



School of International Arbitration

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International Arbitration Case Law

School of International Arbitration, Queen Mary, University of London

International Arbitration Case Law

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Award Name and Date: WNC Factoring Ltd v. The Czech Republic (PCA Case No. 2014-34) – Award - 22 February 2017

Case report by: Viktoriia Korynevych**, Editor Ignacio Torterola***

Summary:

Claimant, an English holding company, advanced claims on behalf of its Czech affiliated company, which purchased Skoda Export, alleging that Respondent, namely, the Czech Republic, breached the UK – Czech Republic BIT (BIT).

In the Award rendered on 22 February 2017, the Tribunal decided that it did not have jurisdiction in respect of the umbrella clause contained in the BIT because the Agreement for the sale and purchase of all shares in Skoda Export (SPA) did not constitute a specific agreement, as required by Article 2(3) of the BIT. The Tribunal found that the SPA was concluded between Claimant’s Czech affiliated company and the Czech Republic and that there was no agreement between a Contracting Party and an investor of the other Contracting Party as contemplated in Article 2(3) of the BIT.

The Tribunal also rejected Claimant’s alternative argument that jurisdiction can be established through the MFN clause, given that such clause was out of the scope of Tribunal’s jurisdiction established by Article 8(1) of the BIT.

The Tribunal only had jurisdiction over the expropriation claim, as Respondent conceded so during its argument. However, the Tribunal did not find any breach of Article 5 of the BIT on the part of Respondent.

Main issues: *jurisdiction* - intra-EU BIT; umbrella clause; MFN clause; privity of contract; *merits* – expropriation claim; attribution of the conduct

Tribunal: Dr. Gavan Griffith QC (President), Professor Robert Volterra, Judge James Crawford

Claimant’s Counsel: Stephen Jagusch, Anthony Sinclair, Epaminontas Triantafilou, Philip Devenish (Quinn Emanuel Urquhart & Sullivan, LLP), Mr. Robert Nemeč, Michal Sylla (PRK Partners S.R.O. Advokatni Kancelir)

Respondent’s Counsel: Karolina Horakova, Libor Moravek, Ivan Cisar, Pavel Kinnert (Weil Gotshal & Manges), Erica Stein, Arif Ali, David Attanasiou (Dechert LLP), Maria Talasova (Ministry of Finance of the Czech Republic)

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Digest:

1. Facts of the Case

Claimant, WNC Factoring Limited, is a company organized under the laws of England and Wales. (¶ 1). Respondent is the Government of the Czech Republic. (¶ 2).

In May 2007, Respondent decided to privatize its ownership interest of Skoda Export. In August 2007, Respondent initiated the public tender process for the sale of its shares. (¶ 34). Claimant participated in this tender through its subsidiary, the Czech company CEX, a.s., further renamed to FITE Export, a.s. (FITE). (¶ 35). FITE was successful in the first round as a qualifying participant and was provided with an information memorandum and access to a due diligence process. (¶ 36).

FITE submitted its tender application on 12 September 2007 for the price of CZK 210,016,800. (¶ 38). On 2 January 2008, FITE was informed that its bid was successful. On 25 February 2008, Respondent formally approved the sale of its shares in Skoda Export to FITE. The sale of the shares was settled on 26 May 2008. (¶ 40).

On 7 December 2007 and 29 February 2008, FITE and the Ministry of Finance of the Czech Republic signed the Agreement for the sale and purchase of all shares in Skoda Export (SPA). The purchase price of the shares under the SPA was CZK 210,016,800. (¶ 41).

On May 2008, FITE carried out an internal post-acquisition audit of Skoda Export and concluded that the forecasted profits fell materially short of the levels it had expected from the information made available during the tender procedure. (¶ 43). On 22 September 2008, FITE informed the Minister of Finance of the Czech Republic that the acquired projects show significantly worse economic results than those presented during the due diligence. (¶ 44).

On 4 November 2008, the Minister of Finance proposed the provision of substantial State guarantees to the benefit of the Czech Export Bank, a.s. (CEB) and requested operational financing to Skoda Export for the duration of the implementation of loss-making projects. (¶ 46). On 22 December 2008, the Minister of Finance advised FITE to directly contact the CEB and Export Guarantee and Insurance Corporation (EGAP). (¶ 47).

On 2 December 2008, Skoda Export submitted to CEB an application for credit in the amount of CZK 1 to 1.3 billion for the purpose of pre-export financing Balloki and Muridke projects. (¶ 48).

On 15 December 2008, FITE filed a petition with the Municipal Court in Prague for the payment of CZK 1,080,333,000 against the Ministry of Finance of the Czech Republic, for repayment of the purchase price paid for the shares in Skoda Export on grounds of Respondent's breach of the duty to notify about the defects, it was aware of under Section 596 of Act No. 40/1964 Coli., the Civil Code. (¶ 50).

On 23 April 2009, the Board of Directors of CEB unanimously approved a resolution in relation to the Balloki project, *inter alia*, taking the following steps: (i) preparation of an agreement on termination of the project to protect the project against the potential insolvency of Skoda Export; (ii) completion of negotiations with Skoda Export regarding an agreement on terms of the extension of guarantees; and (iii) initiation of cooperation with the Czech Ministry of Finance for interim measures to block the removal of assets and the possible damage to creditors by Skoda Export. (¶ 51).

On 24 April 2009, FITE notified the Ministry of Finance of its withdrawal from the SPA for the sale and purchase of Skoda Export and requested repayment of the purchase price.

Following the implementation by Skoda Export of certain banking transactions, on 24 April 2009, the Tax and Money Laundering Section of the Money Laundering Department of the Police of the Czech Republic issued a resolution seizing the funds of Skoda Export on suspicion that "the funds on the above accounts are intended for the commission of a crime", which had the effect of freezing its bank accounts. (¶ 53). On 5 June 2009, the attachment of the cash funds of Skoda Export was lifted by a ruling of the District State Attorney's Office for Prague. (¶ 55).

On 17 June 2009, Siemens Engineering, a.s., a third party, commenced insolvency proceedings against Skoda Export for payments due under contracts for work on the Balloki and Muridke projects. (¶ 56). On 16 November 2009, the bankruptcy of Skoda Export was declared. On 21 February 2011, the Municipal Court in Prague approved the sale of the business of Skoda Export to ROAD Investments, a.s. (¶ 57).

On 26 September 2015, Claimant commenced arbitration proceedings, alleging that the Czech Republic provided bidders for Skoda Export with misleading information during the company's privatization, obstructed Claimant's attempts to restore the company to profitability, and forced Skoda Export into insolvency and caused the complete devaluation of Claimant's investment in the Czech Republic. (¶ 3).

2. Procedural Background

On 26 September 2014, Claimant submitted a Notice of Arbitration under the terms of UK – Czech Republic BIT and the UNCITRAL Rules. (¶ 4). On 9 February 2015, the PCA was designated as registry for the proceedings. (¶ 6) and the procedural hearing was held at The Hague. (¶ 7).

On 2 April 2015, Claimant filed its Statement of Claim. (¶ 8). On 3 August 2015, Respondent filed its Statement of Defense. (¶ 9). On 12 January 2016, Claimant filed its Reply Submission. (¶ 14).

The Parties agreed that the issues of Respondent's Objections to Admissibility and Jurisdiction would not be bifurcated for preliminary determination. (¶ 32).

3. Analysis by the Tribunal

The Tribunal addressed two main issues: (i) jurisdiction and admissibility and (ii) liability for expropriation.

Jurisdiction and Admissibility

3.1 Whether the BIT was suspended by EU law

Respondent argued that the BIT was superseded by EU law and, therefore, terminated pursuant to Article 59(1) of the Vienna Convention on the Law of Treaties (VCLT). Alternatively, Respondent submitted that the BIT was not applicable under Article 30(3) of the VCLT. (¶ 294). Respondent's objection had two limbs: 1) similar subject matter of the BIT and EU law, (¶ 295) and 2) incompatibility between the BIT and EU law. (¶ 309).

The Tribunal rejected both limbs. The first was rejected because the Tribunal stated that in international arbitration practice it was consistently held that EU law and BITs do not have the same subject matter on the basis that EU law does not offer equivalent procedural or substantive protections to foreign investors. Tribunal referred to the precedents, in which it was held that EU law did not provide investors with a right to institute an arbitration against a host State. (¶ 298). Respondent also argued that EU law protects foreign investment by providing investors with access to Member State courts. However, the Tribunal pointed out that in many cases suits in municipal courts under EU law do not offer the same advantages as independent arbitration under an investment BIT. (¶ 300). The Tribunal found that Respondent did not establish that EU law relates to the same subject matter of BIT under Articles 59(1) or 30 of the VCLT. (¶ 308).

The second limb as to the incompatibility of the BIT with EU law also failed as the Tribunal found that the BIT does not discriminate on the grounds of nationality against EU investors from third States. The Tribunal held that the fact that the BIT affords certain rights not available to other EU investors does not make the BIT discriminatory; there is nothing in the BIT that prevents investors of other States claiming equal rights under the BIT. It was also found that the BIT does not bar investors of non-party States from accessing commensurate protections under EU law. (¶ 309). The Tribunal rejected Respondent's argument about the effect of EU law on jurisdiction under the BIT. (¶ 310). The Tribunal decided that it was obligated under the BIT to decide the case based on the consent of the States parties as set out in the text of the BIT, and on the arguments presented by the Parties. (¶ 311).

3.2 The effect of the BIT umbrella clause (Article 2(3)) on the SPA

The second issue the Tribunal addressed in terms of jurisdiction was whether the BIT umbrella clause (Article 2(3)) applied to the SPA, as it was concluded between Claimant's affiliated company FITE and Respondent. Respondent contended that the umbrella clause in the BIT (Article 2(3)) did not apply to the SPA because the SPA is not an agreement between the Czech Republic and Claimant, but between the Czech Republic and FITE, which is a Czech joint stock company, forming part of Claimant's subsidiary. Therefore, Respondent argued that there was no agreement between a Contracting Party and an investor of the other Contracting Party as required by Article 2(3) of the BIT. (¶ 312).

Article 2(3) of the BIT provided that “Investors of one Contracting Party may conclude with the other Contracting Party specific agreements... Each Contracting Party shall, with regard to the investments of investors of the other Contracting Party, observe the provisions of these specific agreements...”. (¶ 314).

The very wording of the above article required the Tribunal to analyze what a “specific agreement” means.

3.2.1 “Specific Agreement” under BIT Article 2(3)

The Tribunal concluded that in the ordinary meaning a “specific agreement” is one between an investor and a Contracting Party. (¶ 317). The Tribunal stated that FITE was not an investor of the UK because it was incorporated in the Czech Republic, and there was no deeming provision giving it standing as a wholly-owned subsidiary. Therefore, *prima facie*, the Tribunal found that the SPA is not a “specific agreement” within the meaning of Article 2(3) of the BIT. (¶ 318).

Claimant contended that, as there was no privity of contract requirement in Article 2(3) of the BIT, it was immaterial whether the investor concluded the specific agreement directly or through an investment vehicle. (¶ 319).

The Tribunal rejected such position and found that even if there was no requirement of privity under umbrella clauses couched in general terms, in contrast, the BIT uses quite precise language: it refers to “specific agreements” which are to be concluded between a Contracting Party and an investor of the other Contracting Party. In the Tribunal’s view, the SPA is not a specific agreement for the purposes of Article 2(3) of the BIT. (¶ 320).

3.2.2 “Umbrella clause” as shorthand for “observation of undertaking”

The Tribunal stipulated that “umbrella clause” means “observation of undertaking” under international law (¶ 321) and reminded that the obligation to observe an undertaking is owed by the State that has given the undertaking and is owed only to the party to which the undertaking has been given. It is not a freely transferrable obligation, without the consent of the State that has given the undertaking. The Tribunal also pointed out that the requisite elements of an undertaking to be observed under international law are a specific, clear and direct commitment from a State to an identified beneficiary (¶ 322) and that the obligation of the undertaking State cannot be expanded to anyone other than the beneficiary. (¶ 324).

3.2.3 Privity of contract under umbrella clauses

The Tribunal called numerous cases, such as *Azurix Corp. v. Argentina* (¶ 326), *Siemens v. Argentina* (¶ 327), *CMS v. Argentina* (¶ 328), *Burlington Resources v. Ecuador* (¶ 329), *Oxus Gold v. Uzbekistan* (¶ 330), etc., to demonstrate that the dominant view in international arbitration practice is that in respect of contractual obligations, only parties entitled to enforce the obligation under the proper law of the contract may sue. (¶ 325). The Tribunal found that Claimant’s contention that there was no requirement of privity in relation to umbrella clauses found no authoritative support in the case law of international investment tribunals. To the contrary, tribunals have rather consistently resolved that they have no jurisdiction under umbrella clauses to consider contractual obligations between host States and investors’ locally incorporated subsidiaries. (¶ 334).

The Tribunal also pointed out that Claimant did not suggest that Czech law entitled it to enforce the rights of FITE under the SPA. (¶ 336). Claimant submitted that the SPA included multiple warranties applying to FITE and its Affiliates, including Claimant. (¶ 338). But the Tribunal rejected such argument and submitted that the SPA does not impose contractual obligations on Claimant and that rather FITE assumed certain contractual obligations that extended to the conduct or state of affairs of Claimant. Therefore, the Tribunal decided that, as the SPA imposes no obligation on Claimant, Claimant and Respondent cannot be said to have a relationship of obligor and obligee. Claimant had no standing to enforce any obligation under the SPA merely because it is referred to in certain provisions. (¶ 339).

3.2.4 Conclusion

For the above reasons, the Tribunal upheld Respondent's objection to jurisdiction in respect of the umbrella clause claims, as they concerned obligations under the SPA and the SPA was found not to be a specific agreement under Article 2(3) of the BIT. (¶ 341).

3.3 Czech law and umbrella clause

Claimant invoked the umbrella clause not only in respect of alleged breaches of the SPA, but also for alleged violations of Czech law. It alleged that Respondent violated an express warranty in the SPA that it had complied with its own legal obligations, including under Czech law; and breached its implied contractual obligations of good faith under Czech law towards FITE in the negotiation, execution and performance of the SPA. (¶ 342). But the Tribunal rejected both allegations. The first was rejected as the warranty did not impose any new obligation on Respondent and only provided FITE with a right to seek damages for a breach of domestic law by the Ministry of Finance and because Article 2(3) of the BIT did not extend rights to Claimant as the SPA was not a "specific agreement". (¶ 345). The second allegation was also rejected as Claimant did not point to any source of Czech law to support its contention that there was an implied obligation of good faith when negotiating agreements and because umbrella clauses did not elevate State domestic laws to the level of the BIT or convert them into promises. (¶ 346).

3.4 MFN clause as a basis for jurisdiction

Claimant alternatively submitted that jurisdiction can be established under more favorable umbrella clauses in other BITs to which Respondent is party. Claimant contended that it was entitled to rely on more favorable umbrella clauses pursuant to Article 3(1) of the BIT. (¶ 348). The Tribunal stated that it had no jurisdiction to hear disputes arising under Article 3, as the Tribunal's jurisdiction derived from Article 8(1) of the BIT, which provided that it can resolve disputes, concerning only obligations under Articles 2(3), 4, 5 and 6 of the BIT. (¶ 349). On this basis, the Tribunal decided that it had no jurisdiction to determine Claimant's arguments based on the MFN clause. (¶ 358).

3.5 Exclusive jurisdiction of Czech Courts

Respondent contended that claims in respect of the SPA were inadmissible because Czech courts had exclusive jurisdiction over those claims (¶ 359), as the SPA dispute resolution clause provided that any such dispute shall be decided by the court in Prague having subject-matter jurisdiction, unless exclusive jurisdiction of a court is stipulated. (¶ 360). However, since the

umbrella clause claim fell outside the Tribunal's jurisdiction on other grounds, the Tribunal did not address this issue. (¶ 361).

3.6 Jurisdiction over the FET claim

Respondent contended that the Tribunal had no jurisdiction to hear Claimant's FET claim. However, the Tribunal decided not to consider this issue as it had already decided that it had no jurisdiction to hear such claim. (¶ 362).

3.7 General international law claim

Claimant requested that the Tribunal declare that Respondent had breached international law in relation to Claimant's investment. The Tribunal found such claim to be out of Article 8(1) of the BIT and affirmed that the principles of international law cannot on their own provide a basis to expand the scope of the Tribunal's jurisdiction. (¶ 364).

3.8 Jurisdiction over the expropriation claim

The Tribunal decided that, as Respondent conceded so during its argument, it had jurisdiction to hear Claimant's expropriation claim as Article 8(1) of the BIT extended to disputes arising *inter alia* under Article 5 of the BIT. (¶ 363).

Liability for expropriation

3.9 Expropriation claim

Claimant alleged that Respondent, (i) through EGAP and CEB, failed to provide critically needed funding, (ii) attempted to divert its projects to third parties, (iii) acted to freeze Skoda Export's bank accounts. (¶ 366). Claimant contended that these three events directly caused Skoda Export's insolvency. (¶ 372). Claimant also alleged that the above events formed part of a conspiracy against Skoda Export. (¶ 374). The Tribunal (1) made findings with respect to the factual allegations made by Claimant and (2) considered whether Respondent's conduct amounted to expropriation. (¶ 375). The Tribunal also held that there were serious issues which arose in attributing the conduct of CEB and EGAP to Respondent under Article 5 of the ILC Articles. In this regard, the Tribunal referred to the decision in *Waste Management*, where it was found that the tribunal does not need to consider the attribution issue unless it finds that there is conduct capable of breaching the expropriation standard in the BIT. (¶ 376).

3.9.1 Factual allegations

Claimant alleged that the Ministry of Finance was involved in CEB's campaign against Skoda Export. However, the Tribunal pointed out that Claimant adduced no evidence to corroborate its allegation of conspiracy. Its case relied on the witness evidence, consisted of complete inference and supposition. (¶ 377). In its Post-Hearing Brief, Claimant asked the Tribunal to draw an adverse inference from the Minister of Finance's failure to appear and give evidence at the hearing. But Claimant did not produce even *prima facie* evidence supporting the alleged conspiracy, and the Tribunal decided not to draw any adverse inference against Minister *vis-à-vis* the Ministry of Finance's involvement in CEB's treatment of Skoda Export. (¶ 379).

Claimant also argued that the fact that it sought a loan from CEB for CZK 1 billion (USD 60 million) and CEB refused to grant it shown a broader conspiracy to undermine and erode the value of Skoda Export. (¶ 380). However, the Tribunal stated that CEB's refusal to grant the loan to Skoda Export on the terms demanded was nothing more than a commercial decision which CEB was free to make as it saw fit. The Tribunal also found that there was no obligation on CEB to grant the loan arising from legal claims made by Claimant against Respondent or otherwise. (¶¶ 381-384).

Apart from it, Claimant alleged that CEB and EGAP attempted to transfer Claimant's key projects to third parties and that it did so by bullying and threatening Claimant's senior management and by approaching Claimant's stakeholders with information about the proposed transfer. (¶ 385). However, in the Tribunal's view, the allegations of threats and harassment against Claimant's management were not made out on the evidence. Moreover, the Tribunal stated that Claimant was open to discussing the transfer of its projects with CEB (¶ 388) and that Claimant was aware of CEB and EGAP's discussions with stakeholders regarding such transfer. The Tribunal also specified that as no actual transfer took place, there was no taking of the assets which could constitute an expropriation. (¶ 400).

With respect to the freezing orders, Claimant alleged that CEB acted to freeze the Skoda Export's accounts on the basis of false and unsubstantiated charges. (¶ 389). The Tribunal decided that CEB acted in accordance with money laundering rules and the District State Attorney's Office investigated the basis for the freezing orders in a timely manner and directed that they be lifted. (¶¶ 390-395).

3.9.2 Whether Respondent's conduct amounted to expropriation

The Tribunal decided, with respect to each allegation made by Claimant, that there was no unlawful or improper conduct on the part of Respondent. It also determined that there was no conspiracy implicating the Ministry of Finance and connecting three events. The Tribunal found that State's actions were not, under these circumstances, expropriatory acts. (¶ 396).

4. The Tribunal's Decision

Decision

The Tribunal dismissed Claimant's claims in full and concluded that it did not have jurisdiction over the alleged breaches of the BIT other than those arising under Article 5 of the BIT as to the expropriation. When considering the latter, the Tribunal decided that Respondent did not breach Article 5 of the BIT, as Claimant failed to prove such breach. (¶ 403).

Costs

The Tribunal decided that Claimant should bear the entire costs of the dispute and ordered Claimant to pay to Respondent USD 452,500.00 to recoup Respondent's share of the costs of the arbitration and CZK 35,940,599.34 for Respondent's costs and expenses. (¶ 424).