 15 April 1971 concerning what the Soviet Union perceived to be the Netherlands’ failure to fulfil its international obligations.²⁵⁵ The incident at issue, an explosion carried out by unknown individuals at the Soviet trade mission in Amsterdam during the night of 14–15 April 1971, caused significant damage to Soviet facilities and injury to staff.²⁵⁶ The Soviet Union asserted that the explosion directly resulted from the Netherlands’ failure to act with due diligence in securing the facility, as the “criminal act [. . .] could only have taken place as the result of failure [. . .] to take effective measures and ensure the security of the trade mission and create normal conditions for its work.”²⁵⁷ According to the protest note, furthermore, the Soviet Union had put the Netherlands on notice about anti-Soviet agitation in the Netherlands against Soviet interests.²⁵⁸ Evidence of such notice would, from the perspective of states’ international obligations for actions or omissions with respect to non-state actors, increase the scrutiny given to a state that would subsequently fail to act with due diligence.

Other relevant diplomatic correspondence between states during the Cold War could be cited at this juncture.²⁵⁹ The examples above, however, demonstrate that states expect other states to act reasonably and according to their international obligations when non-state actors threaten harm to the complaining state or actually harm it or its nationals abroad.

An additional source during the Cold War that provides a perspective on state responsibility, non-state actors, and the due diligence principle involves the ICJ. Islamic revolution and the Ayatollah Khomeini’s rise to power in Iran formed the backdrop to the *United States Diplomatic and Consular Staff in Tehran (Hostages)* case,²⁶⁰ another case on the ICJ’s docket that assists in understanding exactly what is expected of states with regard to the activities of non-state actors.

On 14 February 1979, an armed crowd seized the United States Embassy in Tehran (Embassy), killing two associates of the Embassy, causing serious damage to the facilities, and taking dozens hostage.²⁶¹ There is no indication in the ICJ’s recitation of facts that the members of the crowd had been in any way associated with Iran.²⁶² Iranian security forces responded to the unrest by arriving on the scene, expelling the occupiers

²⁵³ *Ibid.*

²⁵⁴ *Ibid.*

²⁵⁵ *See ibid.* at 118–19.

²⁵⁶ *See ibid.* at 118.

²⁵⁷ *Ibid.*

²⁵⁸ *See ibid.* at 118–19.

²⁵⁹ For a helpful selection of diplomatic correspondence, see *ibid.* at 90–119.

²⁶⁰ *United States Diplomatic and Consular Staff in Tehran (Hostages)* (U.S. v. Iran), 1980 I.C.J. 3.

²⁶¹ *See ibid.* at 10–11.

²⁶² *See ibid.*

of the Embassy, and transferring control back to the United States.²⁶³ A letter of early March 1979 from Iranian Prime Minister Mehdi Bazargan to the United States expressed regret at the incident, stated a desire to make reparation, and sought to assure the United States that such an incident would not occur in future.²⁶⁴ Events several months later, however, would demonstrate the utter inadequacy of Iran's response.

On 22 October 1979, the deposed Shah entered the United States for medical reasons, a turn of events that met with the strong disapproval of Iran and revolutionaries on the ground in Iran.²⁶⁵ The United States had on a number of occasions received assurances from high level Iranian officials that the Embassy would be protected and its integrity maintained, and in fact, on 1 November 1979, when around 5,000 people protested at the Embassy, Iran maintained order.²⁶⁶

The situation drastically changed, however, during the morning of 4 November 1979, when several hundred protesters stormed the Embassy.²⁶⁷ Amidst the chaos, the ICJ noted, Iranian security forces "are reported to have simply disappeared from the scene; at all events it is established that they made no apparent effort to deter or prevent the demonstrators from seizing the Embassy's premises."²⁶⁸ Hostages were taken, and despite repeated American pleas for assistance, Iran made no attempt to affect the release of the hostages or to restore order.²⁶⁹ Making matters worse for the United States, its Consulates in Shiraz and Tabriz were overrun, again without any protection from Iran.²⁷⁰

The ICJ dealt with what it described as the first phase of events, which covered the "armed attack on the United States Embassy by militants on 4 November 1979, the overrunning of its premises, the seizure of its inmates as hostages, the appropriation of its property and archives and the conduct of the Iranian authorities in the face of those occurrences."²⁷¹ Despite the ICJ's conclusion that the protesters who had stormed the premises acted in a private capacity and, as such, were not state actors and the fact that the protesters' conduct could not, therefore, be attributed to Iran,²⁷² the ICJ found that Iran had incurred international responsibility because of its actions or omissions in relation to the incident, "for its own conduct was in conflict with its international obligations."²⁷³ Specifically, the 1961 Vienna Convention on Diplomatic Relations and the 1963 Vienna Convention on Consular Relations, as well as parallel general international law obligations,²⁷⁴ imposed international legal obligations that Iran did

²⁶³ See *ibid.* at 11.

²⁶⁴ See *ibid.*

²⁶⁵ See *ibid.*

²⁶⁶ See *ibid.* at 11–12.

²⁶⁷ See *ibid.* at 12.

²⁶⁸ *Ibid.*

²⁶⁹ See *ibid.* at 12–13.

²⁷⁰ See *ibid.* at 13.

²⁷¹ *Ibid.* at 29. The first phase also included the sieges of the United States Consulates at Shiraz and Tabriz. See *ibid.* at 30.

²⁷² See *ibid.* at 29.

²⁷³ *Ibid.* at 30.

²⁷⁴ See *ibid.* at 30–31.

not satisfy.²⁷⁵ Iran had failed to sufficiently protect the premises or act preventively or during the course of the sieges, despite assurances given to the United States to this effect.²⁷⁶

The ICJ succinctly stated the circumstances under which Iran had incurred responsibility. Specifically, Iranian authorities:

- (a) were fully aware of their obligations under the conventions in force to take appropriate steps to protect the premises of the United States Embassy and its diplomatic and consular staff from any attack and from any infringement of their inviolability, and to ensure the security of such other persons as might be present on the said premises;
- (b) were fully aware, as a result of the appeals for help made by the United States Embassy, of the urgent need for action on their part;
- (c) had the means at their disposal to perform their obligations;
- (d) completely failed to comply with these obligations.²⁷⁷

Commenting on the *Hostages* decision in the context of the due diligence principle under international law, Dupuy makes an important distinction between obligations of conduct, including obligations of prevention, and obligations of result.²⁷⁸ According to him, the crucial point is the steps taken by the state in meeting its particular due diligence obligation under international law, such that, on the *Hostages* facts, “if Iran had been willing and able to demonstrate that it had actually taken all appropriate steps to avoid the taking of diplomats as hostages, then it would not have been held responsible by the Court.”²⁷⁹ Put another way, the due diligence obligation requires the state’s “best effort[s].”²⁸⁰ Without these efforts, or efforts of any kind, the due diligence obligation will be breached, and the state will be responsible.

A final example during the Cold War that touches upon the interface of state responsibility, non-state actors, and the due diligence principle involved a Soviet protest note addressing an incident strikingly similar to that at issue in the *Hostages* case.²⁸¹ In late-December 1980, a “large group of rampaging elements, armed with clubs, stones and knives”²⁸² broke into the Soviet Embassy in Iran, threatened the diplomatic staff, and

²⁷⁵ See *ibid.* at 32. Note that, “[s]o far as concerns the two private United States nationals seized as hostages by the invading militants, that inaction entailed, albeit incidentally, a breach of its obligations under Article II, paragraph 4, of the 1955 Treaty of Amity, Economic Relations, and Consular Rights which, in addition to the obligations of Iran existing under general international law, requires the parties to ensure ‘the most constant protection and security’ to each other’s nationals in their respective territories.” *Ibid.*

²⁷⁶ See *ibid.* at 31–32.

²⁷⁷ *Ibid.* at 32–33. Zegveld refers to “(c) had the means at their disposal to perform their obligations” as the “degree of factual capability.” ZEGVELD, *supra* note 156, at 190.

²⁷⁸ See Pierre-Marie Dupuy, *Reviewing the Difficulties of Codification: On Ago’s Classification of Obligations of Means and Obligations of Result in Relation to State Responsibility*, 10(2) EUR. J. INT’L L. 371, 379 (1999). See also Goodwin-Gill, *supra* note 28, at 77–78; Pisillo Mazzeschi, *The Due Diligence Rule and the Nature of the International Responsibility of States*, *supra* note 16, at 46–49.

²⁷⁹ Dupuy, *supra* note 278.

²⁸⁰ *Ibid.* (stating that “[w]hat counts here is the violation of the best effort obligation, not the end result actually achieved.”). See International Law Commission, *Commentaries. Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 182, at 391–92.

²⁸¹ See BROWNIE, SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY (PART I), *supra* note 86, at 119.

²⁸² *Ibid.*

caused significant damage to the facilities.²⁸³ The charge that Iran had not acted with due diligence in preventing and reacting to the non-state actors who had descended upon the Soviet Embassy was at the heart of the complaint. According to the Soviet Union, Iran had had notice of the impending assault on the Soviet Embassy but failed to take “measures sufficiently urgent and effective to prevent that attack.”²⁸⁴ Furthermore, according to the Soviet protest note, Iran had been slow to intervene and dispel the “rampaging elements.”²⁸⁵

4.4 *The End of the Cold War and Recent Developments*

Since the end of the Cold War and more recently, the interface of state responsibility, non-state actors, and the due diligence principle has been further clarified and emphasized under international law. In *Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka*, for example, the International Centre for the Settlement of Investment Disputes (ICSID) heard a claim brought by AAPL against Sri Lanka based on the 1965 ICSID Convention on the Settlement of Investment Disputes Between States and Nationals of Other States and Article 8(1) of a 1980 Bilateral Investment Treaty between the United Kingdom and Sri Lanka.²⁸⁶ As an ICSID decision, *AAPL* is particularly important.²⁸⁷ AAPL and Sri Lanka agreed that the Bilateral Investment Treaty acted as the underlying law but disagreed as to how it should be interpreted and applied.²⁸⁸

One of AAPL’s Sri Lankan investments, a shrimp farming operation, suffered significant damage after a raid by Sri Lankan security forces in pursuit of the Tamil Tigers, a raid described by AAPL as a “‘murderous overreaction by the STF [i.e., Sri Lankan Special Task Force] which led to [. . .] destruction and civilian deaths.’”²⁸⁹ AAPL alleged that the farm’s management had cooperated with Sri Lanka in its previous counterterrorism efforts.²⁹⁰ According to AAPL, the STF unnecessarily destroyed the shrimp crop, burned the office, repair, dormitory, and store facilities, and executed twenty one members of staff during the raid “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.’”²⁹¹ AAPL also alleged a total

²⁸³ See *ibid.*

²⁸⁴ *Ibid.*

²⁸⁵ *Ibid.*

²⁸⁶ See *Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka*, ICSID Case No. ARB/87/3, 30(3) I.L.M. 577, 580–81 (1991). On bilateral investment treaties generally, see SHAW, *supra* note 5, at 747–49. Shaw adopts a cautious approach to bilateral investment treaties and customary international law. See *ibid.* at 750–51.

²⁸⁷ See Stephen C. Vasciannie, *Bilateral Investment Treaties and Civil Strife: The AAPL/Sri Lanka Arbitration*, 39(3) NETH. INT’L L. REV. 332, 354 (1992) (promoting a cautious approach to the decision, although admitting that, “[b]ecause the AAPL decision is the first case in which an ICSID tribunal derived its jurisdiction through the consent provision in a bilateral investment treaty, there will probably be a tendency to attach special significance to the decision as a precedent in future cases.”).

²⁸⁸ See AAPL, *supra* note 286, at 594.

²⁸⁹ *Ibid.* at 583.

²⁹⁰ See *ibid.* at 613.

²⁹¹ *Ibid.*

investment loss as a result of the operation and claimed compensation from Sri Lanka.²⁹² Sri Lanka, however, argued that a cooperative relationship had existed between the Tamil Tigers and the farm's management, that the Tamil Tigers had used the farm in the past, and that the damage caused during the raid was not inflicted by Sri Lankan forces or, alternatively, was necessary.²⁹³

Since *AAPL* operates within a specific treaty regime,²⁹⁴ its usefulness to international law generally lies in its statement of principles related to states' due diligence obligations that apply outside the particular treaty context at issue. The investment of an alien in a state, even in the absence of a treaty, is entitled to due diligence protection from the state being invested in, the breach of which obligation triggers state responsibility.²⁹⁵ Furthermore, arbitral decisions and scholarship support the interrelated rules of state responsibility according to which:

- (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 resulting from governmental counter-insurgency activities.²⁹⁶

The due diligence standard that applies in such situations, according to the Tribunal, is one that is objective in nature, one which assesses 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."²⁹⁷

The Tribunal found that Sri Lanka had breached its due diligence obligation, therefore triggering its responsibility as a state.²⁹⁸ Relying on evidence of a cooperative relationship between the farm's management and Sri Lanka over the Tamil Tigers, the Tribunal found that Sri Lanka should have exhausted peaceful measures before resorting to the raid on the farm.²⁹⁹ According to it, "through said inaction and omission[, Sri Lanka had] 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."³⁰⁰ The Tribunal stressed the importance of preventive measures to the due diligence obligation because "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."³⁰¹ What states do or fail to do to protect innocent people from the dangers posed by non-state actors will

²⁹² See *ibid.* at 581.

²⁹³ See *ibid.* at 585; *ibid.* at 614.

²⁹⁴ See *ibid.* at 597–98.

²⁹⁵ See *ibid.* at 608–09.

²⁹⁶ *Ibid.* at 609–10.

²⁹⁷ *Ibid.* at 612.

²⁹⁸ See *ibid.* at 615–19.

²⁹⁹ See *ibid.*

³⁰⁰ *Ibid.* at 616.

³⁰¹ *Ibid.*

heavily factor into assessments of potential state responsibility under the due diligence principle.

Samuel K. B. Asante's dissenting opinion in *AAPL* provides an interesting perspective on states' due diligence obligations during times of insurrection.³⁰² Asante stressed that customary international law, as demonstrated by the decisions of international tribunals and publicists, strongly supports the general rule that states do not bear responsibility for loss or damage to foreigners resulting from, among others, insurrections, riots, states of emergency, or armed conflicts.³⁰³ According to Asante, a state's due diligence obligation is "easily discharged in the face of an insurrection or other civil commotion resulting in a temporary loss of control by the host country over the area of insurgency."³⁰⁴ Asante argued that international law presumes a state's fulfillment of the due diligence obligation in such a situation³⁰⁵ and questioned the Tribunal's criticism of Sri Lanka's decision to use force, arguing that this "touches on the sovereign prerogatives of a Government fighting for its very life."³⁰⁶

While the majority opinion stressed that state responsibility will not be presumed,³⁰⁷ Asante seems to have confused this general principle with a non-rebuttable presumption, arguing that, "[o]nce it is conceded that the Government had a compelling sovereign duty to undertake a military operation to regain control, the timing and modalities of the security operation must surely fall within its exclusive discretion."³⁰⁸ Such language seems to undermine the principle of international human rights law according to which certain rights are non-derogable, even during states of emergency and upheaval.³⁰⁹ Indeed, Asante's "must surely fall" language may actually highlight, although no doubt unintentionally on Asante's part, the aspirational nature of his statement rather than its reflection of the current state of international law. One may concur with Asante that tribunals "should be slow to second-guess the tactics and strategies of military commanders on the ground,"³¹⁰ indeed, that is the essence of the idea that state responsibility will not be presumed, but it is unfortunate that his dissent could be construed, rightly or wrongly, as justifying a "blank check" to states when battling insurgencies. International law no longer accepts that "the Crown can do no wrong."

ICSID also dealt with the due diligence principle more recently, in *Noble Ventures, Inc. (Noble) v. Romania*.³¹¹ That arbitral decision involved Noble, an American corporation, and Romania and Romania's role in a privatised formerly state-run steel

³⁰² On due diligence, insurrection, and *force majeure*, see Pisillo Mazzeschi, *The Due Diligence Rule and the Nature of the International Responsibility of States*, *supra* note 16, at 45–46.

³⁰³ See *AAPL*, *supra* note 286, at 646.

³⁰⁴ *Ibid.* at 647.

³⁰⁵ See *ibid.*

³⁰⁶ *Ibid.* at 651. Vasciannie makes a similar theoretical argument. See Vasciannie, *supra* note 287, at 353.

³⁰⁷ See *AAPL*, *supra* note 286, at 606–07.

³⁰⁸ *Ibid.* at 651–52.

³⁰⁹ For a more detailed explanation of this human rights principle, see OFFICE OF THE UNITED NATIONS HIGH COMMISSIONER FOR HUMAN RIGHTS GENEVA, DIGEST OF JURISPRUDENCE OF THE UNITED NATIONS AND REGIONAL ORGANIZATIONS ON THE PROTECTION OF HUMAN RIGHTS WHILE COUNTERING TERRORISM 2–3, U.N. Sales No. HR/PUB/03/1 (2003).

³¹⁰ *AAPL*, *supra* note 286, at 652.

³¹¹ *Noble*, *supra* note 64.

company, Combinatul Siderurgic Resita (CSR), that Noble had come to acquire.³¹² Noble raised issues that mostly involved the 1992 United States-Romania Bilateral Investment Treaty (BIT).³¹³

The most interesting claim that Noble raised in relation to the due diligence principle involved its contention that “from January 2001 onwards demonstrations and protests by CSR’s employees occurred frequently and on a large scale and that they were accompanied by unlawful acts for which the Respondent is responsible by reason of its failure to provide full protection and security as provided for under the BIT.”³¹⁴ Noble argued that Romania knew about the direct action and that the company had complained to the state about it but that Romania simply inflamed the situation.³¹⁵ Furthermore, according to Noble, Romania, in a factual situation generally similar to that in the *Hostages* case, through its “local police refused to exercise adequate measures to protect Noble Ventures and CSR in Resita from unlawful activity on its premises.”³¹⁶ Because of this, Noble complained that its managers were unlawfully imprisoned and sometimes beaten by the strikers, that its industrial capital was damaged, and that its facilities were occupied and looted.³¹⁷ Noble asserted an objective complaint, that Romania had breached its obligation to “provide the reasonable measures of protection which a well-administered government would be expected to exercise under similar circumstances.”³¹⁸ By contrast, Romania argued that it had satisfied its obligation, grounded in the due diligence principle, to Noble.³¹⁹

In rejecting Noble’s argument,³²⁰ the Tribunal clearly understood the BIT provision, the “full protection and security” obligation, as being no more demanding than the due diligence standard under the law of diplomatic protection.³²¹ It analogized to the ICJ’s judgment in *Elettronica Sicula S.p.A.*³²² and noted that, in such situations, “violations of protection standards are not easily to be established.”³²³ In this sense, *Noble* demonstrates the difficulties that courts and tribunals face in dealing with the due diligence principle.

Another important development since the end of the Cold War and more recently has been the ILC’s completion in 2001 of the *Articles on Prevention of Transboundary Harm from Hazardous Activities (Articles on Prevention of Transboundary Harm)*.³²⁴ According to Article 1, the *Articles on Prevention of Transboundary Harm* are only

³¹² See *ibid.* at 9–11.

³¹³ See *ibid.* at 11–16.

³¹⁴ *Ibid.* at 103. According to article II(2)(a), “[i]nvestment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.” *Ibid.* at 47.

³¹⁵ See *ibid.* at 13–14.

³¹⁶ *Ibid.* at 14.

³¹⁷ See *ibid.*

³¹⁸ *Ibid.* at 104.

³¹⁹ See *ibid.* at 104–105.

³²⁰ See *ibid.* at 106.

³²¹ See *ibid.* at 105.

³²² *Elettronica Sicula S.p.A. (U.S. v. Italy)*, 1989 I.C.J. 15.

³²³ Noble, *supra* note 64, at 106.

³²⁴ International Law Commission, *Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 181. Since the project has been completed, this article simply makes reference to them

applicable to “activities not prohibited by international law which involve a risk of causing significant transboundary harm through their physical consequences.”³²⁵ While it is true, as Article 1 and its *Commentary* make clear, that the *Articles on Prevention of Transboundary Harm* must be read within the context of international liability without a wrongful act and not in the context of state responsibility,³²⁶ the ILC’s description of the due diligence principle can be analogized to international law generally when the operative rule at issue imposes a due diligence obligation.

Article 3 of the *Articles on Prevention of Transboundary Harm* requires that states of origin take “all appropriate measures to prevent significant transboundary harm or at any event to minimize the risk thereof.”³²⁷ While it is not possible to describe the “all appropriate measures” duty with more precision than general rules of this nature permit, the *Commentaries* do provide some guidance. While states of origin only have to bear the risk of foreseeable consequences, they do have to take an active stance in identifying activities that, while not presently foreseeable, may evolve into foreseeable risks.³²⁸

As the *Commentaries* make clear, the prevention or minimization duty is a due diligence duty.³²⁹ While states of origin are expected to prevent “significant transboundary harm,” if such harm does occur, they must take “best possible efforts”³³⁰ at minimization. To phrase the due diligence obligation within the context of the *Articles on Prevention of Transboundary Harm* a different way, the due diligence rule requires “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.”³³¹ This general due diligence language will necessarily be assessed within a particular context, and what is required is, in the context of the prevention of transboundary harm from hazardous activities, conduct that is “generally considered to be appropriate and proportional to the degree of risk of transboundary harm in the particular instance.”³³²

in the text as the *Articles on Prevention of Transboundary Harm from Hazardous Activities (Articles on Prevention of Transboundary Harm)*.

³²⁵ *Ibid.* at 371, art. 1.

³²⁶ See International Law Commission, *Commentaries, Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 182, at 382.

³²⁷ International Law Commission, *Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 181. With Article 4, Article 3 describes in full the due diligence obligation. See International Law Commission, *Commentaries, Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 182, at 390. Article 4 states that concerned states should “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.” International Law Commission, *Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 181, at 372, art. 4.

³²⁸ See International Law Commission, *Commentaries, Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 182, at 391.

³²⁹ See *ibid.* The ILC describes the “obligation of due diligence [. . . as] the core basis of the provisions intended to prevent significant transboundary harm, or at any event to minimize the risk thereof.” *Ibid.* at 411.

³³⁰ *Ibid.* at 392.

³³¹ *Ibid.* at 393. This involves policy formulation and implementation. See *ibid.*

³³² *Ibid.* at 394.

The *Articles on Prevention of Transboundary Harm* impose upon states due diligence obligations in the context of “significant transboundary harm.” While general principles can, and should, be sketched in the abstract, here, as elsewhere, the assessment under the due diligence rule is necessarily specific to particular facts and circumstances. The due diligence obligation can be simply stated, yet its complexity and rigour cannot be overstated: “the degree of care in question is that expected of a good Government.”³³³ In this sense, to suggest, as Duffy does, that “[t]here is no single, agreed-upon definition of ‘due diligence’”³³⁴ misleads because the due diligence principle’s definition, as a flexible reasonableness standard adaptable to particular facts and circumstances, provides the underlying legal framework. It amounts to “due, or merited, care.”³³⁵

In assessing the question of transboundary harm to the environment that states must guard against, Article 2 of the *Articles on Prevention of Transboundary Harm* defines “risk of causing significant transboundary harm” by reference to “risks taking the form of a high probability of causing significant transboundary harm and a low probability of causing disastrous transboundary harm.”³³⁶ An assessment of “risk of causing significant transboundary harm” necessarily must balance probability and magnitude, or risk and harm.³³⁷ Like the due diligence principle generally, the question of “risk of causing significant transboundary harm” is flexible and adaptable to particular facts and circumstances and operates along a continuum, in the case of “risk of causing significant transboundary harm,” along a “spectrum of relationships between ‘risk’ and ‘harm’, all of which would reach the level of ‘significant.’”³³⁸

The objective nature of the determination to be made must be constantly kept in mind when assessing the question of transboundary harm to the environment against which states must guard. The cases are necessarily specific to particular facts and circumstances and must balance a number of concerns, such as property, human health, and the environment in other states, while at the same time the ill effects must be “susceptible of being measured by factual and objective standards.”³³⁹ In that the *Articles on Prevention of Transboundary Harm* clearly assess risk objectively, with reference to an “appreciation of possible harm resulting from an activity which a properly informed observer had or ought to have had,”³⁴⁰ the assessment of risk is similar to the

³³³ *Ibid.* at 395.

³³⁴ DUFFY, *supra* note 204, at 57 n.55.

³³⁵ Corino, *supra* note 76, at 120.

³³⁶ International Law Commission, *Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 181, at 371, art. 2. Such probability-based language is common in international environmental law generally. European Directive 2004/35/CE, for example, defines the concept of “‘imminent threat of damage’ [. . . as] a sufficient likelihood that environmental damage will occur in the near future.” Directive 2004/35/CE of the European Parliament and of the Council of 21 April 2004 on Environmental Liability with Regard to the Prevention and Remedying of Environmental Damage, art. 2(9), 2004 O.J. (L 143) 56, 60.

³³⁷ See International Law Commission, *Commentaries, Articles on Prevention of Transboundary Harm from Hazardous Activities*, *supra* note 182, at 387.

³³⁸ *Ibid.*

³³⁹ *Ibid.* at 388.

³⁴⁰ *Ibid.* at 385.

assessment of foreseeable risk of harm under the American tort law of negligence.³⁴¹ The foreseeability of the risk of harm is rooted in reasonableness.³⁴²

Another example since the end of the Cold War and more recently on the interface of state responsibility, non-state actors, and the due diligence principle in the context of international environmental law is European Directive 2004/35/CE.³⁴³ That Directive addresses itself to “establish[ing] a framework of environmental liability based on the ‘polluter-pays’ principle, to prevent and remedy environmental damage.”³⁴⁴ To that end, it details preventive and remedial measures that must be taken, preferably by the operator, in the context of environmental damage and the imminent threat thereof.³⁴⁵ Article 7(2) states that the competent authority determines which measures must be taken in remedial situations.³⁴⁶ In doing so with respect to damage to protected species, water, or natural habitats, Annex II notes that “[t]he reasonable remedial options should be evaluated, using best available technologies,”³⁴⁷ with regard being had to such factors as cost, effectiveness, prophylactic potential, and sensitivity to local concerns.³⁴⁸ The question of due diligence arises in this context because what a competent authority may regard as a reasonable remedial option may, in fact, be patently unreasonable under the particular facts and circumstances. The state cannot expect to shield itself when it acts, to use words already quoted from the *Commentaries to the Articles on Prevention of Transboundary Harm*, contrary to the “the degree of care [. . .] expected of a good Government.”

Within the context of international human rights law, Chinkin has noted that the due diligence principle has undermined the public versus private divide that had hitherto strictly separated those activities for which the state, respectively, could and could not be held responsible.³⁴⁹ As the Inter-American Court of Human Rights noted in 1988:

[a]n illegal act which violates human rights and which is initially not directly imputable to a State (for example, because it is the act of a private person or because the person responsible has not been identified) can lead to international responsibility of the State, not because of the act itself, but because of the lack

³⁴¹ On Anglo-American law in this regard, see H. L. A. HART, *THE CONCEPT OF LAW* 132–33 (2d ed. 1994).

³⁴² See BIRNIE & BOYLE, *supra* note 173, at 115 (stating that, “[c]learly, a state cannot be required to regulate activities of which it is not and could not reasonably have been aware; equally clearly the same is true of activities which the state did not know, and could not reasonably have known, to be potentially harmful.”).

³⁴³ Directive 2004/35/CE, *supra* note 336.

³⁴⁴ *Ibid.* at art. 1, 59. “According to the ‘polluter-pays’ principle, an operator causing environmental damage or creating an imminent threat of such damage should, in principle, bear the cost of the necessary preventive or remedial measures. In cases where a competent authority acts, itself or through a third party, in the place of an operator, that authority should ensure that the cost incurred by it is recovered from the operator. It is also appropriate that the operators should ultimately bear the cost of assessing environmental damage and, as the case may be, assessing an imminent threat of such damage occurring.” *Ibid.* at Preamble, para. 18, 57–58.

³⁴⁵ See *ibid.* at arts. 5–6, 61–62.

³⁴⁶ See *ibid.* at art. 7(2), 62.

³⁴⁷ *Ibid.* at Annex II, para. 1.3.1, 68.

³⁴⁸ See *ibid.*

³⁴⁹ See Christine Chinkin, *A Critique of the Public/Private Dimension*, 10(2) *EUR. J. INT’L L.* 387 (1999). See also Jan Arno Hessbruegge, *The Historical Development of the Doctrines of Attribution and Due Diligence in International Law*, 36(2–3) *N.Y.U. J. INT’L L. & POL.* 265, 275 (2004).

of due diligence to prevent the violation or to respond to it as required by the [American] Convention [on Human Rights].³⁵⁰

The Northern Ireland Human Rights Commission has also made a similar point.³⁵¹ In realizing human rights, states' procedural obligations are particularly crucial.³⁵²

A further example of the due diligence principle is provided by the General Assembly's adoption of the *Basic Principles and Guidelines on the Right to a Remedy and Reparation for Victims of Gross Violations of International Human Rights Law and Serious Violations of International Humanitarian Law* in Resolution 60/147.³⁵³ Regarding international human rights law and international humanitarian law, Resolution 60/147 recognizes states' obligations to act with due diligence. States must, for example, "[t]ake appropriate legislative and administrative and other appropriate measures to prevent violations,"³⁵⁴ "[i]nvestigate violations effectively, promptly, thoroughly and impartially and, where appropriate, take action against those allegedly responsible in accordance with domestic and international law,"³⁵⁵ "[p]rovide those who claim to be victims of a human rights or humanitarian law violation with equal and effective access to justice, as described below, irrespective of who may ultimately be the bearer of responsibility for the violation,"³⁵⁶ and "[p]rovide effective remedies to victims, including reparation, as described below."³⁵⁷

Like the due diligence principle generally under international law, whether a state has complied with the obligations spelled out in General Assembly Resolution 60/147 will trigger an assessment on the basis of a reasonableness standard. It is important to note that the "equal and effective access to justice" obligation applies "irrespective of who may ultimately be the bearer of responsibility for the violation."³⁵⁸ This language

³⁵⁰ Velásquez Rodríguez, *supra* note 132, at para. 172. Chinkin discusses this case at Chinkin, *supra* note 349, at 394. For further on this point, see Luigi Condorelli, *The Imputability to States of Acts of International Terrorism*, 19 *Isr. Y.B. H.R.* 233, 241–42 (1989); Olivier de Schutter, *The Accountability of Multinationals for Human Rights Violations in European Law*, in *NON-STATE ACTORS AND HUMAN RIGHTS* 227, 233–35 (Philip Alston ed., 2005); DUFFY, *supra* note 204, at 301–303; Frey, *supra* note 38; Reinisch, *supra* note 108, at 78–82; Colin Warbrick, *The European Response to Terrorism in an Age of Human Rights*, 15(5) *EUR. J. INT'L L.* 989, 1006 (2004).

³⁵¹ See MARK KELLY, *NORTHERN IRELAND HUMAN RIGHTS COMMISSION, A PRACTICAL GUIDE TO THE EUROPEAN CONVENTION ON HUMAN RIGHTS: THE RIGHT TO LIFE* 14–15 (2005) (maintaining that the "European Court of Human Rights takes the view that Article 2 of the ECHR not only prohibits unlawful killing by agents of the State, but also places States under a 'positive obligation' to take preventive operational measures to protect persons whose lives are threatened, even if those threats are from another private person, rather than an agent of the state.").

³⁵² See Jan Klabbbers, *Straddling Law and Politics: Judicial Review in International Law*, in *TOWARDS WORLD CONSTITUTIONALISM: ISSUES IN THE LEGAL ORDERING OF THE WORLD COMMUNITY* 809, 828 (Ronald St. John Macdonald & Douglas M. Johnston eds., 2005). Klabbbers tends toward the view that "the substantive core of rights can only come to life by being surrounded by procedural notions, or perhaps consists exclusively of bundles of procedural rights." *Ibid.*

³⁵³ G. A. Res. 60/147, *supra* note 82.

³⁵⁴ *Ibid.* at Annex, 4.

³⁵⁵ *Ibid.*

³⁵⁶ *Ibid.* at Annex, 5.

³⁵⁷ *Ibid.*

³⁵⁸ *Ibid.*

suggests that a state's obligation in this respect is no less demanding if non-state actors inflict injury.

A final example since the end of the Cold War and more recently on the interface of state responsibility, non-state actors, and the due diligence principle can be found in the ICJ's 2005 decision in *Armed Activities on the Territory of the Congo*.³⁵⁹ In that contentious case, the ICJ held that Uganda bore the obligations in Ituri region in the Democratic Republic of the Congo of an occupying power,³⁶⁰ one of which was the duty to "take appropriate measures to prevent the looting, plundering and exploitation of natural resources in the occupied territory to cover private persons in this district and not only members of Ugandan military forces."³⁶¹ The ICJ referred to this elsewhere as a "duty of vigilance."³⁶² Demonstrating that the due diligence obligation under international law also extends to occupying powers in situations when natural resources are exploited, the ICJ found Uganda responsible as a state.³⁶³

Finally, it should be noted that the *Hostages* due diligence test continues to demonstrate its relevance as a legal framework within which to assess state action and omission. As applied to destruction caused by rioters to the Danish and Norwegian embassies in Damascus in early-February 2006, for example, it informs whether Syria bears responsibility as a state for an internationally wrongful act.³⁶⁴

5. Conclusion

In conclusion, international law recognizes a number of principles of responsibility. One of these, the due diligence principle, applies across many areas of international law, and international legal developments during the last century support this conclusion. Condorelli accurately refers to the due diligence principle, as this article has attempted to demonstrate, as a "basic principle of international law."³⁶⁵

The due diligence principle is especially important under international law because it can be applied to varied facts and circumstances. In an age of modern terrorism, for example, the due diligence principle can be used to hold states responsible for their actions or omissions when dealing with international terrorism committed by non-state actors.³⁶⁶ How, whether, and with what breadth the due diligence principle is applied, however, remains one of political will.

³⁵⁹ *Armed Activities on the Territory of the Congo (Congo v. Uganda)*, 2005 I.C.J., available at http://www.icj-cij.org/icjwww/idocket/ico/ico_judgments/ico_judgment_20051219.pdf.

³⁶⁰ See *ibid.* at para. 178.

³⁶¹ *Ibid.* at para. 248.

³⁶² *Ibid.* at para. 247.

³⁶³ See *ibid.* at para. 250.

³⁶⁴ On this incident, see *Uproar At Syrian Cartoon Protests*, BBC NEWS, 5 Feb. 2006, available at http://news.bbc.co.uk/go/pr/fr/-/1/hi/world/middle_east/4682388.stm. For a similar example, see *China Rejects Japan's Demand for Apology*, CBC NEWS, 17 Apr. 2005, available at <http://www.cbc.ca/storyview/MSN/world/national/2005/04/17/china-japan050417.html>.

³⁶⁵ Condorelli, *supra* note 350, at 240.

³⁶⁶ See Barnidge, *supra* note *, at 103–25; Condorelli, *supra* note 350, at 241.

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Oxford Reports on International Law

United States Diplomatic and Consular Staff in Tehran, United States v Iran, Judgment, ICJ GL No 64, [1980] ICJ Rep 3, ICGJ 124 (ICJ 1980), 24th May 1980, International Court of Justice [ICJ]

Date: 24 May 1980

Content type: International Court Decisions

Jurisdiction: International Court of Justice [ICJ]

Citation(s): ICJ GL No 64 (Official Case No)

[1980] ICJ Rep 3 (Official Citation)

ICGJ 124 (ICJ 1980) (OUP reference)

Product: Oxford Reports on International Law [ORIL]

Module: International Courts of General Jurisdiction [ICGJ]

Parties: United States
Iran

Judges/Arbitrators: Sir Humphrey Waldcock (President); Taslim Olawale Elias (Vice-President); Isaac Forster; André Gros; Manfred Lachs; Platon Dmitrievich Morozov; Nagendra Singh; José Maria Ruda; Hermann Mosler; Salah El Dine Tarazi; Shigeru Oda; Roberto Ago; Abdullah El-Erian; José Sette-Camara; Richard R Baxter

Procedural Stage: Judgment

Previous Procedural Stage(s):

Provisional Measures, Order; *United States Diplomatic and Consular Staff in Iran, Iran v United States*, General List No 64; ICGJ 122 (ICJ 1979), 15 December 1979

Subsequent Development(s):

Removal From List, Order; *United States Diplomatic and Consular Staff in Tehran, United States v Iran*, (1981) ICJ Rep 45; ICGJ 123 (ICJ 1981), 12 May 1981

Subject(s):

Consular relations — Diplomatic immunity — Diplomatic relations — Detention — Individuals and non-state actors — International courts and tribunals, admissibility — International courts and tribunals, jurisdiction — International courts and tribunals, procedure — Hostage taking — Equitable principles — Attribution — Customary international law — International courts and tribunals, admissibility of claims — Use of force, prohibition — Reparation

Core Issue(s):

Whether the preliminary questions of admissibility and jurisdiction barred the Court from hearing the dispute.

Whether the seizure, hostage taking, and detention of United States diplomatic and consular members by Iranian militants was attributable to Iran, considering that Iran knew about, but completely failed to act on, its obligations to prevent and intervene in the conduct in question.

Whether Iran had violated, and continued to violate, its obligations under the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations, in the seizure and hostage-taking

of members of United States diplomatic and consular staff in Iran.

Whether any United States diplomatic or consular staff member may be detained by Iran to be subjected to or participate in any form of judicial proceedings.

Whether Iran must make reparations for the above-mentioned violations, and if so, whether the Court may set the amount of reparations absent an agreement between Iran and the United States.

Decision - full text

Paragraph numbers have been added to this decision by OUP

Present : President Sir Humphrey Waldock ; Vice-President Elias ; Judges Forster, Gros, Lachs, Morozov, Nagendra Singh, Ruda, Mosler, Tarazi, Oda, Ago, El-Erian, Sstte-Camara, Baxter ; Registrar Aquarone.

In the case concerning United States Diplomatic and Consular Staff in Tehran,

between

the United States of America,

represented by

The Honorable Roberts B. Owen, Legal Adviser, Department of State,

as Agent,

H.E. Mrs. Geri Joseph, Ambassador of the United States of America to the Netherlands,

as Deputy Agent,

Mr. Stephen M. Schwebel, Deputy Legal Adviser, Department of State,

as Deputy Agent and Counsel,

Mr. Thomas J. Dunnigan, Counsellor, Embassy of the United States of America,

as Deputy Agent,

assisted by

Mr. David H. Small, Assistant Legal Adviser, Department of State,

Mr. Ted L. Stein, Attorney-Adviser, Department of State,

Mr. Hugh V. Simon, Jr., Second Secretary, Embassy of the United States of America,

as Advisers,

and

the Islamic Republic of Iran,

The Court,

composed as above,

delivers the following Judgment :

1. On 29 November 1979, the Legal Adviser of the Department of State of the United States of America handed to the Registrar an Application instituting proceedings against the Islamic Republic of Iran in respect of a dispute concerning the seizure and holding as hostages of members of the United States diplomatic and consular staff and certain other United States nationals.

2. Pursuant to Article 40, paragraph 2, of the Statute and Article 38, paragraph 4, of the Rules of Court, the Application was at once communicated to the Government of Iran. In accordance with Article 40, paragraph 3, of the Statute and Article 42 of the Rules of Court, the Secretary-General of

the United Nations, the Members of the United Nations, and other States entitled to appear before the Court were notified of the Application.

3. On 29 November 1979, the same day as the Application was filed, the Government of the United States filed in the Registry of the Court a request for the indication of provisional measures under Article 41 of the Statute and Article 73 of the Rules of Court. By an Order dated 15 December 1979, and adopted unanimously, the Court indicated provisional measures in the case.

4. By an Order made by the President of the Court dated 24 December 1979, 15 January 1980 was fixed as the time-limit for the filing of the Memorial of the United States, and 18 February 1980 as the time-limit for the Counter-Memorial of Iran, with liberty for Iran, if it appointed an Agent for the purpose of appearing before the Court and presenting its observations on the case, to apply for reconsideration of such time-limit. The Memorial of the United States was filed on 15 January 1980, within the time-limit prescribed, and was communicated to the Government of Iran ; no Counter-Memorial was filed by the Government of Iran, nor was any agent appointed or any application made for reconsideration of the time-limit.

5. The case thus became ready for hearing on 19 February 1980, the day following the expiration of the time-limit fixed for the Counter-Memorial of Iran. In circumstances explained in paragraphs 41 and 42 below, and after due notice to the Parties, 18 March 1980 was fixed as the date for the opening of the oral proceedings ; on 18, 19 and 20 March 1980, public hearings were held, in the course of which the Court heard the oral argument of the Agent and Counsel of the United States ; the Government of Iran was not represented at the hearings. Questions were addressed to the Agent of the United States by Members of the Court both during the course of the hearings and subsequently, and replies were given either orally at the hearings or in writing, in accordance with Article 61, paragraph 4, of the Rules of Court.

6. On 6 December 1979, the Registrar addressed the notifications provided for in Article 63 of the Statute of the Court to the States which according to information supplied by the Secretary-General of the United Nations as depositary were parties to one or more of the following Conventions and Protocols :

- (a) the Vienna Convention on Diplomatic Relations of 1961 ;
- (b) the Optional Protocol to that Convention concerning the Compulsory Settlement of Disputes ;
- (c) the Vienna Convention on Consular Relations of 1963 ;
- (d) the Optional Protocol to that Convention concerning the Compulsory Settlement of Disputes ;
- (e) the Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents, of 1973 .

7. The Court, after ascertaining the views of the Government of the United States on the matter, and affording the Government of Iran the opportunity of making its views known, decided pursuant to Article 53, paragraph 2, of the Rules of Court that copies of the pleadings and documents annexed should be made accessible to the public with effect from 25 March 1980.

8. In the course of the written proceedings the following submissions were presented on behalf of the Government of the United States of America :

in the Application :

“The United States requests the Court to adjudge and declare as follows :

(a) That the Government of Iran, in tolerating, encouraging, and failing to prevent and punish the conduct described in the preceding Statement of Facts, violated its international legal obligations to the United States as provided by

— Articles 22 , 24 , 25 , 27 , 29 , 31 , 37 and 47 of the Vienna Convention on Diplomatic Relations ,

— Articles 28 , 31 , 33 , 34 , 36 and 40 of the Vienna Convention on Consular Relations ,

— Articles 4 and 7 of the Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents , and

— Articles II (4) , XIII , XVIII and XIX of the Treaty of Amity, Economic Relations, and Consular Rights between the United States and Iran , and

— Articles 2 (3) , 2 (4) and 33 of the Charter of the United Nations ;

(b) That pursuant to the foregoing international legal obligations, the Government of Iran is under a particular obligation immediately to secure the release of all United States nationals currently being detained within the premises of the United States Embassy in Tehran and to assure that all such persons and all other United States nationals in Tehran are allowed to leave Iran safely ;

(c) That the Government of Iran shall pay to the United States, in its own right and in the exercise of its right of diplomatic protection of its nationals, reparation for the foregoing violations of Iran's international legal obligations to the United States, in a sum to be determined by the Court ; and

(d) That the Government of Iran submit to its competent authorities for the purpose of prosecution those persons responsible for the crimes committed against the premises and staff of the United States Embassy and against the premises of its Consulates” ;

in the Memorial :

“The Government of the United States respectfully requests that the Court adjudge and declare as follows :

(a) that the Government of the Islamic Republic of Iran, in permitting, tolerating, encouraging, adopting, and endeavouring to exploit, as well as in failing to prevent and punish, the conduct described in the Statement of the Facts, violated its international legal obligations to the United States as provided by :

— Articles 22 , 24 , 25 , 26 , 27 , 29 , 31 , 37 , 44 and 47 of the Vienna Convention on Diplomatic Relations ;

— Articles 5 , 27 , 28 , 31 , 33 , 34 , 35 , 36 , 40 and 72 of the Vienna Convention on Consular Relations ;

— Article II (4) , XIII , XVIII and XIX of the Treaty of Amity, Economic Relations, and Consular Rights between the United States of America and Iran ; and

— Articles 2 , 4 and 7 of the Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents ;

(b) that, pursuant to the foregoing international legal obligations :

(i) the Government of the Islamic Republic of Iran shall immediately ensure that the premises at the United States Embassy, Chancery and Consulates are restored to the possession of the United States authorities under their exclusive control, and shall ensure their inviolability and effective protection as provided for by the treaties in force between the two States, and by general international law ;

(ii) the Government of the Islamic Republic of Iran shall ensure the immediate release, without any exception, of all persons of United States nationality who are or have been held in the Embassy of the United States of America or in the Ministry of Foreign Affairs in Tehran, or who are or have been held as hostages elsewhere, and afford full protection to all such persons, in accordance with the treaties in force between the two States, and with general international law ;

(iii) the Government of the Islamic Republic of Iran shall, as from that moment, afford to all the diplomatic and consular personnel of the United States the protection, privileges and immunities to which they are entitled under the treaties in force between the two States, and under general international law, including immunity from any form of criminal jurisdiction and freedom and facilities to leave the territory of Iran ;

(iv) the Government of the Islamic Republic of Iran shall, in affording the diplomatic and consular personnel of the United States the protection, privileges and immunities to which they are entitled, including immunity from any form of criminal jurisdiction, ensure that no such personnel shall be obliged to appear on trial or as a witness, deponent, source of information, or in any other role, at any proceedings, whether formal or informal, initiated by or with the acquiescence of the Iranian Government, whether such proceedings be denominated a "trial", "grand jury", "international commission" or otherwise ;

(v) the Government of the Islamic Republic of Iran shall submit to its competent authorities for the purpose of prosecution, or extradite to the United States, those persons responsible for the crimes committed against the personnel and premises of the United States Embassy and Consulates in Iran ;

(c) that the United States of America is entitled to the payment to it, in its own right and in the exercise of its right of diplomatic protection of its nationals held hostage, of reparation by the Islamic Republic of Iran for the violations of the above international legal obligations which it owes to the United States, in a sum to be determined by the Court at a subsequent stage of the proceedings."

9. At the close of the oral proceedings, written submissions were filed in the Registry of the Court on behalf of the Government of the United States of America in accordance with Article 60, paragraph 2, of the Rules of Court ; a copy thereof was transmitted to the Government of Iran. Those submissions were identical with the submissions presented in the Memorial of the United States.

10. No pleadings were filed by the Government of Iran, which also was not represented at the oral proceedings, and no submissions were therefore presented on its behalf. The position of that Government was, however, defined in two communications addressed to the Court by the Minister for Foreign Affairs of Iran ; the first of these was a letter dated 9 December 1979 and transmitted by

telegram the same day (the text of which was set out in full in the Court's Order of 15 December 1979, *I.C.J. Reports 1979*, pp. 10–11); the second was a letter transmitted by telex dated 16 March 1980 and received on 17 March 1980, the text of which followed closely that of the letter of 9 December 1979 and reads as follows :

[Translation from French]

“I have the honour to acknowledge receipt of the telegram concerning the meeting of the International Court of Justice to be held on 17 March 1980 at the request of the Government of the United States of America, and to set forth for you below, once again, the position of the Government of the Islamic Republic of Iran in that respect :

The Government of the Islamic Republic of Iran wishes to express its respect for the International Court of Justice, and for its distinguished Members, for what they have achieved in the quest for a just and equitable solution to legal conflicts between States, and respectfully draws the attention of the Court to the deep-rootedness and the essential character of the Islamic Revolution of Iran, a revolution of a whole oppressed nation against its oppressors and their masters, the examination of whose numerous repercussions is essentially and directly a matter within the national sovereignty of Iran.

The Government of the Islamic Republic of Iran considers that the Court cannot and should not take cognizance of the case which the Government of the United States of America has submitted to it, and in the most significant fashion, a case confined to what is called the question of the ‘hostages of the American Embassy in Tehran’.

For this question only represents a marginal and secondary aspect of an overall problem, one such that it cannot be studied separately, and which involves, *inter alia*, more than 25 years of continual interference by the United States in the internal affairs of Iran, the shameless exploitation of our country, and numerous crimes perpetrated against the Iranian people, contrary to and in conflict with all international and humanitarian norms.

The problem involved in the conflict between Iran and the United States is thus not one of the interpretation and the application of the treaties upon which the American Application is based, but results from an overall situation containing much more fundamental and more complex elements. Consequently, the Court cannot examine the American Application divorced from its proper context, namely the whole political dossier of the relations between Iran and the United States over the last 25 years.

With regard to the request for provisional measures, as formulated by the United States, it in fact implies that the Court should have passed judgment on the actual substance of the case submitted to it, which the Court cannot do without breach of the norms governing its jurisdiction. Furthermore, since provisional measures are by definition intended to protect the interest of the parties, they cannot be unilateral, as they are in the request submitted by the American Government.”

The matters raised in those two communications are considered later in this Judgment (paragraphs 33–38 and 81–82).

* * *

11. The position taken up by the Iranian Government in regard to the present proceedings brings into operation Article 53 of the Statute, under which the Court is required *inter alia* to satisfy itself that the claims of the Applicant are well founded in fact. As to this article the Court pointed out in the *Corfu Channel* case that this requirement is to be understood as applying within certain limits :

“While Article 53 thus obliges the Court to consider the submissions of the Party which

appears, it does not compel the Court to examine their accuracy in all their details ; for this might in certain unopposed cases prove impossible in practice. It is sufficient for the Court to convince itself by such methods as it considers suitable that the submissions are well founded." (*I.C.J. Reports 1949*, p. 248.)

In the present case, the United States has explained that, owing to the events in Iran of which it complains, it has been unable since then to have access to its diplomatic and consular representatives, premises and archives in Iran ; and that in consequence it has been unable to furnish detailed factual evidence on some matters occurring after 4 November 1979. It mentioned in particular the lack of any factual evidence concerning the treatment and conditions of the persons held hostage in Tehran. On this point, however, without giving the names of the persons concerned, it has submitted copies of declarations sworn by six of the 13 hostages who had been released after two weeks of detention and returned to the United States in November 1979.

12. The essential facts of the present case are, for the most part, matters of public knowledge which have received extensive coverage in the world press and in radio and television broadcasts from Iran and other countries. They have been presented to the Court by the United States in its Memorial, in statements of its Agent and Counsel during the oral proceedings, and in written replies to questions put by Members of the Court. Annexed or appended to the Memorial are numerous extracts of statements made by Iranian and United States officials, either at press conferences or on radio or television, and submitted to the Court in support of the request for provisional measures and as a means of demonstrating the truth of the account of the facts stated in the Memorial. Included also in the Memorial is a "Statement of Verification" made by a high official of the United States Department of State having "overall responsibility within the Department for matters relating to the crisis in Iran". While emphasizing that in the circumstances of the case the United States has had to rely on newspaper, radio and television reports for a number of the facts stated in the Memorial, the high official concerned certifies that to the best of his knowledge and belief the facts there stated are true. In addition, after the filing of the Memorial, and by leave of the Court, a large quantity of further documents of a similar kind to those already presented were submitted by the United States for the purpose of bringing up to date the Court's information concerning the continuing situation in regard to the occupation of the Embassy and detention of the hostages.

13. The result is that the Court has available to it a massive body of information from various sources concerning the facts and circumstances of the present case, including numerous official statements of both Iranian and United States authorities. So far as newspaper, radio and television reports emanating from Iran are concerned, the Court has necessarily in some cases relied on translations into English supplied by the Applicant. The information available, however, is wholly consistent and concordant as to the main facts and circumstances of the case. This information, as well as the United States Memorial and the records of the oral proceedings, has all been communicated by the Court to the Iranian Government without having evoked from that Government any denial or questioning of the facts alleged before the Court by the United States. Accordingly, the Court is satisfied that, within the meaning of Article 53 of the Statute, the allegations of fact on which the United States bases its claims in the present case are well founded.

* * *

14. Before examining the events of 4 November 1979, directly complained of by the Government of the United States, it is appropriate to mention certain other incidents which occurred before that date. At about 10.45 a.m. on 14 February 1979, during the unrest in Iran following the fall of the Government of Dr. Bakhtiar, the last Prime Minister appointed by the Shah, an armed group attacked and seized the United States Embassy in Tehran, taking prisoner the 70 persons they found there, including the Ambassador. Two persons associated with the Embassy staff were killed ; serious damage was caused to the Embassy and there were some acts of pillaging of the Ambassador's residence. On this occasion, while the Iranian authorities had not been able to

prevent the incursion, they acted promptly in response to the urgent appeal for assistance made by the Embassy during the attack. At about 12 noon, Mr. Yazdi, then a Deputy Prime Minister, arrived at the Embassy accompanied by a member of the national police, at least one official and a contingent of Revolutionary Guards ; they quelled the disturbance and returned control of the compound to American diplomatic officials. On 11 March 1979 the United States Ambassador received a letter dated 1 March from the Prime Minister, Dr. Bazargan, expressing regrets for the attack on the Embassy, stating that arrangements had been made to prevent any repetition of such incidents, and indicating readiness to make reparation for the damage. Attacks were also made during the same period on the United States Consulates in Tabriz and Shiraz.

15. In October 1979, the Government of the United States was contemplating permitting the former Shah of Iran, who was then in Mexico, to enter the United States for medical treatment. Officials of the United States Government feared that, in the political climate prevailing in Iran, the admission of the former Shah might increase the tension already existing between the two States, and *inter alia* result in renewed violence against the United States Embassy in Tehran, and it was decided for this reason to request assurances from the Government of Iran that adequate protection would be provided. On 21 October 1979, at a meeting at which were present the Iranian Prime Minister, Dr. Bazargan, the Iranian Minister for Foreign Affairs, Dr. Yazdi, and the United States Charge d'affaires in Tehran, the Government of Iran was informed of the decision to admit the former Shah to the United States, and of the concern felt by the United States Government about the possible public reaction in Tehran. When the United States Chargé d'affaires requested assurances that the Embassy and its personnel would be adequately protected, assurances were given by the Foreign Minister that the Government of Iran would fulfil its international obligation to protect the Embassy. The request for such assurances was repeated at a further meeting the following day, 22 October, and the Foreign Minister renewed his assurances that protection would be provided. The former Shah arrived in the United States on 22 October. On 30 October, the Government of Iran, which had repeatedly expressed its serious opposition to the admission of the former Shah to the United States, and had asked the United States to permit two Iranian physicians to verify the reality and the nature of his illness, requested the United States to bring about his return to Iran. Nevertheless, on 31 October, the Security Officer of the United States Embassy was told by the Commander of the Iranian National Police that the police had been instructed to provide full protection for the personnel of the Embassy.

16. On 1 November 1979, while a very large demonstration was being held elsewhere in Tehran, large numbers of demonstrators marched to and fro in front of the United States Embassy. Under the then existing security arrangements the Iranian authorities normally maintained 10 to 15 uniformed policemen outside the Embassy compound and a contingent of Revolutionary Guards nearby ; on this occasion the normal complement of police was stationed outside the compound and the Embassy reported to the State Department that it felt confident that it could get more protection if needed. The Chief of Police came to the Embassy personally and met the Chargé d'affaires, who informed Washington that the Chief was "taking his job of protecting the Embassy very seriously". It was announced on the radio, and by the prayer leader at the main demonstration in another location in the city, that people should not go to the Embassy. During the day, the number of demonstrators at the Embassy was around 5,000, but protection was maintained by Iranian security forces. That evening, as the crowd dispersed, both the Iranian Chief of Protocol and the Chief of Police expressed relief to the Chargé d'affaires that everything had gone well.

17. At approximately 10.30 a.m. on 4 November 1979, during the course of a demonstration of approximately 3,000 persons, the United States Embassy compound in Tehran was overrun by a strong armed group of several hundred people. The Iranian security personnel are reported to have simply disappeared from the scene ; at all events it is established that they made no apparent effort to deter or prevent the demonstrators from seizing the Embassy's premises. The invading group (who subsequently described themselves as "Muslim Student Followers of the Imam's Policy",

and who will hereafter be referred to as “the militants”) gained access by force to the compound and to the ground floor of the Chancery building. Over two hours after the beginning of the attack, and after the militants had attempted to set fire to the Chancery building and to cut through the upstairs steel doors with a torch, they gained entry to the upper floor ; one hour later they gained control of the main vault. The militants also seized the other buildings, including the various residences, on the Embassy compound. In the course of the attack, all the diplomatic and consular personnel and other persons present in the premises were seized as hostages, and detained in the Embassy compound ; subsequently other United States personnel and one United States private citizen seized elsewhere in Tehran were brought to the compound and added to the number of hostages.

18. During the three hours or more of the assault, repeated calls for help were made from the Embassy to the Iranian Foreign Ministry, and repeated efforts to secure help from the Iranian authorities were also made through direct discussions by the United States Chargé d'affaires, who was at the Foreign Ministry at the time, together with two other members of the mission. From there he made contact with the Prime Minister's Office and with Foreign Ministry officials. A request was also made to the Iranian Chargé d'affaires in Washington for assistance in putting an end to the seizure of the Embassy. Despite these repeated requests, no Iranian security forces were sent in time to provide relief and protection to the Embassy. In fact when Revolutionary Guards ultimately arrived on the scene, despatched by the Government “to prevent clashes”, they considered that their task was merely to “protect the safety of both the hostages and the students”, according to statements subsequently made by the Iranian Government's spokesman, and by the operations commander of the Guards. No attempt was made by the Iranian Government to clear the Embassy premises, to rescue the persons held hostage, or to persuade the militants to terminate their action against the Embassy.

19. During the morning of 5 November, only hours after the seizure of the Embassy, the United States Consulates in Tabriz and Shiraz were also seized ; again the Iranian Government took no protective action. The operation of these Consulates had been suspended since the attack in February 1979 (paragraph 14 above), and therefore no United States personnel were seized on these premises.

20. The United States diplomatic mission and consular posts in Iran were not the only ones whose premises were subjected to demonstrations during the revolutionary period in Iran. On 5 November 1979, a group invaded the British Embassy in Tehran but was ejected after a brief occupation. On 6 November 1979 a brief occupation of the Consulate of Iraq at Kermanshah occurred but was brought to an end on instructions of the Ayatollah Khomeini ; no damage was done to the Consulate or its contents. On 1 January 1980 an attack was made on the Embassy in Tehran of the USSR by a large mob, but as a result of the protection given by the Iranian authorities to the Embassy, no serious damage was done.

21. The premises of the United States Embassy in Tehran have remained in the hands of militants ; and the same appears to be the case with the Consulates at Tabriz and Shiraz. Of the total number of United States citizens seized and held as hostages, 13 were released on 18–20 November 1979, but the remainder have continued to be held up to the present time. The release of the 13 hostages was effected pursuant to a decree by the Ayatollah Khomeini addressed to the militants, dated 17 November 1979, in which he called upon the militants to “hand over the blacks and the women, if it is proven they did not spy, to the Ministry of Foreign Affairs so that they may be immediately expelled from Iran”.

22. The persons still held hostage in Iran include, according to the information furnished to the Court by the United States, at least 28 persons having the status, duly recognized by the Government of Iran, of “member of the diplomatic staff” within the meaning of the Vienna Convention on Diplomatic Relations of 1961; at least 20 persons having the status, similarly

recognized, of “member of the administrative and technical staff” within the meaning of that Convention ; and two other persons of United States nationality not possessing either diplomatic or consular status. Of the persons with the status of member of the diplomatic staff, four are members of the Consular Section of the Mission.

23. Allegations have been made by the Government of the United States of inhumane treatment of hostages ; the militants and Iranian authorities have asserted that the hostages have been well treated, and have allowed special visits to the hostages by religious personalities and by representatives of the International Committee of the Red Cross. The specific allegations of ill-treatment have not however been refuted. Examples of such allegations, which are mentioned in some of the sworn declarations of hostages released in November 1979, are as follows : at the outset of the occupation of the Embassy some were paraded bound and blindfolded before hostile and chanting crowds ; at least during the initial period of their captivity, hostages were kept bound, and frequently blindfolded, denied mail or any communication with their government or with each other, subjected to interrogation, threatened with weapons.

24. Those archives and documents of the United States Embassy which were not destroyed by the staff during the attack on 4 November have been ransacked by the militants. Documents purporting to come from this source have been disseminated by the militants and by the Government-controlled media.

25. The United States Chargé d'affaires in Tehran and the two other members of the diplomatic staff of the Embassy who were in the premises of the Iranian Ministry of Foreign Affairs at the time of the attack have not left the Ministry since ; their exact situation there has been the subject of conflicting statements. On 7 November 1979, it was stated in an announcement by the Iranian Foreign Ministry that “as the protection of foreign nationals is the duty of the Iranian Government”, the Chargé d'affaires was “staying in” the Ministry. On 1 December 1979, Mr. Sadegh Ghotbzadeh, who had become Foreign Minister, stated that

“it has been announced that, if the U.S. Embassy's chargé d'affaires and his two companions, who have sought asylum in the Iranian Ministry of Foreign Affairs, should leave this ministry, the ministry would not accept any responsibility for them”.

According to a press report of 4 December, the Foreign Minister amplified this statement by saying that as long as they remained in the ministry he was personally responsible for ensuring that nothing happened to them, but that “as soon as they leave the ministry precincts they will fall back into the hands of justice, and then I will be the first to demand that they be arrested and tried”. The militants made it clear that they regarded the Chargé and his two colleagues as hostages also. When in March 1980 the Public Prosecutor of the Islamic Revolution of Iran called for one of the three diplomats to be handed over to him, it was announced by the Foreign Minister that

“Regarding the fate of the three Americans in the Ministry of Foreign Affairs, the decision rests first with the imam of the nation [i.e., the Ayatollah Khomeini] ; in case there is no clear decision by the imam of the nation, the Revolution Council will make a decision on this matter.”

26. From the outset of the attack upon its Embassy in Tehran, the United States protested to the Government of Iran both at the attack and at the seizure and detention of the hostages. On 7 November a former Attorney-General of the United States, Mr. Ramsey Clark, was instructed to go with an assistant to Iran to deliver a message from the President of the United States to the Ayatollah Khomeini. The text of that message has not been made available to the Court by the Applicant, but the United States Government has informed the Court that it thereby protested at the conduct of the Government of Iran and called for release of the hostages, and that Mr. Clark was also authorized to discuss all avenues for resolution of the crisis. While he was en route, Tehran radio broadcast a message from the Ayatollah Khomeini dated 7 November, solemnly forbidding

members of the Revolutionary Council and all the responsible officials to meet the United States representatives. In that message it was asserted that “the U.S. Embassy in Iran is our enemies' centre of espionage against our sacred Islamic movement”, and the message continued :

“Should the United States hand over to Iran the deposed shah ... and give up espionage against our movement, the way to talks would be opened on the issue of certain relations which are in the interest of the nation.”

Subsequently, despite the efforts of the United States Government to open negotiations, it became clear that the Iranian authorities would have no direct contact with representatives of the United States Government concerning the holding of the hostages.

27. During the period which has elapsed since the seizure of the Embassy a number of statements have been made by various governmental authorities in Iran which are relevant to the Court's examination of the responsibility attributed to the Government of Iran in the submissions of the United States. These statements will be examined by the Court in considering these submissions (paragraphs 59 and 70–74 below).

* *

28. On 9 November 1979, the Permanent Representative of the United States to the United Nations addressed a letter to the President of the Security Council, requesting urgent consideration of what might be done to secure the release of the hostages and to restore the “sanctity of diplomatic personnel and establishments”. The same day, the President of the Security Council made a public statement urging the release of the hostages, and the President of the General Assembly announced that he was sending a personal message to the Ayatollah Khomeini appealing for their release. On 25 November 1979, the Secretary-General of the United Nations addressed a letter to the President of the Security Council referring to the seizure of the United States Embassy in Tehran and the detention of its diplomatic personnel, and requesting an urgent meeting of the Security Council “in an effort to seek a peaceful solution to the problem”. The Security Council met on 27 November and 4 December 1979 ; on the latter occasion, no representative of Iran was present, but the Council took note of a letter of 13 November 1979 from the Supervisor of the Iranian Foreign Ministry to the Secretary-General. The Security Council then adopted resolution 457 (1979), calling on Iran to release the personnel of the Embassy immediately, to provide them with protection and to allow them to leave the country. The resolution also called on the two Governments to take steps to resolve peacefully the remaining issues between them, and requested the Secretary-General to lend his good offices for the immediate implementation of the resolution, and to take all appropriate measures to that end. It further stated that the Council would “remain actively seized of the matter” and requested the Secretary-General to report to it urgently on any developments with regard to his efforts.

29. On 31 December 1979, the Security Council met again and adopted resolution 461 (1979), in which it reiterated both its calls to the Iranian Government and its request to the Secretary-General to lend his good offices for achieving the object of the Council's resolution. The Secretary-General visited Tehran on 1–3 January 1980, and reported to the Security Council on 6 January. On 20 February 1980, the Secretary-General announced the setting up of a commission to undertake a “fact-finding mission” to Iran. The Court will revert to the terms of reference of this commission and the progress of its work in connection with a question of admissibility of the proceedings (paragraphs 39–40 below).

* *

30. Prior to the institution of the present proceedings, in addition to the approach made by the Government of the United States to the United Nations Security Council, that Government also took certain unilateral action in response to the actions for which it holds the Government of Iran

responsible. On 10 November 1979, steps were taken to identify all Iranian students in the United States who were not in compliance with the terms of their entry visas, and to commence deportation proceedings against those who were in violation of applicable immigration laws and regulations. On 12 November 1979, the President of the United States ordered the discontinuation of all oil purchases from Iran for delivery to the United States. Believing that the Government of Iran was about to withdraw all Iranian funds from United States banks and to refuse to accept payment in dollars for oil, and to repudiate obligations owed to the United States and to United States nationals, the President on 14 November 1979 acted to block the very large official Iranian assets in the United States or in United States control, including deposits both in banks in the United States and in foreign branches and subsidiaries of United States banks. On 12 December 1979, after the institution of the present proceedings, the United States informed the Iranian Chargé d'affaires in Washington that the number of personnel assigned to the Iranian Embassy and consular posts in the United States was to be restricted.

31. Subsequently to the indication by the Court of provisional measures, and during the present proceedings, the United States Government took other action. A draft resolution was introduced into the United Nations Security Council calling for economic sanctions against Iran. When it was put to the vote on 13 January 1980, the result was 10 votes in favour, 2 against, and 2 abstentions (one member not having participated in the voting) ; as a permanent member of the Council cast a negative vote, the draft resolution was not adopted. On 7 April 1980 the United States Government broke off diplomatic relations with the Government of Iran. At the same time, the United States Government prohibited exports from the United States to Iran—one of the sanctions previously proposed by it to the Security Council. Steps were taken to prepare an inventory of the assets of the Government of Iran frozen on 14 November 1979, and to make a census of outstanding claims of American nationals against the Government of Iran, with a view to “designing a program against Iran for the hostages, the hostage families and other U.S. claimants” involving the preparation of legislation “to facilitate processing and paying of these claims” and all visas issued to Iranian citizens for future entry into the United States were cancelled. On 17 April 1980, the United States Government announced further economic measures directed against Iran, prohibited travel there by United States citizens, and made further plans for reparations to be paid to the hostages and their families out of frozen Iranian assets.

32. During the night of 24–25 April 1980 the President of the United States set in motion, and subsequently terminated for technical reasons, an operation within Iranian territory designed to effect the rescue of the hostages by United States military units. In an announcement made on 25 April, President Carter explained that the operation had been planned over a long period as a humanitarian mission to rescue the hostages, and had finally been set in motion by him in the belief that the situation in Iran posed mounting dangers to the safety of the hostages and that their early release was highly unlikely. He stated that the operation had been under way in Iran when equipment failure compelled its termination ; and that in the course of the withdrawal of the rescue forces two United States aircraft had collided in a remote desert location in Iran. He further stated that preparations for the rescue operations had been ordered for humanitarian reasons, to protect the national interests of the United States, and to alleviate international tensions. At the same time, he emphasized that the operation had not been motivated by hostility towards Iran or the Iranian people. The texts of President Carter's announcement and of certain other official documents relating to the operation have been transmitted to the Court by the United States Agent in response to a request made by the President of the Court on 25 April. Amongst these documents is the text of a report made by the United States to the Security Council on 25 April, “pursuant to Article 51 of the Charter of the United Nations”. In that report, the United States maintained that the mission had been carried out by it “in exercise of its inherent right of self-defence with the aim of extricating American nationals who have been and remain the victims of the Iranian armed attack on our Embassy”. The Court will refer further to this operation later in the present Judgment (paragraphs 93 and 94 below).

* * *

33. It is to be regretted that the Iranian Government has not appeared before the Court in order to put forward its arguments on the questions of law and of fact which arise in the present case ; and that, in consequence, the Court has not had the assistance it might have derived from such arguments or from any evidence adduced in support of them. Nevertheless, in accordance with its settled jurisprudence, the Court, in applying Article 53 of its Statute, must first take up, *proprio motu*, any preliminary question, whether of admissibility or of jurisdiction, that appears from the information before it to arise in the case and the decision of which might constitute a bar to any further examination of the merits of the Applicant's case. The Court will, therefore, first address itself to the considerations put forward by the Iranian Government in its letters of 9 December 1979 and 16 March 1980, on the basis of which it maintains that the Court ought not to take cognizance of the present case.

34. The Iranian Government in its letter of 9 December 1979 drew attention to what it referred to as the “deep rootedness and the essential character of the Islamic Revolution of Iran, a revolution of a whole oppressed nation against its oppressors and their masters”. The examination of the “numerous repercussions” of the revolution, it added, is “a matter essentially and directly within the national sovereignty of Iran”. However, as the Court pointed out in its Order of 15 December 1979,

“a dispute which concerns diplomatic and consular premises and the detention of internationally protected persons, and involves the interpretation or application of multilateral conventions codifying the international law governing diplomatic and consular relations, is one which by its very nature falls within international jurisdiction (*I.C.J. Reports 1979*, p. 16, para. 25).

In its later letter of 16 March 1980 the Government of Iran confined itself to repeating the observations on this point which it had made in its letter of 9 December 1979, without putting forward any additional arguments or explanations. In these circumstances, the Court finds it sufficient here to recall and confirm its previous statement on the matter in its Order of 15 December 1979.

35. In its letter of 9 December 1979 the Government of Iran maintained that the Court could not and should not take cognizance of the present case for another reason, namely that the case submitted to the Court by the United States, is “confined to what is called the question of the ‘hostages of the American Embassy in Tehran’ ”. It then went on to explain why it considered this to preclude the Court from taking cognizance of the case :

For this question only represents a marginal and secondary aspect of an overall problem, one such that it cannot be studied separately, and which involves, *inter alia*, more than 25 years of continual interference by the United States in the internal affairs of Iran, the shameless exploitation of our country, and numerous crimes perpetrated against the Iranian people, contrary to and in conflict with all international and humanitarian norms.

The problem involved in the conflict between Iran and the United States is thus not one of the interpretation and the application of the treaties upon which the American Application is based, but results from an overall situation containing much more fundamental and more complex elements. Consequently, the Court cannot examine the American Application divorced from its proper context, namely the whole political dossier of the relations between Iran and the United States over the last 25 years. This dossier includes, *inter alia*, all the crimes perpetrated in Iran by the American Government, in particular the *coup d'état* of 1953 stirred up and carried out by the CIA, the overthrow of the lawful national government of Dr. Mossadegh, the restoration of the Shah and of his régime which was under the control of American interests, and all the social, economic, cultural and political

consequences of the direct interventions in our internal affairs, as well as grave, flagrant and continuous violations of all international norms, committed by the United States in Iran.”

36. The Court, however, in its Order of 15 December 1979, made it clear that the seizure of the United States Embassy and Consulates and the detention of internationally protected persons as hostages cannot be considered as something “secondary” or “marginal”, having regard to the importance of the legal principles involved. It also referred to a statement of the Secretary-General of the United Nations, and to Security Council resolution 457 (1979), as evidencing the importance attached by the international community as a whole to the observance of those principles in the present case as well as its concern at the dangerous level of tension between Iran and the United States. The Court, at the same time, pointed out that no provision of the Statute or Rules contemplates that the Court should decline to take cognizance of one aspect of a dispute merely because that dispute has other aspects, however important. It further underlined that, if the Iranian Government considered the alleged activities of the United States in Iran legally to have a close connection with the subject-matter of the United States' Application, it was open to that Government to present its own arguments regarding those activities to the Court either by way of defence in a Counter-Memorial or by way of a counter-claim.

37. The Iranian Government, notwithstanding the terms of the Court's Order, did not file any pleadings and did not appear before the Court. By its own choice, therefore, it has forgone the opportunities offered to it under the Statute and Rules of Court to submit evidence and arguments in support of its contention in regard to the “overall problem”. Even in its later letter of 16 March 1980, the Government of Iran confined itself to repeating what it had said in its letter of 9 December 1979, without offering any explanations in regard to the points to which the Court had drawn attention in its Order of 15 December 1979. It has provided no explanation of the reasons why it considers that the violations of diplomatic and consular law alleged in the United States' Application cannot be examined by the Court separately from what it describes as the “overall problem” involving “more than 25 years of continual interference by the United States in the internal affairs of Iran”. Nor has it made any attempt to explain, still less define, what connection, legal or factual, there may be between the “overall problem” of its general grievances against the United States and the particular events that gave rise to the United States' claims in the present case which, in its view, precludes the separate examination of those claims by the Court. This was the more necessary because legal disputes between sovereign States by their very nature are likely to occur in political contexts, and often form only one element in a wider and long-standing political dispute between the States concerned. Yet never has the view been put forward before that, because a legal dispute submitted to the Court is only one aspect of a political dispute, the Court should decline to resolve for the parties the legal questions at issue between them. Nor can any basis for such a view of the Court's functions or jurisdiction be found in the Charter or the Statute of the Court ; if the Court were, contrary to its settled jurisprudence, to adopt such a view, it would impose a far-reaching and unwarranted restriction upon the role of the Court in the peaceful solution of international disputes.

38. It follows that the considerations and arguments put forward in the Iranian Government's letters of 9 December 1979 and 16 March 1980 do not, in the opinion of the Court, disclose any ground on which it should conclude that it cannot or ought not to take cognizance of the present case.

* *

39. The Court, however, has also thought it right to examine, *ex officio*, whether its competence to decide the present case, or the admissibility of the present proceedings, might possibly have been affected by the setting up of the Commission announced by the Secretary-General of the United Nations on 20 February 1980. As already indicated, the occupation of the Embassy and detention of its diplomatic and consular staff as hostages was referred to the United Nations Security Council

by the United States on 9 November 1979 and by the Secretary-General on 25 November. Four days later, while the matter was still before the Security Council, the United States submitted the present Application to the Court together with a request for the indication of provisional measures. On 4 December, the Security Council adopted resolution 457 (1979) (the terms of which have already been indicated in paragraph 28 above), whereby the Council would “remain actively seized of the matter” and the Secretary-General was requested to report to it urgently on developments regarding the efforts he was to make pursuant to the resolution. In announcing the setting up of the Commission on 20 February 1980, the Secretary-General stated its terms of reference to be “to undertake a fact-finding mission to Iran to hear Iran's grievances and to allow for an early solution of the crisis between Iran and the United States” ; and he further stated that it was to complete its work as soon as possible and submit its report to him. Subsequently, in a message cabled to the President of the Court on 15 March 1980, the Secretary-General confirmed the mandate of the Commission to be as stated in his announcement of 20 February, adding that the Governments of Iran and the United States had “agreed to the establishment of the Commission on that basis”. In this message, the Secretary-General also informed the Court of the decision of the Commission to suspend its activities in Tehran and to return to New York on 11 March 1980 “to confer with the Secretary-General with a view to pursuing its tasks which it regards as indivisible”. The message stated that while, in the circumstances, the Commission was not in a position to submit its report, it was prepared to return to Tehran, in accordance with its mandate and the instructions of the Secretary-General, when the situation required. The message further stated that the Secretary-General would continue his efforts, as requested by the Security Council, to search for a peaceful solution of the crisis, and would remain in contact with the parties and the Commission regarding the resumption of its work.

40. Consequently, there can be no doubt at all that the Security Council was “actively seized of the matter” and that the Secretary-General was under an express mandate from the Council to use his good offices in the matter when, on 15 December, the Court decided unanimously that it was competent to entertain the United States' request for an indication of provisional measures, and proceeded to indicate such measures. As already mentioned the Council met again on 31 December 1979 and adopted resolution 461 (1979). In the preamble to this second resolution the Security Council expressly took into account the Court's Order of 15 December 1979 indicating provisional measures ; and it does not seem to have occurred to any member of the Council that there was or could be anything irregular in the simultaneous exercise of their respective functions by the Court and the Security Council. Nor is there in this any cause for surprise. Whereas Article 12 of the Charter expressly forbids the General Assembly to make any recommendation with regard to a dispute or situation while the Security Council is exercising its functions in respect of that dispute or situation, no such restriction is placed on the functioning of the Court by any provision of either the Charter or the Statute of the Court. The reasons are clear. It is for the Court, the principal judicial organ of the United Nations, to resolve any legal questions that may be in issue between parties to a dispute ; and the resolution of such legal questions by the Court may be an important, and sometimes decisive, factor in promoting the peaceful settlement of the dispute. This is indeed recognized by Article 36 of the Charter, paragraph 3 of which specifically provides that :

“In making recommendations under this Article the Security Council should also take into consideration that legal disputes should as a general rule be referred by the parties to the International Court of Justice in accordance with the provisions of the Statute of the Court.”

41. In the present instance the proceedings before the Court continued in accordance with the Statute and Rules of Court and, on 15 January 1980, the United States filed its Memorial. The time-limit fixed for delivery of Iran's Counter-Memorial then expired on 18 February 1980 without Iran's having filed a Counter-Memorial or having made a request for the extension of the time-limit. Consequently, on the following day the case became ready for hearing and, pursuant to Article 31 of the Rules, the views of the Applicant State were requested regarding the date for the opening of the oral proceedings. On 19 February 1980 the Court was informed by the United States Agent that,

owing to the delicate stage of negotiations bearing upon the release of the hostages in the United States Embassy, he would be grateful if the Court for the time being would defer setting a date for the opening of the oral proceedings. On the very next day, 20 February, the Secretary-General announced the establishment of the above-mentioned Commission, which commenced its work in Tehran on 23 February. Asked on 27 February to clarify the position of the United States in regard to the future procedure, the Agent stated that the Commission would not address itself to the claims submitted by the United States to the Court. The United States, he said, continued to be anxious to secure an early judgment on the merits, and he suggested 17 March as a convenient date for the opening of the oral proceedings. At the same time, however, he added that consideration of the well-being of the hostages might lead the United States to suggest a later date. The Iranian Government was then asked, in a telex message of 28 February, for any views it might wish to express as to the date for the opening of the hearings, mention being made of 17 March as one possible date. No reply had been received from the Iranian Government when, on 10 March, the Commission, unable to complete its mission, decided to suspend its activities in Tehran and to return to New York.

42. On 11 March, that is immediately upon the departure of the Commission from Tehran, the United States notified the Court of its readiness to proceed with the hearings, suggesting that they should begin on 17 March. A further telex was accordingly sent to the Iranian Government on 12 March informing it of the United States' request and stating that the Court would meet on 17 March to determine the subsequent procedure. The Iranian Government's reply was contained in the letter of 16 March to which the Court has already referred (paragraph 10 above). In that letter, while making no mention of the proposed oral proceedings, the Iranian Government reiterated the reasons advanced in its previous letter of 9 December 1979 for considering that the Court ought not to take cognizance of the case. The letter contained no reference to the Commission, and still less any suggestion that the continuance of the proceedings before the Court might be affected by the existence of the Commission or the mandate given to the Secretary-General by the Security Council. Having regard to the circumstances which the Court has described, it can find no trace of any understanding on the part of either the United States or Iran that the establishment of the Commission might involve a postponement of all proceedings before the Court until the conclusion of the work of the Commission and of the Security Council's consideration of the matter.

43. The Commission, as previously observed, was established to undertake a "fact-finding mission to Iran to hear Iran's grievances and to *allow* for an early solution of the *crisis* between Iran and the United States" (emphasis added). It was not set up by the Secretary-General as a tribunal empowered to decide the matters of fact or of law in dispute between Iran and the United States ; nor was its setting up accepted by them on any such basis. On the contrary, he created the Commission rather as an organ or instrument for mediation, conciliation or negotiation to provide a means of easing the situation of crisis existing between the two countries ; and this, clearly, was the basis on which Iran and the United States agreed to its being set up. The establishment of the Commission by the Secretary-General with the agreement of the two States cannot, therefore, be considered in itself as in any way incompatible with the continuance of parallel proceedings before the Court. Negotiation, enquiry, mediation, conciliation, arbitration and judicial settlement are enumerated together in Article 33 of the Charter as means for the peaceful settlement of disputes. As was pointed out in the *Aegean Sea Continental Shelf* case, the jurisprudence of the Court provides various examples of cases in which negotiations and recourse to judicial settlement by the Court have been pursued *pari passu*. In that case, in which also the dispute had been referred to the Security Council, the Court held expressly that "the fact that negotiations are being actively pursued during the present proceedings is not, legally, any obstacle to the exercise by the Court of its judicial function" (*I.C.J. Reports 1978*, p. 12, para. 29).

44. It follows that neither the mandate given by the Security Council to the Secretary-General in resolutions 457 and 461 of 1979, nor the setting up of the Commission by the Secretary-General, can be considered as constituting any obstacle to the exercise of the Court's jurisdiction in the

present case. It further follows that the Court must now proceed, in accordance with Article 53, paragraph 2, of the Statute, to determine whether it has jurisdiction to decide the present case and whether the United States' claims are well founded in fact and in law.

* * *

45. Article 53 of the Statute requires the Court, before deciding in favour of an Applicant's claim, to satisfy itself that it has jurisdiction, in accordance with Articles 36 and 37, empowering it to do so. In the present case the principal claims of the United States relate essentially to alleged violations by Iran of its obligations to the United States under the Vienna Conventions of 1961 on Diplomatic Relations and of 1963 on Consular Relations. With regard to these claims the United States has invoked as the basis for the Court's jurisdiction Article I of the Optional Protocols concerning the Compulsory Settlement of Disputes which accompany these Conventions. The United Nations publication *Multilateral Treaties in respect of which the Secretary-General Performs Depository Functions* lists both Iran and the United States as parties to the Vienna Conventions of 1961 and 1963, as also to their accompanying Protocols concerning the Compulsory Settlement of Disputes, and in each case without any reservation to the instrument in question. The Vienna Conventions, which codify the law of diplomatic and consular relations, state principles and rules essential for the maintenance of peaceful relations between States and accepted throughout the world by nations of all creeds, cultures and political complexions. Moreover, the Iranian Government has not maintained in its communications to the Court that the two Vienna Conventions and Protocols are not in force as between Iran and the United States. Accordingly, as indicated in the Court's Order of 15 December 1979, the Optional Protocols manifestly provide a possible basis for the Court's jurisdiction, with respect to the United States' claims under the Vienna Conventions of 1961 and 1963. It only remains, therefore, to consider whether the present dispute in fact falls within the scope of their provisions.

46. The terms of Article I, which are the same in the two Protocols, provide :

“Disputes arising out of the interpretation or application of the Convention shall lie within the compulsory jurisdiction of the International Court of Justice and may accordingly be brought before the Court by an application made by any party to the dispute being a Party to the present Protocol.”

The United States' claims here in question concern alleged violations by Iran of its obligations under several articles of the Vienna Conventions of 1961 and 1963 with respect to the privileges and immunities of the personnel, the inviolability of the premises and archives, and the provision of facilities for the performance of the functions of the United States Embassy and Consulates in Iran. In so far as its claims relate to two private individuals held hostage in the Embassy, the situation of these individuals falls under the provisions of the Vienna Convention of 1961 guaranteeing the inviolability of the premises of embassies, and of Article 5 of the 1963 Convention concerning the consular functions of assisting nationals and protecting and safeguarding their interests. By their very nature all these claims concern the interpretation or application of one or other of the two Vienna Conventions.

47. The occupation of the United States Embassy by militants on 4 November 1979 and the detention of its personnel as hostages was an event of a kind to provoke an immediate protest from any government, as it did from the United States Government, which despatched a special emissary to Iran to deliver a formal protest. Although the special emissary, denied all contact with Iranian officials, never entered Iran, the Iranian Government was left in no doubt as to the reaction of the United States to the taking over of its Embassy and detention of its diplomatic and consular staff as hostages. Indeed, the Court was informed that the United States was meanwhile making its views known to the Iranian Government through its Chargé d'affaires, who has been kept since 4 November 1979 in the Iranian Foreign Ministry itself, where he happened to be with two other members of his mission during the attack on the Embassy. In any event, by a letter of 9 November

1979, the United States brought the situation in regard to its Embassy before the Security Council. The Iranian Government did not take any part in the debates on the matter in the Council, and it was still refusing to enter into any discussions on the subject when, on 29 November 1979, the United States filed the present Application submitting its claims to the Court. It is clear that on that date there existed a dispute arising out of the interpretation or application of the Vienna Conventions and thus one falling within the scope of Article I of the Protocols.

48. Articles II and III of the Protocols, it is true, provide that within a period of two months after one party has notified its opinion to the other that a dispute exists, the parties may agree either : (a) “to resort not to the International Court of Justice but to an arbitral tribunal”, or (b) “to adopt a conciliation procedure before resorting to the International Court of Justice”. The terms of Articles II and III however, when read in conjunction with those of Article I and with the Preamble to the Protocols, make it crystal clear that they are not to be understood as laying down a precondition of the applicability of the precise and categorical provision contained in Article I establishing the compulsory jurisdiction of the Court in respect of disputes arising out of the interpretation or application of the Vienna Convention in question. Articles II and III provide only that, as a substitute for recourse to the Court, the parties *may agree* upon resort either to arbitration or to conciliation. It follows, first, that Articles II and III have no application unless recourse to arbitration or conciliation has been proposed by one of the parties to the dispute and the other has expressed its readiness to consider the proposal. Secondly, it follows that only then may the provisions in those articles regarding a two months' period come into play, and function as a time-limit upon the conclusion of the agreement as to the organization of the alternative procedure.

49. In the present instance, neither of the parties to the dispute proposed recourse to either of the two alternatives, before the filing of the Application or at any time afterwards. On the contrary, the Iranian authorities refused to enter into any discussion of the matter with the United States, and this could only be understood by the United States as ruling out, *in limine*, any question of arriving at an agreement to resort to arbitration or conciliation under Article II or Article III of the Protocols, instead of recourse to the Court. Accordingly, when the United States filed its Application on 29 November 1979, it was unquestionably free to have recourse to Article I of the Protocols, and to invoke it as a basis for establishing the Court's jurisdiction with respect to its claims under the Vienna Conventions of 1961 and 1963.

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50. However, the United States also presents claims in respect of alleged violations by Iran of Articles II, paragraph 4, XIII, XVIII and XIX of the Treaty of Amity, Economic Relations, and Consular Rights of 1955 between the United States and Iran, which entered into force on 16 June 1957. With regard to these claims the United States has invoked paragraph 2 of Article XXI of the Treaty as the basis for the Court's jurisdiction. The claims of the United States under this Treaty overlap in considerable measure with its claims under the two Vienna Conventions and more especially the Convention of 1963. In this respect, therefore, the dispute between the United States and Iran regarding those claims is at the same time a dispute arising out of the interpretation or application of the Vienna Conventions which falls within Article I of their Protocols. It was for this reason that in its Order of 15 December 1979 indicating provisional measures the Court did not find it necessary to enter into the question whether Article XXI, paragraph 2, of the 1955 Treaty might also have provided a basis for the exercise of its jurisdiction in the present case. But taking into account that Article II, paragraph 4, of the 1955 Treaty provides that “nationals of either High Contracting Party shall receive the most constant protection and security within the territories of the other High Contracting Party ...”, the Court considers that at the present stage of the proceedings that Treaty has importance in regard to the claims of the United States in respect of the two private individuals said to be held hostage in Iran. Accordingly, the Court will now consider whether a basis for the exercise of its jurisdiction with respect to the alleged violations of the 1955 Treaty may be found in Article XXI, paragraph 2, of the Treaty.

51. Paragraph 2 of that Article reads :

“Any dispute between the High Contracting Parties as to the interpretation or application of the present Treaty, not satisfactorily adjusted by diplomacy, shall be submitted to the International Court of Justice, unless the High Contracting Parties agree to settlement by some other pacific means.”

As previously pointed out, when the United States filed its Application on 29 November 1979, its attempts to negotiate with Iran in regard to the overrunning of its Embassy and detention of its nationals as hostages had reached a deadlock, owing to the refusal of the Iranian Government to enter into any discussion of the matter. In consequence, there existed at that date not only a dispute but, beyond any doubt, a “dispute ... not satisfactorily adjusted by diplomacy” within the meaning of Article XXI, paragraph 2, of the 1955 Treaty ; and this dispute comprised, *inter alia*, the matters that are the subject of the United States' claims under that Treaty.

52. The provision made in the 1955 Treaty for disputes as to its interpretation or application to be referred to the Court is similar to the system adopted in the Optional Protocols to the Vienna Conventions which the Court has already explained. Article XXI, paragraph 2, of the Treaty establishes the jurisdiction of the Court as compulsory for such disputes, unless the parties *agree* to settlement by some other means. In the present instance, as in the case of the Optional Protocols, the immediate and total refusal of the Iranian authorities to enter into any negotiations with the United States excluded *in limine* any question of an *agreement* to have recourse to “some other pacific means” for the settlement of the dispute. Consequently, under the terms of Article XXI, paragraph 2, the United States was free on 29 November 1979 to invoke its provisions for the purpose of referring its claims against Iran under the 1955 Treaty to the Court. While that Article does not provide in express terms that either party may bring a case to the Court by unilateral application, it is evident, as the United States contended in its Memorial, that this is what the parties intended. Provisions drawn in similar terms are very common in bilateral treaties of amity or of establishment, and the intention of the parties in accepting such clauses is clearly to provide for such a right of unilateral recourse to the Court, in the absence of agreement to employ some other pacific means of settlement.

53. The point has also been raised whether, having regard to certain counter-measures taken by the United States vis-à-vis Iran, it is open to the United States to rely on the Treaty of Amity, Economic Relations, and Consular Rights in the present proceedings. However, all the measures in question were taken by the United States after the seizure of its Embassy by an armed group and subsequent detention of its diplomatic and consular staff as hostages. They were measures taken in response to what the United States believed to be grave and manifest violations of international law by Iran, including violations of the 1955 Treaty itself. In any event, any alleged violation of the Treaty by either party could not have the effect of precluding that party from invoking the provisions of the Treaty concerning pacific settlement of disputes.

54. No suggestion has been made by Iran that the 1955 Treaty was not in force on 4 November 1979 when the United States Embassy was overrun and its nationals taken hostage, or on 29 November when the United States submitted the dispute to the Court. The very purpose of a treaty of amity, and indeed of a treaty of establishment, is to promote friendly relations between the two countries concerned, and between their two peoples, more especially by mutual undertakings to ensure the protection and security of their nationals in each other's territory. It is precisely when difficulties arise that the treaty assumes its greatest importance, and the whole object of Article XXI, paragraph 2, of the 1955 Treaty was to establish the means for arriving at a friendly settlement of such difficulties by the Court or by other peaceful means. It would, therefore, be incompatible with the whole purpose of the 1955 Treaty if recourse to the Court under Article XXI, paragraph 2, were now to be found not to be open to the parties precisely at the moment when such recourse was most needed. Furthermore, although the machinery for the effective operation of the 1955 Treaty

has, no doubt, now been impaired by reason of diplomatic relations between the two countries having been broken off by the United States, its provisions remain part of the corpus of law applicable between the United States and Iran.

* *

55. The United States has further invoked Article 13 of the Convention of 1973 on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents, as a basis for the exercise of the Court's jurisdiction with respect to its claims under that Convention. The Court does not, however, find it necessary in the present Judgment to enter into the question whether, in the particular circumstances of the case, Article 13 of that Convention provides a basis for the exercise of the Court's jurisdiction with respect to those claims.

* * *

56. The principal facts material for the Court's decision on the merits of the present case have been set out earlier in this Judgment. Those facts have to be looked at by the Court from two points of view. First, it must determine how far, legally, the acts in question may be regarded as imputable to the Iranian State. Secondly, it must consider their compatibility or incompatibility with the obligations of Iran under treaties in force or under any other rules of international law that may be applicable. The events which are the subject of the United States' claims fall into two phases which it will be convenient to examine separately.

57. The first of these phases covers the armed attack on the United States Embassy by militants on 4 November 1979, the overrunning of its premises, the seizure of its inmates as hostages, the appropriation of its property and archives and the conduct of the Iranian authorities in the face of those occurrences. The attack and the subsequent overrunning, bit by bit, of the whole Embassy premises, was an operation which continued over a period of some three hours without any body of police, any military unit or any Iranian official intervening to try to stop or impede it from being carried through to its completion. The result of the attack was considerable damage to the Embassy premises and property, the forcible opening and seizure of its archives, the confiscation of the archives and other documents found in the Embassy and, most grave of all, the seizure by force of its diplomatic and consular personnel as hostages, together with two United States nationals.

58. No suggestion has been made that the militants, when they executed their attack on the Embassy, had any form of official status as recognized "agents" or organs of the Iranian State. Their conduct in mounting the attack, overrunning the Embassy and seizing its inmates as hostages cannot, therefore, be regarded as imputable to that State on that basis. Their conduct might be considered as itself directly imputable to the Iranian State only if it were established that, in fact, on the occasion in question the militants acted on behalf of the State, having been charged by some competent organ of the Iranian State to carry out a specific operation. The information before the Court does not, however, suffice to establish with the requisite certainty the existence at that time of such a link between the militants and any competent organ of the State.

59. Previously, it is true, the religious leader of the country, the Ayatollah Khomeini, had made several public declarations inveighing against the United States as responsible for all his country's problems. In so doing, it would appear, the Ayatollah Khomeini was giving utterance to the general resentment felt by supporters of the revolution at the admission of the former Shah to the United States. The information before the Court also indicates that a spokesman for the militants, in explaining their action afterwards, did expressly refer to a message issued by the Ayatollah Khomeini, on 1 November 1979. In that message the Ayatollah Khomeini had declared that it was "up to the dear pupils, students and theological students to expand with all their might their attacks against the United States and Israel, so they may force the United States to return the deposed and criminal shah, and to condemn this great plot" (that is, a plot to stir up dissension between the main streams of Islamic thought). In the view of the Court, however, it would be going too far to interpret

such general declarations of the Ayatollah Khomeini to the people or students of Iran as amounting to an authorization from the State to undertake the specific operation of invading and seizing the United States Embassy. To do so would, indeed, conflict with the assertions of the militants themselves who are reported to have claimed credit for having devised and carried out the plan to occupy the Embassy. Again, congratulations after the event, such as those reportedly telephoned to the militants by the Ayatollah Khomeini on the actual evening of the attack, and other subsequent statements of official approval, though highly significant in another context shortly to be considered, do not alter the initially independent and unofficial character of the militants' attack on the Embassy.

60. The first phase, here under examination, of the events complained of also includes the attacks on the United States Consulates at Tabriz and Shiraz. Like the attack on the Embassy, they appear to have been executed by militants not having an official character, and successful because of lack of sufficient protection.

61. The conclusion just reached by the Court, that the initiation of the attack on the United States Embassy on 4 November 1979, and of the attacks on the Consulates at Tabriz and Shiraz the following day, cannot be considered as in itself imputable to the Iranian State does not mean that Iran is, in consequence, free of any responsibility in regard to those attacks ; for its own conduct was in conflict with its international obligations. By a number of provisions of the Vienna Conventions of 1961 and 1963, Iran was placed under the most categorical obligations, as a receiving State, to take appropriate steps to ensure the protection of the United States Embassy and Consulates, their staffs, their archives, their means of communication and the freedom of movement of the members of their staffs.

62. Thus, after solemnly proclaiming the inviolability of the premises of a diplomatic mission, Article 22 of the 1961 Convention continues in paragraph 2 :

“The receiving State is under a special duty to take all appropriate steps to protect the premises of the mission against any intrusion or damage and to prevent any disturbance of the peace of the mission or impairment of its dignity.” (Emphasis added.)

So, too, after proclaiming that the person of a diplomatic agent shall be inviolable, and that he shall not be liable to any form of arrest or detention, Article 29 provides :

“The receiving State shall treat him with due respect and shall take all appropriate steps to prevent any attack on his person, freedom or dignity.” (Emphasis added.)

The obligation of a receiving State to protect the inviolability of the archives and documents of a diplomatic mission is laid down in Article 24, which specifically provides that they are to be “inviolable at any time and wherever they may be”. Under Article 25 it is required to “accord full facilities for the performance of the functions of the mission”, under Article 26 to “ensure to all members of the mission freedom of movement and travel in its territory”, and under Article 27 to “permit and protect free communication on the part of the mission for all official purposes”. Analogous provisions are to be found in the 1963 Convention regarding the privileges and immunities of consular missions and their staffs (Art. 31, para. 3, Arts. 40, 33, 28, 34 and 35). In the view of the Court, the obligations of the Iranian Government here in question are not merely contractual obligations established by the Vienna Conventions of 1961 and 1963, but also obligations under general international law.

63. The facts set out in paragraphs 14 to 27 above establish to the satisfaction of the Court that on 4 November 1979 the Iranian Government failed altogether to take any “appropriate steps” to protect the premises, staff and archives of the United States' mission against attack by the militants, and to take any steps either to prevent this attack or to stop it before it reached its completion. They also show that on 5 November 1979 the Iranian Government similarly failed to take

appropriate steps for the protection of the United States Consulates at Tabriz and Shiraz. In addition they show, in the opinion of the Court, that the failure of the Iranian Government to take such steps was due to more than mere negligence or lack of appropriate means.

64. The total inaction of the Iranian authorities on that date in face of urgent and repeated requests for help contrasts very sharply with its conduct on several other occasions of a similar kind. Some eight months earlier, on 14 February 1979, the United States Embassy in Tehran had itself been subjected to the armed attack mentioned above (paragraph 14), in the course of which the attackers had taken the Ambassador and his staff prisoner. On that occasion, however, a detachment of Revolutionary Guards, sent by the Government, had arrived promptly, together with a Deputy Prime Minister, and had quickly succeeded in freeing the Ambassador and his staff and restoring the Embassy to him. On 1 March 1979, moreover, the Prime Minister of Iran had sent a letter expressing deep regret at the incident, giving an assurance that appropriate arrangements had been made to prevent any repetition of such incidents, and indicating the willingness of his Government to indemnify the United States for the damage. On 1 November 1979, only three days before the events which gave rise to the present case, the Iranian police intervened quickly and effectively to protect the United States Embassy when a large crowd of demonstrators spent several hours marching up and down outside it. Furthermore, on other occasions in November 1979 and January 1980, invasions or attempted invasions of other foreign embassies in Tehran were frustrated or speedily terminated.

65. A similar pattern of facts appears in relation to consulates. In February 1979, at about the same time as the first attack on the United States Embassy, attacks were made by demonstrators on its Consulates in Tabriz and Shiraz ; but the Iranian authorities then took the necessary steps to clear them of the demonstrators. On the other hand, the Iranian authorities took no action to prevent the attack of 5 November 1979, or to restore the Consulates to the possession of the United States. In contrast, when on the next day militants invaded the Iraqi Consulate in Kermanshah, prompt steps were taken by the Iranian authorities to secure their withdrawal from the Consulate. Thus in this case, the Iranian authorities and police took the necessary steps to prevent and check the attempted invasion or return the premises to their rightful owners.

66. As to the actual conduct of the Iranian authorities when faced with the events of 4 November 1979, the information before the Court establishes that, despite assurances previously given by them to the United States Government and despite repeated and urgent calls for help, they took no apparent steps either to prevent the militants from invading the Embassy or to persuade or to compel them to withdraw. Furthermore, after the militants had forced an entry into the premises of the Embassy, the Iranian authorities made no effort to compel or even to persuade them to withdraw from the Embassy and to free the diplomatic and consular staff whom they had made prisoner.

67. This inaction of the Iranian Government by itself constituted clear and serious violation of Iran's obligations to the United States under the provisions of Article 22, paragraph 2, and Articles 24, 25, 26, 27 and 29 of the 1961 Vienna Convention on Diplomatic Relations, and Articles 5 and 36 of the 1963 Vienna Convention on Consular Relations. Similarly, with respect to the attacks on the Consulates at Tabriz and Shiraz, the inaction of the Iranian authorities entailed clear and serious breaches of its obligations under the provisions of several further articles of the 1963 Convention on Consular Relations. So far as concerns the two private United States nationals seized as hostages by the invading militants, that inaction entailed, albeit incidentally, a breach of its obligations under Article II, paragraph 4, of the 1955 Treaty of Amity, Economic Relations, and Consular Rights which, in addition to the obligations of Iran existing under general international law, requires the parties to ensure "the most constant protection and security" to each other's nationals in their respective territories.

68. The Court is therefore led inevitably to conclude, in regard to the first phase of the events

which has so far been considered, that on 4 November 1979 the Iranian authorities :

- (a) were fully aware of their obligations under the conventions in force to take appropriate steps to protect the premises of the United States Embassy and its diplomatic and consular staff from any attack and from any infringement of their inviolability, and to ensure the security of such other persons as might be present on the said premises ;
- (b) were fully aware, as a result of the appeals for help made by the United States Embassy, of the urgent need for action on their part ;
- (c) had the means at their disposal to perform their obligations ;
- (d) completely failed to comply with these obligations.

Similarly, the Court is led to conclude that the Iranian authorities were equally aware of their obligations to protect the United States Consulates at Tabriz and Shiraz, and of the need for action on their part, and similarly failed to use the means which were at their disposal to comply with their obligations.

* *

69. The second phase of the events which are the subject of the United States' claims comprises the whole series of facts which occurred following the completion of the occupation of the United States Embassy by the militants, and the seizure of the Consulates at Tabriz and Shiraz. The occupation having taken place and the diplomatic and consular personnel of the United States' mission having been taken hostage, the action required of the Iranian Government by the Vienna Conventions and by general international law was manifest. Its plain duty was at once to make every effort, and to take every appropriate step, to bring these flagrant infringements of the inviolability of the premises, archives and diplomatic and consular staff of the United States Embassy to a speedy end, to restore the Consulates at Tabriz and Shiraz to United States control, and in general to re-establish the status quo and to offer reparation for the damage.

70. No such step was, however, taken by the Iranian authorities. At a press conference on 5 November the Foreign Minister, Mr. Yazdi, conceded that "according to international regulations the Iranian Government is dutybound to safeguard the life and property of foreign nationals". But he made no mention of Iran's obligation to safeguard the inviolability of foreign embassies and diplomats ; and he ended by announcing that the action of the students "enjoys the endorsement and support of the government, because America herself is responsible for this incident". As to the Prime Minister, Mr. Bazargan, he does not appear to have made any statement on the matter before resigning his office on 5 November.

71. In any event expressions of approval of the take-over of the Embassy, and indeed also of the Consulates at Tabriz and Shiraz, by militants came immediately from numerous Iranian authorities, including religious, judicial, executive, police and broadcasting authorities. Above all, the Ayatollah Khomeini himself made crystal clear the endorsement by the State both of the take-over of the Embassy and Consulates and of the detention of the Embassy staff as hostages. At a reception in Qom on 5 November, the Ayatollah Khomeini left his audience in no doubt as to his approval of the action of the militants in occupying the Embassy, to which he said they had resorted "because they saw that the shah was allowed in America". Saying that he had been informed that the "centre occupied by our young men ... has been a lair of espionage and plotting", he asked how the young people could be expected "simply to remain idle and witness all these things". Furthermore he expressly stigmatized as rotten roots "those in Iran who were hoping we would mediate and tell the young people to leave this place. The Ayatollah's refusal to order "the young people" to put an end to their occupation of the Embassy, or the militants in Tabriz and Shiraz to evacuate the United States Consulates there, must have appeared the more significant when, on 6 November, he

instructed “the young people” who had occupied the Iraqi Consulate in Kermanshah that they should leave it as soon as possible. The true significance of this was only reinforced when, next day, he expressly forbade members of the Revolutionary Council and all responsible officials to meet the special representatives sent by President Carter to try and obtain the release of the hostages and evacuation of the Embassy.

72. At any rate, thus fortified in their action, the militants at the Embassy at once went one step farther. On 6 November they proclaimed that the Embassy, which they too referred to as “the U.S. centre of plots and espionage”, would remain under their occupation, and that they were watching “most closely” the members of the diplomatic staff taken hostage whom they called “U.S. mercenaries and spies”.

73. The seal of official government approval was finally set on this situation by a decree issued on 17 November 1979 by the Ayatollah Khomeini. His decree began with the assertion that the American Embassy was “a centre of espionage and conspiracy” and that “those people who hatched plots against our Islamic movement in that place do not enjoy international diplomatic respect”. He went on expressly to declare that the premises of the Embassy and the hostages would remain as they were until the United States had handed over the former Shah for trial and returned his property to Iran. This statement of policy the Ayatollah qualified only to the extent of requesting the militants holding the hostages to “hand over the blacks and the women, if it is proven that they did not spy, to the Ministry of Foreign Affairs so that they may be immediately expelled from Iran”. As to the rest of the hostages, he made the Iranian Government's intentions all too clear :

“The noble Iranian nation will not give permission for the release of the rest of them. Therefore, the rest of them will be under arrest until the American Government acts according to the wish of the nation.”

74. The policy thus announced by the Ayatollah Khomeini, of maintaining the occupation of the Embassy and the detention of its inmates as hostages for the purpose of exerting pressure on the United States Government was complied with by other Iranian authorities and endorsed by them repeatedly in statements made in various contexts. The result of that policy was fundamentally to transform the legal nature of the situation created by the occupation of the Embassy and the detention of its diplomatic and consular staff as hostages. The approval given to these facts by the Ayatollah Khomeini and other organs of the Iranian State, and the decision to perpetuate them, translated continuing occupation of the Embassy and detention of the hostages into acts of that State. The militants, authors of the invasion and jailers of the hostages, had now become agents of the Iranian State for whose acts the State itself was internationally responsible. On 6 May 1980, the Minister for Foreign Affairs, Mr. Ghotbzadeh, is reported to have said in a television interview that the occupation of the United States Embassy had been “done by our nation”. Moreover, in the prevailing circumstances the situation of the hostages was aggravated by the fact that their detention by the militants did not even offer the normal guarantees which might have been afforded by police and security forces subject to the discipline and the control of official superiors.

75. During the six months which have elapsed since the situation just described was created by the decree of the Ayatollah Khomeini, it has undergone no material change. The Court's Order of 15 December 1979 indicating provisional measures, which called for the immediate restoration of the Embassy to the United States and the release of the hostages, was publicly rejected by the Minister for Foreign Affairs on the following day and has been ignored by all Iranian authorities. On two occasions, namely on 23 February and on 7 April 1980, the Ayatollah Khomeini laid it down that the hostages should remain at the United States Embassy under the control of the militants until the new Iranian parliament should have assembled and taken a decision as to their fate. His adherence to that policy also made it impossible to obtain his consent to the transfer of the hostages from the control of the militants to that of the Government or of the Council of the Revolution. In any event,

while highly desirable from the humanitarian and safety points of view, such a transfer would not have resulted in any material change in the legal situation, for its sponsors themselves emphasized that it must not be understood as signifying the release of the hostages.

* *

76. The Iranian authorities' decision to continue the subjection of the premises of the United States Embassy to occupation by militants and of the Embassy staff to detention as hostages, clearly gave rise to repeated and multiple breaches of the applicable provisions of the Vienna Conventions even more serious than those which arose from their failure to take any steps to prevent the attacks on the inviolability of these premises and staff.

77. In the first place, these facts constituted breaches additional to those already committed of paragraph 2 of Article 22 of the 1961 Vienna Convention on Diplomatic Relations which requires Iran to protect the premises of the mission against any intrusion or damage and to prevent any disturbance of its peace or impairment of its dignity. Paragraphs 1 and 3 of that Article have also been infringed, and continue to be infringed, since they forbid agents of a receiving State to enter the premises of a mission without consent or to undertake any search, requisition, attachment or like measure on the premises. Secondly, they constitute continuing breaches of Article 29 of the same Convention which forbids any arrest or detention of a diplomatic agent and any attack on his person, freedom or dignity. Thirdly, the Iranian authorities are without doubt in continuing breach of the provisions of Articles 25, 26 and 27 of the 1961 Vienna Convention and of pertinent provisions of the 1963 Vienna Convention concerning facilities for the performance of functions, freedom of movement and communications for diplomatic and consular staff, as well as of Article 24 of the former Convention and Article 33 of the latter, which provide for the absolute inviolability of the archives and documents of diplomatic missions and consulates. This particular violation has been made manifest to the world by repeated statements by the militants occupying the Embassy, who claim to be in possession of documents from the archives, and by various government authorities, purporting to specify the contents thereof. Finally, the continued detention as hostages of the two private individuals of United States nationality entails a renewed breach of the obligations of Iran under Article II, paragraph 4, of the 1955 Treaty of Amity, Economic Relations, and Consular Rights.

78. Inevitably, in considering the compatibility or otherwise of the conduct of the Iranian authorities with the requirements of the Vienna Conventions, the Court has focussed its attention primarily on the occupation of the Embassy and the treatment of the United States diplomatic and consular personnel within the Embassy. It is however evident that the question of the compatibility of their conduct with the Vienna Conventions also arises in connection with the treatment of the United States Chargé d'affaires and two members of his staff in the Ministry of Foreign Affairs on 4 November 1979 and since that date. The facts of this case establish to the satisfaction of the Court that on 4 November 1979 and thereafter the Iranian authorities have withheld from the Chargé d'affaires and the two members of his staff the necessary protection and facilities to permit them to leave the Ministry in safety. Accordingly it appears to the Court that with respect to these three members of the United States' mission the Iranian authorities have committed a continuing breach of their obligations under Articles 26 and 29 of the 1961 Vienna Convention on Diplomatic Relations. It further appears to the Court that the continuation of that situation over a long period has, in the circumstances, amounted to detention in the Ministry.

79. The Court moreover cannot conclude its observations on the series of acts which it has found to be imputable to the Iranian State and to be patently inconsistent with its international obligations under the Vienna Conventions of 1961 and 1963 without mention also of another fact. This is that judicial authorities of the Islamic Republic of Iran and the Minister for Foreign Affairs have frequently voiced or associated themselves with, a threat first announced by the militants, of having some of the hostages submitted to trial before a court or some other body. These threats may at present merely be acts in contemplation. But the Court considers it necessary here and now to stress that,

if the intention to submit the hostages to any form of criminal trial or investigation were to be put into effect, that would constitute a grave breach by Iran of its obligations under Article 31, paragraph 1, of the 1961 Vienna Convention. This paragraph states in the most express terms : "A diplomatic agent shall enjoy immunity from the criminal jurisdiction of the receiving State." Again, if there were an attempt to compel the hostages to bear witness, a suggestion renewed at the time of the visit to Iran of the Secretary-General's Commission, Iran would without question be violating paragraph 2 of that same Article of the 1961 Vienna Convention which provides that : "A diplomatic agent is not obliged to give evidence as a witness."

* *

80. The facts of the present case, viewed in the light of the applicable rules of law, thus speak loudly and clearly of successive and still continuing breaches by Iran of its obligations to the United States under the Vienna Conventions of 1961 and 1963, as well as under the Treaty of 1955. Before drawing from this finding the conclusions which flow from it, in terms of the international responsibility of the Iranian State vis-é-vis the United States of America, the Court considers that it should examine one further point. The Court cannot overlook the fact that on the Iranian side, in often imprecise terms, the idea has been put forward that the conduct of the Iranian Government, at the time of the events of 4 November 1979 and subsequently, might be justified by the existence of special circumstances.

81. In his letters of 9 December 1979 and 16 March 1980, as previously recalled, Iran's Minister for Foreign Affairs referred to the present case as only "a marginal and secondary aspect of an overall problem". This problem, he maintained, "involves, *inter alia*, more than 25 years of continual interference by the United States in the internal affairs of Iran, the shameless exploitation of our country, and numerous crimes perpetrated against the Iranian people, contrary to and in conflict with all international and humanitarian norms". In the first of the two letters he indeed singled out amongst the "crimes" which he attributed to the United States an alleged complicity on the part of the Central Intelligence Agency in the coup d'état of 1953 and in the restoration of the Shah to the throne of Iran. Invoking these alleged crimes of the United States, the Iranian Foreign Minister took the position that the United States' Application could not be examined by the Court divorced from its proper context, which he insisted was "the whole political dossier of the relations between Iran and the United States over the last 25 years".

82. The Court must however observe, first of all, that the matters alleged in the Iranian Foreign Minister's letters of 9 December 1979 and 16 March 1980 are of a kind which, if invoked in legal proceedings, must clearly be established to the satisfaction of the tribunal with all the requisite proof. The Court, in its Order of 15 December 1979, pointed out that if the Iranian Government considered the alleged activities of the United States in Iran legally to have a close connection with the subject-matter of the Application it was open to Iran to present its own case regarding those activities to the Court by way of defence to the United States' claims. The Iranian Government, however, did not appear before the Court. Moreover, even in his letter of 16 March 1980, transmitted to the Court some three months after the issue of that Order, the Iranian Foreign Minister did not furnish the Court with any further information regarding the alleged criminal activities of the United States in Iran, or explain on what legal basis he considered these allegations to constitute a relevant answer to the United States' claims. The large body of information submitted by the United States itself to the Court includes, it is true, some statements emanating from Iranian authorities or from the militants in which reference is made to alleged espionage and interference in Iran by the United States centred upon its Embassy in Tehran. These statements are, however, of the same general character as the assertions of alleged criminal activities of the United States contained in the Foreign Minister's letters, and are unsupported by evidence furnished by Iran before the Court. Hence they do not provide a basis on which the Court could form a judicial opinion on the truth or otherwise of the matters there alleged.

83. In any case, even if the alleged criminal activities of the United States in Iran could be considered as having been established, the question would remain whether they could be regarded by the Court as constituting a justification of Iran's conduct and thus a defence to the United States claims in the present case. The Court, however, is unable to accept that they can be so regarded. This is because diplomatic law itself provides the necessary means of defence against, and sanction for, illicit activities by members of diplomatic or consular missions.

84. The Vienna Conventions of 1961 and 1963 contain express provisions to meet the case when members of an embassy staff, under the cover of diplomatic privileges and immunities, engage in such abuses of their functions as espionage or interference in the internal affairs of the receiving State. It is precisely with the possibility of such abuses in contemplation that Article 41, paragraph 1, of the Vienna Convention on Diplomatic Relations, and Article 55, paragraph 1, of the Vienna Convention on Consular Relations, provide

“Without prejudice to their privileges and immunities, it is the duty of all persons enjoying such privileges and immunities to respect the laws and regulations of the receiving State. They also have a duty not to interfere in the internal affairs of that State.”

Paragraph 3 of Article 41 of the 1961 Convention further states : “The premises of the mission must not be used in any manner incompatible with the functions of the missions ...”: an analogous provision, with respect to consular premises is to be found in Article 55, paragraph 2, of the 1963 Convention.

85. Thus, it is for the very purpose of providing a remedy for such possible abuses of diplomatic functions that Article 9 of the 1961 Convention on Diplomatic Relations stipulates :

“**1.** The receiving State may at any time and without having to explain its decision, notify the sending State that the head of the mission or any member of the diplomatic staff of the mission is *persona non grata* or that any other member of the staff of the mission is not acceptable. In any such case, the sending State shall, as appropriate, either recall the person concerned or terminate his functions with the mission. A person may be declared *non grata* or not acceptable before arriving in the territory of the receiving State.

2. If the sending State refuses or fails within a reasonable period to carry out its obligations under paragraph 1 of this Article, the receiving State may refuse to recognize the person concerned as a member of the mission.”

The 1963 Convention contains, in Article 23, paragraphs 1 and 4, analogous provisions in respect of consular officers and consular staff. Paragraph 1 of Article 9 of the 1961 Convention, and paragraph 4 of Article 23 of the 1963 Convention, take account of the difficulty that may be experienced in practice of proving such abuses in every case or, indeed, of determining exactly when exercise of the diplomatic function, expressly recognized in Article 3 (1) (d) of the 1961 Convention, of “ascertaining by all lawful means conditions and developments in the receiving State” may be considered as involving such acts as “espionage” or “interference in internal affairs”. The way in which Article 9, paragraph 1, takes account of any such difficulty is by providing expressly in its opening sentence that the receiving State may “at any time and without having to explain its decision” notify the sending State that any particular member of its diplomatic mission is “*persona non grata*” or “not acceptable” (and similarly Article 23, paragraph 4, of the 1963 Convention provides that “the receiving State is not obliged to give to the sending State reasons for its decision”). Beyond that remedy for dealing with abuses of the diplomatic function by individual members of a mission, a receiving State has in its hands a more radical remedy if abuses of their functions by members of a mission reach serious proportions. This is the power which every receiving State has, at its own discretion, to break off diplomatic relations with a sending State and to call for the immediate closure of the offending mission.

86. The rules of diplomatic law, in short, constitute a self-contained régime which, on the one hand, lays down the receiving State's obligations regarding the facilities, privileges and immunities to be accorded to diplomatic missions and, on the other, foresees their possible abuse by members of the mission and specifies the means at the disposal of the receiving State to counter any such abuse. These means are, by their nature, entirely efficacious, for unless the sending State recalls the member of the mission objected to forthwith, the prospect of the almost immediate loss of his privileges and immunities, because of the withdrawal by the receiving State of his recognition as a member of the mission, will in practice compel that person, in his own interest, to depart at once. But the principle of the inviolability of the persons of diplomatic agents and the premises of diplomatic missions is one of the very foundations of this long-established régime, to the evolution of which the traditions of Islam made a substantial contribution. The fundamental character of the principle of inviolability is, moreover, strongly underlined by the provisions of Articles 44 and 45 of the Convention of 1961 (cf. also Articles 26 and 27 of the Convention of 1963). Even in the case of armed conflict or in the case of a breach in diplomatic relations those provisions require that both the inviolability of the members of a diplomatic mission and of the premises, property and archives of the mission must be respected by the receiving State. Naturally, the observance of this principle does not mean—and this the Applicant Government expressly acknowledges—that a diplomatic agent caught in the act of committing an assault or other offence may not, on occasion, be briefly arrested by the police of the receiving State in order to prevent the commission of the particular crime. But such eventualities bear no relation at all to what occurred in the present case.

87. In the present case, the Iranian Government did not break off diplomatic relations with the United States ; and in response to a question put to him by a Member of the Court, the United States Agent informed the Court that at no time before the events of 4 November 1979 had the Iranian Government declared, or indicated any intention to declare, any member of the United States diplomatic or consular staff in Tehran *persona non grata*. The Iranian Government did not, therefore, employ the remedies placed at its disposal by diplomatic law specifically for dealing with activities of the kind of which it now complains. Instead, it allowed a group of militants to attack and occupy the United States Embassy by force, and to seize the diplomatic and consular staff as hostages ; instead, it has endorsed that action of those militants and has deliberately maintained their occupation of the Embassy and detention of its staff as a means of coercing the sending State. It has, at the same time, refused altogether to discuss this situation with representatives of the United States. The Court, therefore, can only conclude that Iran did not have recourse to the normal and efficacious means at its disposal, but resorted to coercive action against the United States Embassy and its staff.

88. In an address given on 5 November 1979, the Ayatollah Khomeini traced the origin of the operation carried out by the Islamic militants on the previous day to the news of the arrival of the former Shah of Iran in the United States. That fact may no doubt have been the ultimate catalyst of the resentment felt in certain circles in Iran and among the Iranian population against the former Shah for his alleged misdeeds, and also against the United States Government which was being publicly accused of having restored him to the throne, of having supported him for many years and of planning to go on doing so. But whatever be the truth in regard to those matters, they could hardly be considered as having provided a justification for the attack on the United States Embassy and its diplomatic mission. Whatever extenuation of the responsibility to be attached to the conduct of the Iranian authorities may be found in the offence felt by them because of the admission of the Shah to the United States, that feeling of offence could not affect the imperative character of the legal obligations incumbent upon the Iranian Government which is not altered by a state of diplomatic tension between the two countries. Still less could a mere refusal or failure on the part of the United States to extradite the Shah to Iran be considered to modify the obligations of the Iranian authorities, quite apart from any legal difficulties, in internal or international law, there might be in acceding to such a request for extradition.

89. Accordingly, the Court finds that no circumstances exist in the present case which are

capable of negating the fundamentally unlawful character of the conduct pursued by the Iranian State on 4 November 1979 and thereafter. This finding does not however exclude the possibility that some of the circumstances alleged, if duly established, may later be found to have some relevance in determining the consequences of the responsibility incurred by the Iranian State with respect to that conduct, although they could not be considered to alter its unlawful character.

* * *

90. On the basis of the foregoing detailed examination of the merits of the case, the Court finds that Iran, by committing successive and continuing breaches of the obligations laid upon it by the Vienna Conventions of 1961 and 1963 on Diplomatic and Consular Relations, the Treaty of Amity, Economic Relations, and Consular Rights of 1955, and the applicable rules of general international law, has incurred responsibility towards the United States. As to the consequences of this finding, it clearly entails an obligation on the part of the Iranian State to make reparation for the injury thereby caused to the United States. Since however Iran's breaches of its obligations are still continuing, the form and amount of such reparation cannot be determined at the present date.

91. At the same time the Court finds itself obliged to stress the cumulative effect of Iran's breaches of its obligations when taken together. A marked escalation of these breaches can be seen to have occurred in the transition from the failure on the part of the Iranian authorities to oppose the armed attack by the militants on 4 November 1979 and their seizure of the Embassy premises and staff, to the almost immediate endorsement by those authorities of the situation thus created, and then to their maintaining deliberately for many months the occupation of the Embassy and detention of its staff by a group of armed militants acting on behalf of the State for the purpose of forcing the United States to bow to certain demands. Wrongfully to deprive human beings of their freedom and to subject them to physical constraint in conditions of hardship is in itself manifestly incompatible with the principles of the Charter of the United Nations, as well as with the fundamental principles enunciated in the Universal Declaration of Human Rights. But what has above all to be emphasized is the extent and seriousness of the conflict between the conduct of the Iranian State and its obligations under the whole corpus of the international rules of which diplomatic and consular law is comprised, rules the fundamental character of which the Court must here again strongly affirm. In its Order of 15 December 1979, the Court made a point of stressing that the obligations laid on States by the two Vienna Conventions are of cardinal importance for the maintenance of good relations between States in the interdependent world of today. "There is no more fundamental prerequisite for the conduct of relations between States", the Court there said, "than the inviolability of diplomatic envoys and embassies, so that throughout history nations of all creeds and cultures have observed reciprocal obligations for that purpose." The institution of diplomacy, the Court continued, has proved to be "an instrument essential for effective co-operation in the international community, and for enabling States, irrespective of their differing constitutional and social systems, to achieve mutual understanding and to resolve their differences by peaceful means" (*I.C.J. Reports 1979*, p. 19).

92. It is a matter of deep regret that the situation which occasioned those observations has not been rectified since they were made. Having regard to their importance the Court considers it essential to reiterate them in the present Judgment. The frequency with which at the present time the principles of international law governing diplomatic and consular relations are set at naught by individuals or groups of individuals is already deplorable. But this case is unique and of very particular gravity because here it is not only private individuals or groups of individuals that have disregarded and set at naught the inviolability of a foreign embassy, but the government of the receiving State itself. Therefore in recalling yet again the extreme importance of the principles of law which it is called upon to apply in the present case, the Court considers it to be its duty to draw the attention of the entire international community, of which Iran itself has been a member since time immemorial, to the irreparable harm that may be caused by events of the kind now before the Court. Such events cannot fail to undermine the edifice of law carefully constructed by mankind

over a period of centuries, the maintenance of which is vital for the security and well-being of the complex international community of the present day, to which it is more essential than ever that the rules developed to ensure the ordered progress of relations between its members should be constantly and scrupulously respected.

* *

93. Before drawing the appropriate conclusions from its findings on the merits in this case, the Court considers that it cannot let pass without comment the incursion into the territory of Iran made by United States military units on 24–25 April 1980, an account of which has been given earlier in this Judgment (paragraph 32). No doubt the United States Government may have had understandable preoccupations with respect to the well-being of its nationals held hostage in its Embassy for over five months. No doubt also the United States Government may have had understandable feelings of frustration at Iran's long-continued detention of the hostages, notwithstanding two resolutions of the Security Council as well as the Court's own Order of 15 December 1979 calling expressly for their immediate release. Nevertheless, in the circumstances of the present proceedings, the Court cannot fail to express its concern in regard to the United States' incursion into Iran. When, as previously recalled, this case had become ready for hearing on 19 February 1980, the United States Agent requested the Court, owing to the delicate stage of certain negotiations, to defer setting a date for the hearings. Subsequently, on 11 March, the Agent informed the Court of the United States Government's anxiety to obtain an early judgment on the merits of the case. The hearings were accordingly held on 18, 19 and 20 March, and the Court was in course of preparing the present judgment adjudicating upon the claims of the United States against Iran when the operation of 24 April 1980 took place. The Court therefore feels bound to observe that an operation undertaken in those circumstances, from whatever motive, is of a kind calculated to undermine respect for the judicial process in international relations ; and to recall that in paragraph 47, 1 B, of its Order of 15 December 1979 the Court had indicated that no action was to be taken by either party which might aggravate the tension between the two countries.

94. At the same time, however, the Court must point out that neither the question of the legality of the operation of 24 April 1980, under the Charter of the United Nations and under general international law, nor any possible question of responsibility flowing from it, is before the Court. It must also point out that this question can have no bearing on the evaluation of the conduct of the Iranian Government over six months earlier, on 4 November 1979, which is the subject-matter of the United States' Application. It follows that the findings reached by the Court in this Judgment are not affected by that operation.

* * *

95. For these reasons,

The Court,

1. By thirteen votes to two,

Decides that the Islamic Republic of Iran, by the conduct which the Court has set out in this Judgment, has violated in several respects, and is still violating, obligations owed by it to the United States of America under international conventions in force between the two countries, as well as under long-established rules of general international law ;

IN FAVOUR : *President* Sir Humphrey Waldock ; *Vice-President* Elias ; *Judges* Forster, Gros, Lachs, Nagendra Singh, Ruda, Mosler, Oda, Ago, El-Erian, Sette-Camara and Baxter.

AGAINST : *Judges* Morozov and Tarazi.

2. By thirteen votes to two,

Decides that the violations of these obligations engage the responsibility of the Islamic Republic of Iran towards the United States of America under international law ;

IN FAVOUR : *President* Sir Humphrey Waldock ; *Vice-President* Elias ; *Judges* Forster, Gros, Lachs, Nagendra Singh, Ruda, Mosler, Oda, Ago, El-Erian, Sette-Camara and Baxter.

AGAINST : *Judges* Morozov and Tarazi.

3. Unanimously,

Decides that the Government of the Islamic Republic of Iran must immediately take all steps to redress the situation resulting from the events of 4 November 1979 and what followed from these events, and to that end :

(a) must immediately terminate the unlawful detention of the United States Chargé d'affaires and other diplomatic and consular staff and other United States nationals now held hostage in Iran, and must immediately release each and every one and entrust them to the protecting Power (Article 45 of the 1961 Vienna Convention on Diplomatic Relations) ;

(b) must ensure that all the said persons have the necessary means of leaving Iranian territory, including means of transport ;

(c) must immediately place in the hands of the protecting Power the premises, property, archives and documents of the United States Embassy in Tehran and of its Consulates in Iran ;

4. Unanimously,

Decides that no member of the United States diplomatic or consular staff may be kept in Iran to be subjected to any form of judicial proceedings or to participate in them as a witness ;

5. By twelve votes to three,

Decides that the Government of the Islamic Republic of Iran is under an obligation to make reparation to the Government of the United States of America for the injury caused to the latter by the events of 4 November 1979 and what followed from these events ;

IN FAVOUR : *President* Sir Humphrey Waldock ; *Vice-President* Elias ; *Judges* Forster, Gros, Nagendra Singh, Ruda, Mosler, Oda, Ago, El-Erian, Sette-Camara and Baxter.

AGAINST : *Judges* Lachs, Morozov and Tarazi.

6. By fourteen votes to one,

Decides that the form and amount of such reparation, failing agreement between the Parties, shall be settled by the Court, and reserves for this purpose the subsequent procedure in the case.

IN FAVOUR : *President* Sir Humphrey Waldock ; *Vice-President* Elias ; *Judges* Forster, Gros, Lachs, Nagendra Singh, Ruda, Mosler, Tarazi, Oda, Ago, El-Erian, Sette-Camara and Baxter.

AGAINST : *Judge* Morozov.

Done in English and in French, the English text being authoritative, at the Peace Palace, The Hague, this twenty-fourth day of May, one thousand nine hundred and eighty, in three copies, one of which will be placed in the archives of the Court, and the others transmitted to the Government of the United States of America and the Government of the Islamic Republic of Iran, respectively.

(Signed) Humphrey Waldock,

President.

(Signed) S. Aquarone,

Registrar.

Judge Lachs appends a separate opinion to the Judgment of the Court.

Judges Morozov and Tarazi append dissenting opinions to the Judgment of the Court.

(Initialed) H.W.

(Initialed) S.A.

Separate Opinion of Judge Lachs

Judge Lachs

1 I wish to make some comments regarding the Judgment and the solution of the outstanding issues between the two States concerned. First I wish to express some preoccupation over the inclusion of the decision recorded in subparagraph 5 of the operative part.

2 It is not that there can be any doubt as to the principle involved, for that the breach of an undertaking, resulting in injury, entails an obligation to make reparation is a point which international courts have made on several occasions. Indeed, the point is implicit, it can go without saying. "Reparation", said the Permanent Court of International Justice, "is the indispensable complement of a failure to apply a convention and there is no necessity for this to be stated in the convention itself" (*P.C.I.J., Series A, No. 9*, p. 21). This dictum did not, as it happens refer to a judicial decision but to a convention. But the Courts Judgment of 9 April 1949 in the *Corfu Channel* case illustrates the point in a decision of the Court, which then, in the operative paragraph, did not make any statement on the obligation to make reparation.

3 There was thus no necessity for the operative paragraph of the present Judgment to decide the obligation, when the responsibility from which it might be deduced had been clearly spelled out both in the reasoning and in subparagraph 2. I accordingly felt subparagraph 5 to be redundant. In the circumstances of the case it would, to my mind, have been sound judicial economy to confine the *res judicata* to the first four subparagraphs and to conclude with the reservation for further decision, failing agreement between the Parties, of any subsequent procedure necessitated in respect of a claim to reparation.

4 By so proceeding the Court would in my opinion have left the ground clear for such subsequent procedure, while not depriving the Applicant of a sufficient response to its present claim under that head.

*

5 I wish now to emphasize the value which the present Judgment possesses in my eyes. I consider it to constitute not only a decision of the instant case but an important confirmation of a body of law which is one of the main pillars of the international community. This body of law has been specifically enshrined in the Vienna Conventions of 1961 and 1963, which in my view constitute, together with the rules of general international law, the basis of the present Judgment. The principles and rules of diplomatic privileges and immunities are not—and this cannot be overstressed—the invention or device of one group of nations, of one continent or one circle of culture, but have been established for centuries and are shared by nations of all races and all

civilizations. Characteristically, the preamble of the 1961 Convention “*Recall[s]* that peoples of all nations from ancient times have recognized the status of diplomatic agents” and concludes with the words : “*Affirming* that the rules of customary international law should continue to govern questions not expressly regulated by the provisions of the present Convention.” Moreover, by 31 December 1978 the Vienna Convention of 1961 on Diplomatic Relations had been ratified or acceded to by 132 States, including 61 from Africa and Asia. In the case of the 1963 Convention on Consular Relations, the figures at the same date were 81, with 45 from those two continents. It is thus clear that these Conventions reflect the law as approved by all regions of the globe, and by peoples belonging to both North and South, East and West alike. The laws in question are the common property of the international community and were confirmed in the interest of all.

*

6 It is a matter of particular concern, however, that the Court has again had to make its pronouncements without the assistance of the Respondent's defence, apart from the general arguments contained in two letters addressed to it. The Court took note of the claims of the Islamic Republic of Iran against the United States of America and kept the door open for their substantiation before it. But, unfortunately, Iran chose to deprive itself of the available means for developing its contentions. While discharging its obligations under Article 53 of its Statute, the Court could not decide on any claim of the Iranian Government, for no such claim was submitted ; thus the responsibility for not doing so cannot be laid at the door of the Court.

7 In this context I am anxious to recall that the Court was called into being by the Charter of the United Nations as “the principal judicial organ of the United Nations” (Art. 92), and is intended to serve all the international community in order to “decide in accordance with international law such disputes as are submitted to it” (Statute, Art. 38, para. 1). But to be able to perform this task, the Court needs the assistance of the States concerned. Governments remain, of course, free to act as they wish in this matter, but I think that, having called it into existence, they owe it to the Court to appear before it when so notified—to admit, defend or counter-claim—whichever role they wish to assume. On the other hand, the Applicant, having instituted proceedings, is precluded from taking unilateral action, military or otherwise, as if no case is pending.

*

8 The Court having given its ruling on the issues of law placed before it, one should consider whether one can usefully point the way towards the practical solution of the problems between the parties. Here it would not be realistic to ignore the fact that the mandate given by the Secretary-General of the United Nations to his special commission linked the grievances of either side.

9 The efforts of that commission thus brought the problem into a field of diplomatic negotiation where its solution should have been greatly facilitated. Unfortunately, those efforts failed, while further events contributed to an aggravation of the tension. Nevertheless, now that the Judgment has, with force of law, determined one of the major issues in question, it should in my opinion be possible for negotiations to be resumed with a view to seeking a peaceful solution to the dispute. I can only repeat the deep-rooted conviction I have expressed on other occasions, that, while the Court is not entitled to oblige parties to enter into negotiations, its Judgment should where appropriate encourage them to do so, in consonance with its role as an institution devoted to the cause of peaceful settlement.

10 Accordingly, both countries, as parties to the Charter and members of the international community, should now engage in negotiations with a view to terminating their disagreement, which with other factors is sustaining the cloud of tension and misunderstanding that now hangs over that part of the world. By taking such account of the grievances of Iran against the United States as it had been enabled to do, the Court gave its attention not only to the immediate question of responsibility for specific acts placed before it, but also to the wider disagreement that has

perturbed relations between the two countries. In view of the fact that the Islamic Republic of Iran has radically severed its ties with the recent past under the former ruler, it is necessary to adopt a renewed approach to the solution of these problems, and while both parties are not on speaking terms I believe recourse should be had to a third-party initiative. The States concerned must be encouraged to seek a solution in order to avoid a further deterioration of the situation between them. To close the apparent abyss, to dispel the tension and the mistrust, only patient and wise action—mediation, conciliation or good offices—should be resorted to. The role of the Secretary-General of the United Nations may here be the key.

11 I append these words to the Judgment because I am hopeful that its pronouncements may mark a step towards the resolution of the grave differences which remain in the relations between the two States concerned. The peaceful means which I have enumerated may still appear difficult of application, but our age has shown that, with their aid, progress can be made towards the solution of even more complex problems, while perilous methods tend to render them even more intractable. Past efforts have failed for a variety of reasons, many of them deriving precisely from the lack of direct communication, and the situation being dominated by factors unrelated to the specific nature of the dispute. Against this back-ground, the crucial element of timing went awry.

12 It will be necessary to seize the propitious moment when a procedure acceptable to both sides can be devised. But the uses of diplomacy which are corroborated on the present occasion will, I am confident, be vindicated in the event.

(Signed) Manfred Lachs.

Dissenting Opinion of Judge Morozov

Judge Morozov

I voted against paragraphs 1, 2, 5 and 6 and in favour of paragraphs 3 and 4 of the operative part of the Judgment. Furthermore, there were some points in the reasoning which I could not accept, and I would like to explain the reasons for this.

1. I consider that the long-established rules of general international law relating to the privileges, inviolabilities and immunities of diplomatic and consular personnel are among those which are particularly important for the implementation of such basic principles of contemporary international law as the peaceful coexistence of countries with different political, social and economic structures. These rules are reflected in the Vienna Convention of 18 April 1961 on Diplomatic Relations and the Vienna Convention of 24 April 1963 on Consular Relations.

The obligations laid on the parties to the Conventions should be strictly observed and any violation of their provisions by any country should be immediately terminated.

2. But the Court will be competent to deal with the question of such violations at the request of one party to the dispute only if the *other* party in one or another of the forms provided by Article 36 or 37 of the Statute has expressed its agreement to refer the case to the Court. For the purposes of this dispute, which has been referred to the Court only by *one* party, it is necessary to notice that the two Optional Protocols to the two Vienna Conventions provide in Article I that :

“Disputes arising out of the interpretation or application of the Convention shall lie within the compulsory jurisdiction of the International Court of Justice and may accordingly be brought before the Court by an application made *by any party to the dispute being a Party to the present Protocol.*” (Emphasis added.)

The Optional Protocols were duly ratified by the United States and Iran.

3. It would therefore not have been necessary to undertake any further examination of the

question of jurisdiction if the Court in operative paragraph 1 had limited itself to recognition of the fact that the Islamic Republic of Iran had violated several obligations owed by it *under the Vienna Conventions of 1961 and 1963*.

Instead, the Court qualified the actions of Iran as violations of its obligations "*under international conventions in force between the two countries*" (emphasis added).

The formula adopted by the Court, read in combination with paragraphs 50, 51, 52, 53 and 54 of the Judgment, signifies recognition that the Treaty of Amity, Economic Relations, and Consular Rights between the United States and Iran of 1955 is an additional source for jurisdiction of the Court in the current case.

If one compares the text of Article I of the two Optional Protocols to the Vienna Conventions with the text of Article XXI (2) of the Treaty of 1955, one finds without difficulty that the latter text (unlike the Optional Protocols) does not provide for unconditional jurisdiction of the Court at the request of *only one party to the dispute*.

In its Memorial (p. 41) the Applicant concedes : "It is, of course, true that the text of Article XXI (2) does not provide in express terms that either party to a dispute may bring the case to the Court by unilateral application."

Following passages of the Memorial contain references to the understanding allegedly reached between the United States of America and other countries on some bilateral treaties of the same type. According to the Agent of the United States of America, a number of countries understand that a formula analogous to Article XXI (2) of the Treaty gives to any party the right to submit a dispute to the Court by unilateral application.

But as is correctly said on page 42 of the same Memorial : "Iran is not, of course, bound by any understanding between the United States and third countries." Thus the Applicant itself recognized that, legally speaking, the Treaty of Amity, Economic Relations, and Consular Rights of 1955 could not be used as a source of the Court's jurisdiction.

In the light of the actions taken by the Government of the United States of America in November 1979 and further during the period from December 1979 to April 1980—military invasion of the territory of Iran, a series of economic sanctions and other coercive measures which are, to say the least, incompatible with such notions as amity—, it is clear that the United States of America, according to commonly recognized principles of international law, has now deprived itself of any right to refer to the Treaty of 1955 in its relations with the Islamic Republic of Iran.

In an endeavour to show that provisions of the Treaty of 1955 may be considered as a source of jurisdiction in this case, the Court, in some of its reasoning, goes so far as to consider the actions of the United States of America as some kind of normal counter-measures, and overlooks the fact that they are incompatible not only with the Treaty of 1955 but with the provisions of general international law, including the Charter of the United Nations.

4. On the other hand, the formula used by the Court in paragraph 1 of the operative part of the Judgment, read in combination with paragraph 55 of the reasoning and operative paragraphs 5 and 6, implies that the Court *only in the present Judgment* has decided not to enter into the question whether, in the particular circumstances of the case, Article 13 of the Convention of 1973 on the Prevention and Punishment of Crimes against Internationally Protected Persons including Diplomatic Agents "provides a basis for the exercise of the Court's jurisdiction with respect" to the claims of the United States of America.

Taking into account the fact that in operative paragraph 6 the Court provides for a possible continuation of the case on a question of reparation, this implies that the Court does not exclude the possibility that the claim of the United States of America to found jurisdiction on the 1973

Convention might in future be re-examined. Therefore I am obliged to observe that the Convention of 1973 does not provide for the *unconditional* right of *one* party to a dispute to present an application to the Court. This right arises, according to Article 13 of the Convention, only if the other party in the course of six months has not accepted a request to organize an arbitration. The Memorial of the United States, as well as additional explanations given by Counsel for the United States at the public meeting of the Court on 20 March 1980, provide evidence that the United States Government never suggested to the Government of the Islamic Republic of Iran the organization of any arbitration as provided for by the Convention of 1973.

It is also necessary to take note that the 1973 Convention is not a substitute for either of the Vienna Conventions of 1961 and 1963 ; it was drawn up for the purpose of ensuring co-operation among States in their efforts to fight international terrorism.

The formula employed by the Court in operative paragraph 1, when read in combination with paragraph 91, serves also to level at Iran the unfounded allegation that it has violated the Charter of the United Nations and the Universal Declaration of Human Rights.

5. Paragraphs 2, 5 and 6 of the operative part of the Judgment relate to the question of the responsibility of the Islamic Republic of Iran towards the United States of America and the obligation of Iran to make reparation to the United States.

It is well known that, in accordance with the provisions of general international law, some violations of freely accepted international obligations may be followed by a duty to make compensation for the resultant damage.

But taking into account the extraordinary circumstances which occurred during the period of judicial deliberation on the case, when the Applicant itself committed many actions which caused enormous damage to the Islamic Republic of Iran, the Applicant has forfeited the legal right as well as the moral right to expect the Court to uphold any claim for reparation.

The situation in which the Court has carried on its judicial deliberations in the current case has no precedent in the whole history of the administration of international justice either before this Court, or before any international judicial institution.

While declaring its intention to settle the dispute between the United States of America and the Islamic Republic of Iran exclusively by peaceful means, and presenting its Application to the Court, the Applicant in fact simultaneously acted contrary to its own declaration, and committed a series of grave violations of the provisions of general international law and the Charter of the United Nations. Pending the Judgment of the Court these violations included unilateral economic sanctions and many other coercive measures against Iran, and culminated in a military attack on the territory of the Islamic Republic of Iran.

One element of these violations was the decision to freeze Iranian assets in the United States, which, according to press and broadcast reports, amount to some 12 billion dollars. On 7 April 1980 new measures were taken by the President of the United States with the future disposal of the frozen assets by the American authorities in view. In the letter from the Deputy Agent of the United States of 15 April 1980, these actions of the President were explained particularly by the necessity to make an inventory and by the idea that the calculation might "well be useful in further proceedings before the Court as to the amount of reparations owed by Iran". But in this letter the Deputy Agent failed to comment on the *crucial* point of the statement of the President of the United States on 7 April 1980, which undoubtedly shows that the real purpose of his order relating to Iranian frozen assets is to use them in accordance with decisions which would be taken in a domestic framework by the United States itself.

In the statement of the President of the United States of 7 April 1980 we read :

“3. The Secretary of the Treasury will make a formal inventory of the assets of the Iranian Government which were frozen by my previous order and also make a census or inventory of the outstanding claims of American citizens and corporations against the Government of Iran. *This accounting of claims will aid in designing a program against Iran for the hostages, the hostage families and other US claimants. We are now preparing legislation which will be introduced in the Congress to facilitate processing and paying of these claims.*” (Emphasis added.)

In the context of the statement, this implies that the United States is acting as a “judge” in its own cause. It should be noted that, according to a communication published in the *International Herald Tribune* on 19–20 April 1980, the above-mentioned request to the United States Congress included a provision to “reimburse the United States for military costs because of the hostage crisis” (emphasis added).

6. Furthermore, despite the fact that the Security Council did not adopt the suggestion of the United States to order sanctions against the Islamic Republic of Iran, the Government of the United States decided not only to undertake unilaterally all these sanctions but also to take some additional coercive measures.

In these completely unusual circumstances, it is not possible to include in the Judgment any provisions establishing the responsibility of the Islamic Republic of Iran towards the United States of America and a duty to make reparation, as is done in paragraphs 2, 5 and 6 of the operative part of the Judgment. The Court has disregarded the unlawfulness of the above-mentioned actions of the United States of America and has consequently said nothing about the Applicant's responsibility for those actions to the Islamic Republic of Iran.

Operative paragraph 6 of the Judgment, which provides that the “form and amount of such reparation, failing agreement between the Parties, shall be settled by the Court” and “reserves for this purpose the subsequent procedure in the case”, does not affect my objection. Even if these provisions are detached from operative paragraph 5, and read only with operative paragraph 2, it is still apparent that the Court has recognized an imperative duty on the part of Iran to make reparation to the United States.

It has been mentioned that the absence of Iran from the judicial proceedings allegedly created an obstacle to considering its possible counter-claims against the United States of America. But the wholly unilateral actions committed by the United States of America against Iran simultaneously with the judicial proceedings were clearly proved by documents presented at the request of the Court by the Applicant itself, and there was no legal obstacle to the Court's taking this evidence into account *proprio motu* under Article 53 of the Statute, at least when considering the question of responsibility.

7. Some parts of *the reasoning* of the Judgment described the circumstances of the case in what I find to be an incorrect or one-sided way.

It is not my intention to refer to all those paragraphs in the reasoning which I could not accept. Accordingly I confine myself to the inclusion in this opinion of the points which, it seems to me, are the most important.

8. I was unable to accept paragraphs 32, 93 and 94. The language used by the Court in those paragraphs does not give a full and correct description of the actions of the United States which took place on the territory of the Islamic Republic of Iran on 24–25 April 1980. Some of the wording used by the Court for its description of the events follows uncritically the terminology used in the statement made by the President of the United States on 25 April 1980, in which various attempts were made to justify, from the point of view of international law, the so-called rescue operation. But even when the President's statement is quoted, some parts thereof, which are important for a

correct assessment of those events, are omitted.

What happened in reality ? During the night of 24–25 April 1980 armed units of the military forces of the United States committed an invasion of the territory of the Islamic Republic of Iran. In accordance with the statement of the President of the United States of 25 April 1980, the planning of this invasion “*began shortly after our Embassy was seized ... this complex operation had to be the product of intensive training and repeated rehearsal*” (emphasis added). This means, first, that almost simultaneously with its filing of the Application with a view to settling the dispute by peaceful means, the United States started preparing for settlement of the dispute by the use of armed force, and, secondly, that it proceeded to carry out its plan while the Judgment of the Court was still pending.

It is a well-known fact that in the course of the period preceding the military invasion, the United States concentrated naval forces near the shore of Iran, including an *aircraft-carrier*, the *Nimitz*. And in the statement of the United States Secretary of Defence on 25 April 1980 we read : “*The second helicopter [which participated in the invasion] had difficulties, reversed course, and landed aboard the carrier Nimitz in the Arabian Sea.*” (Emphasis added.)

The Court requested the United States Agent to present documents related to the events of 24–25 April, and they were officially transmitted to it. Among them is the text of a report made by the United States to the Security Council on 25 April “pursuant to Article 51 of the Charter of the United Nations”. In that report the United States maintained that the “mission” had been carried out “in exercise of its inherent right of self-defense”.

The question of a military invasion committed by one Member of the United Nations against another should of course be considered on every occasion by the Security Council of the United Nations, in accordance with its exclusive competence as provided by the Charter of the United Nations.

But, as has been observed, the invasion of the territory of Iran was committed by the United States in a period of judicial deliberation, and was directed (at least according to the explanation given by the United States) not toward the settlement of the dispute in a peaceful way, for example, by negotiations or similar means (which could take place in parallel with judicial proceedings), but *by force*.

In my view, the Court should not, in this completely unusual situation, have limited itself to stating that “an operation undertaken in those circumstances, from whatever motive, is of a kind calculated to undermine respect for the judicial process in international relations” and to “recall[ing] that in paragraph 47, 1 B, of its Order of 15 December 1979 the Court had indicated that no action was to be taken by either party which might aggravate the tension between the two countries” (par. 93). At the same time the Court said that “the question of the legality of the operation of 24 April 1980, under the Charter of the United Nations and under general international law”, is not “before the Court” and that “It follows that the findings reached by the Court in this Judgment are not affected by that operation” (par. 94).

I consider that, without any prejudice to the above-mentioned exclusive competence of the Security Council, the Court, from a purely legal point of view, could have drawn attention to the undeniable legal fact that Article 51 of the Charter, establishing the right of self-defence, may be invoked only “if an armed attack occurs against a Member of the United Nations”. It should have added that in the documentation officially presented by the United States to the Court in response to its request relating to the events of 24–25 April 1980 there is no evidence that any armed attack had occurred against the United States.

Furthermore, some indication should have been included in the Judgment that the Court considers that settlement of the dispute between the United States and the Islamic Republic of Iran should be reached exclusively by peaceful means.

9. Among the paragraphs of the reasoning which I described in point 7 above as incorrect or one-sided is paragraph 88, which deals with the authorization extended to the former Shah to come to New York. This authorization was extended to him even though the United States Government was well aware that he was considered by the Government and people of the Islamic Republic of Iran as a person whom the United States had restored to the throne after overthrowing the legitimate government of Dr. Mossadegh, and as a man who had committed the gravest crimes having been responsible for the torture and execution of thousands of Iranians. His admission to the United States, and the subsequent refusal to extradite him, were thus real provocations and not, as the Judgment suggests, merely ordinary acts which just happened to give rise to a “feeling of offence”.

(Signed) P. Morozov.

Dissenting Opinion of Judge Tarazi

Judge Tarazi

[Translation]

1 Having perused the Application instituting proceedings which the Government of the United States of America filed on 29 November 1979, read the Memorial filed by it on 15 January 1980 and listened to the oral arguments during the hearings of 18,19 and 20 March 1980, the Court had before it a series of facts, historical developments and legal arguments which were to lead to its delivering a Judgment of, in my view, cardinal importance. I concurred in the findings of the Judgment concerning the necessity of compliance by the Government of the Islamic Republic of Iran with the obligations incumbent upon it under the Vienna Conventions of 1961 and 1963 on, respectively, Diplomatic and Consular Relations. I nevertheless found some difficulty, arising on the one hand from the situation which has developed in Iran since the overthrow of the régime of which the former Shah was the symbol, and on the other hand from the conduct of the applicant State both before and after the events of 4 November 1979, in deciding and declaring only that the Government of the Islamic Republic of Iran was responsible vis-à-vis that of the United States of America while neglecting to point out at the same time that the latter had also incurred responsibility, to an extent remaining to be determined, vis-à-vis the Government of Iran.

2 My intention here is to indicate, with as brief explanations as possible, the reasons for my attitude and position. To that end I will have to consider the following points :

1. The principle of the inviolability of diplomatic and consular missions and of the immunity enjoyed by their members ;
2. The factors which enter into the assessment in principle of the responsibility incurred by the Government of the Islamic Republic of Iran ;
3. The actions undertaken by the United States Government both before and after the seisin of the Court which were capable of affecting the course of the proceedings.

1. The Inviolability of Diplomatic and Consular Missions and the Immunity Enjoyed by Their Members

3 I entirely concurred in the reasoning of the Judgment on this point. I was pleased to note that the Judgment took particular account of the traditions of Islam, which contributed along with others to the elaboration of the rules of contemporary public international law on diplomatic and consular inviolability and immunity.

4 In a course of lectures which he gave in 1937 at the Hague Academy of International Law on the subject of “Islam and *jus gentium*”, Professor Ahmed Rehid of the Istanbul law faculty gave the

following account of the inviolability of the envoy in Muslim law :

“In Arabia, the person of the ambassador had always been regarded as sacred. Muhammad consecrated this inviolability. Never were ambassadors to Muhammad or to his successors molested. One day, the envoy of a foreign nation, at an audience granted to him by the Prophet, was so bold as to use insulting language. Muhammad said to him : ‘If you were not an envoy I would have you put to death.’ The author of the ‘Siyer’ which relates this incident draws from it the conclusion that there is an obligation to respect the person of ambassadors.”

5 Ahmed Rehid adds further on :

“The Prophet always treated the envoys of foreign nations with consideration and great affability. He used to shower gifts upon them and recommended his companions to follow his example, saying : ‘Do the same as I’¹.”

6 In a work entitled *International Law*, published by the Institute of State and Law of the Academy of Sciences of the USSR, the following is to be read on the conduct in the Middle Ages of the Arabs, the bearers of the Islamic faith :

“The Arab States, which played an important part in international relations in the Middle Ages (from the 7th century) had well-developed conceptions regarding the Law of Nations, closely linked with religious precepts.

The Arabs recognised the inviolability of Ambassadors and the need for the fulfilment of treaty obligations. They resorted to arbitration to settle international disputes and considered the observance of definite rules of law necessary in time of war (“the blood of women, children and old men shall not besmirch your victory”).”

2. Factors Which Enter into the Assessment in Principle of the Responsibility Incurred by the Iranian Government

7 The deductions made by the Court from the fact that the Government of the Islamic Republic of Iran had violated its binding international obligations to the United States of America with regard to diplomatic inviolability and immunity have led it to declare the former responsible by reason of acts of both omission and commission.

8 I find this approach inadequate. It is not right to proclaim the responsibility of the Iranian Government unless its examination is first preceded by an appropriate study of the historical facts antedating the seizure by Islamic students of the United States Embassy in Tehran on 4 November 1979. In that respect, it is a matter for deep regret that the Iranian Government refused to appear before the Court. Nevertheless, it emerges from the two identical communications addressed to the Court by the Iranian Minister for Foreign Affairs on 9 November 1979 and 16 March 1980 that the Government of the Islamic Republic of Iran considers that the present proceedings are only a marginal aspect of a wider dispute dividing Iran and the United States since the Shah was in 1953 restored to the throne thanks to the intrigues of the CIA and the United States Government continued to meddle in Iran's internal affairs.

9 In spite, and perhaps because of the absence, of the Government of Iran from the proceedings, it behoved the Court to elucidate this particular point before pronouncing on the responsibility of the Iranian State. That responsibility ought to have been qualified as relative and not absolute.

10 I recognize that the Court made a laudable effort in that direction. This, however, remained insufficient. It has been argued that more would mean examining deeds of a political nature which lay outside the framework of the Court's powers. But is it possible to ignore historical developments

which have direct repercussions on legal conflicts ? The Permanent Court of International Justice well clarified this point when in its Judgment of 7 June 1932 (*Free Zones of Upper Savoy and the District of Gex*), it stated :

“The era of the Napoleonic Wars preceding the Hundred Days was brought to an end by the treaties concluded at Paris on May 30th, 1814, between France, on the one hand, and Austria, Great Britain, Prussia and Russia respectively, on the other.” (*P.C.I.J., Series A/B, No. 46, 1932, p. 115.*)

11 One could therefore have devoted some attention to the events of 1953 with a view to gauging to what extent the assertion of the Iranian Minister for Foreign Affairs was plausible. On this essential question, I have been able to glean some impression from a source that does not look with any favourable eye upon the Islamic Revolution of Iran. In his work entitled *The Fall of the Shah*, Mr. Fereydoun Hoveyda, the brother of the ex-sovereign's former Prime Minister, Mr. Abbas Amir Hoveyda, who was condemned to death and executed after the ex-sovereign left Iran, says :

“Some Iranian observers were sceptical, considering that foreign interests were pulling the strings : top-ranking non-British companies on the world market were pushing for a break of the contract with the AIOC [Anglo-Iranian Oil Company]. Be that as it may, when the nationalist uproar grew, the Iranian ruling class and various foreign powers got the wind up and turned to the Shah again. It was then that the CIA floated the idea of a coup d'etat, and in 1953 Kermit Roosevelt visited Tehran to examine the possibilities and find a likely candidate. He found his man in General Zahedi, and the plotters staged the departure of the Shah after having him sign a decree naming Zahedi prime minister. He used CIA money to buy the services of Shaban-bi-mokh (literally Shaban the Scatterbrain), the master of a famous ‘Zurkhané’ (a traditional gymnastics club), in order to recruit a commando squad of ‘civilians’ to act in concert with the army. The operation begun in August 1953 did not take more than a day, and then the Shah made a triumphal return. And the very people who had followed Mossadeq right up to the eleventh hour scurried to the airport and prostrated themselves before the sovereign to kiss his boots !

In spite of the facts, which have been disclosed by the Americans themselves, the Shah was pleased to consider the 1953 coup as a ‘popular revolution’ which gave him the mandate of the people. And apparently he ended up by believing his own propaganda. Already the sovereign was showing a tendency to bend the truth ; it was to intensify to the point of cutting him right off from the realities of the country ¹.”

12 Thus, in the eyes of the present Iranian leaders, the power of the Shah had lacked all legitimacy or legality ever since the overthrow of Dr. Mossadegh in 1953. This point should have been examined carefully, because these same leaders say that they are firmly convinced that the Shah would not have been able to maintain himself upon the throne without the backing given him by the Government of the United States of America.

13 This opinion concords with the reflections of Dr. Henry Kissinger, the former Secretary of State of the United States of America. In his work entitled *The White House Years*, Dr. Kissinger states that :

“Under the Shah's leadership the land bridge between Asia and Europe, so often the hinge of world history, was pro-American and pro-West beyond any challenge. Alone among the countries of the region — Israel aside — Iran made friendship with the United States the starting point of its foreign policy. That it was based on a cold-eyed assessment that a threat to Iran would most likely come from the Soviet Union, in combination with radical Arab states, is only another way of saying that the Shah's view of the realities of world politics paralleled our own. Iran's influence was always on our side ; its resources reinforced ours even in some distant enterprises — in aiding South Vietnam at the time of

the 1973 Paris Agreement, helping Western Europe in its economic crisis in the 1970s, supporting moderates in Africa against Soviet-Cuban encroachment ... In the 1973 Middle East war, for example, Iran was the *only* country bordering the Soviet Union not to permit the Soviets use of its air space — in contrast to several NATO allies. The Shah ... refueled our fleets without question. He never used his control of oil to bring political pressure ; he never joined any oil embargo against the West or Israel. Iran under the Shah, in short, was one of America's best, most important, and most loyal friends in the world. The least we owe him is not retrospectively to vilify the actions that eight American Presidents — including the present incumbent — gratefully welcomed ¹.”

14 It is in these words that Dr. Kissinger himself describes the links which existed between the presence of the Shah at the head of the Iranian State and the exigencies of American worldwide and Middle-East strategy. These links do not in any way justify the occupation of the Embassy. But they should be placed in the balance when the responsibility incurred by the Iranian Government falls to be weighed.

15 Furthermore, the ex-Shah, when in Mexico, was authorized to enter United States territory. The United States authorities were perfectly aware that this authorization might have untoward consequences. They nevertheless granted it, thus committing a serious fault which the Court could have taken into consideration. In what has become a classic work, entitled *Traité théorique et pratique de la responsabilité civile délictuelle et contractuelle*, the brothers Henri, Léon and Jean Mazeaud write :

“If the sole cause of the injury is an act of the complainant, the defendant should always be absolved, for it was not his fault if harm was done. He is thus entitled to rely on the complainant's act, whatever it be. Here it should be pointed out that the question whether the complainant's act contained an element of fault does not even arise. The defendant is absolved because it was not *his* act which was held to be the cause of the injury. In reality, he relies on the complainant's act solely in order to establish the absence of any causal connection between his own act and the harm done ².”

16 Similarly, before reaching the point of declaring the Iranian State responsible, one should take into consideration the circumstances in which the facts complained of occurred. In doing so, one must bear in mind the essential point that Iran is at present traversing a period of revolution. It is no longer valid to assess the obligations of the Iranian State in accordance with the criteria which were current before the departure of the Shah. This corresponds to the essence of the theory recognized in French administrative law with regard to the influence of war on the obligations of the State and public bodies. In its Judgment of 30 March 1916 (*Compagnie du gaz de Bordeaux*) the French Conseil d'Etat confirmed the principle of the collapse of the economy of contracts on account of war ¹. This principle was endorsed by the great French jurist Maurice Hauriou, in his theory of the unforeseen ².

17 With this essential factor added to those already mentioned, the responsibility of the Government of the Islamic Republic of Iran ought to have been envisaged in the context of the revolution which took place in that country and brought about, as it were, a break with a past condemned as oppressive. Thus it would in my view be unjust to lay all the facts complained of at the door of the Iranian Government without subjecting the circumstances in which those acts took place to the least preliminary examination.

3. The Actions Undertaken Before and After the Seisin of the Court Which Were Capable of Affecting the Course of the Proceedings

18 The Government of the United States of America referred its dispute with Iran to the Court on 29 November 1979. It is certain that the Court's jurisdiction is not automatic. The Court possesses only

such jurisdiction as is conferred upon it. Two essential consequences flow from this :

(a) any State is free to ignore the possibility of the judicial solution of a dispute, either by omitting to refer it to the International Court of Justice, or by refusing to submit to the Court's jurisdiction, to the extent that the circumstances of the case enable it so to refuse ;

(b) however, once a State presents itself before the Court as an applicant and requests it to direct the respondent State to submit to the law, the option it possessed before the institution of proceedings disappears. The whole dossier of the dispute at issue is taken in hand by the Court. The applicant State must refrain from taking any decisions on the planes of either domestic or international law which could have the effect of impeding the proper administration of justice.

19 Yet, even before turning to the Court, the Government of the United States of America had already decided to freeze the Iranian assets in United States dollars lodged in United States banks or their branches abroad.

20 Subsequently, just when the Court was embarking upon its deliberation prior to the Judgment it was to adopt, the President of the United States of America, on 7 April 1980, announced a series of measures he had decided to take which were closely connected with the case before the Court. Having regard to the normal exercise of the Court's powers, the most important of these measures was unquestionably the third, whereby he ordered the Secretary of the Treasury to :

“make a formal inventory of the assets of the Iranian Government which were frozen by my previous order and also make a census or inventory of the outstanding claims of American citizens and corporations against the Government of Iran. This accounting of claims will aid in designing a program against Iran for the hostages, the hostage families and other United States claimants.”

21 The President added : “We are now preparing legislation which will be introduced in the Congress to facilitate processing and paying of these claims.”

22 This, in my view, constituted an encroachment on the functions of the Court, for until the Court has ruled upon the principle of reparation the applicant State is not entitled to consider that its submissions, or part of them, have already been accepted and recognized as well founded. What is more, the decision of the United States President to propose the adoption by Congress of legislation granting victims the possibility of receiving compensation out of the Iranian assets frozen in the United States, when the action before the Court has not yet been exhausted, raises the problem of a conflict between the rules of municipal law and those of international law. Were the legislation contemplated to be passed, the conflict would be settled to the detriment of the latter.

23 However, it was the military operation of 24 April 1980 which was the gravest encroachment upon the Court's exercise of its power to declare the law in respect of the dispute laid before it. This operation was called off by the President of the United States for technical reasons. It is not my intention to characterize that operation or to make any legal value-judgment in its respect, but only to allude to it in connection with the case before the Court. I must say that it was not conducive to facilitating the judicial settlement of the dispute.

24 In his report to the Security Council of 25 April 1980, Mr. Donald McHenry, the Permanent Representative of the United States of America, stated that the military operation of 24 April 1980 had been undertaken pursuant to Article 51 of the Charter of the United Nations. Yet Article 51 provides for the eventuality of that kind of operation only “if an armed attack occurs against a Member of the United Nations”. One can only wonder, therefore, whether an armed attack attributable to the Iranian Government has been committed against the territory of the United States, apart from its Embassy and Consulates in Iran.

25 To sum up my position, I would like to mention the following points :

(a) I consider that the Court has jurisdiction to decide the present case only under the provisions of the Vienna Conventions of 1961 and 1963 on, respectively, Diplomatic and Consular Relations. Any direct or indirect reference to the 1955 Treaty between the United States and Iran or to the 1973 Convention is, from my point of view, unacceptable.

(b) I consider that the Iranian Government has violated its obligations under the two Vienna Conventions mentioned above. I concur in those parts of the operative paragraph which deal with this question.

(c) On the other hand, I could not support the idea that the Iranian Government should be declared responsible unless the Court also found :

(i) that the responsibility in question is relative and not absolute, that it must straightway be qualified in accordance with the criteria which I have put forward and others which may be envisaged ;

(ii) that the Government of the United States of America, by reason of its conduct both before and after the institution of proceedings, has equally incurred responsibility.

(Signed) S. Tarazi.

Footnotes:

1 Ahmed Rechid, "L'Islam et le droit des gens", 60 *Recueil des cours de l'Académie de droit international*, 1937-II, pp. 421 f.

1 Fereydoun Hoveyda (trans. Roger Liddell), *The Fall of the Shah*, London, 1979, pp. 92 f.

1 H. Kissinger, *The White House Years*, London, 1979, p. 1262.

2 H., L. and J. Mazeaud, *Traité théorique et pratique de la responsabilité civile délictuelle et contractuelle*. Tome II, 6th ed., Paris, 1970, p. 552.

1 Conseil d'Etat, 30 March 1916, *Recueil Sirey*, 1916, Part III, pp. 17 ff.

2 Maurice Hauriou, note to judgment in question (*ibid.*)