



School of International Arbitration

School of International Arbitration, Queen Mary, University of London

# International Arbitration Case Law

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## MR A J O AND MRS T L V. THE SLOVAK REPUBLIC

### FINAL AWARD

Case Report by Anita Ghazi Rahman\*\*  
Edited by Ignacio Torterola \*\*\*

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An Award rendered on April 23, 2012, under the Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and Czech and Slovak Federal Republic of April 29, 1991 ("BIT"), and in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law of 1976 (UNCITRAL).

**Tribunal:** Prof. Gabrielle Kaufmann-Kohler, President  
Prof. Mikhail Wladimiroff, Arbitrator  
Dr. Vojtěch Trapl, Arbitrator

**Claimant's counsel:** Mr. J. L. M. v G  
V G & D K

**Defendant's Counsel:** Messrs Martin Maisner, Ludovít Mic'insky' and Jir'í Zeman of ROWAN Legal s.r.o, Námestie Slobody

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## *Digest*

### **1. Facts of the Case**

Pursuant to a public tender from the Slovak Republic's National Property Fund in December 1994, the company B C T, a.s. ("BCT") was privatized to attract foreign investors to the thread industry of the Slovak Republic. At the time of privatization, BCT had tax arrears and other liabilities.

The Claimants, a Dutch couple, between 1994 to 1996 acquired approximately 68% shares in the company and introduced changes in the administration of BCT, including establishing a number of subsidiaries of the company in Slovakia (1996-1997). The real property assets of BCT were thereafter transferred into the subsidiary companies. BCT's tax arrears and liabilities increased under the Claimants' administration. On BCT's request, the Slovak Republic granted the company tax allowances as well as extensions for tax payments, arranging for accumulated tax debts to be paid in installments.

By 1999, the liabilities of BCT and its subsidiaries ("BCT Group") exceeded its assets and most of the BCT Group's real property assets were pledged. On February 17, 2000, the Tax Authority of Bratislava II (the "Tax Authority"), amongst other creditors, notified BST that its tax arrears totaled SKK 57,886,634 (Slovak koruna fifty seven million eight hundred and eighty six thousand six hundred and thirty four).

On April 14, 2003, the Regional Court declared BCT in bankruptcy and appointed trustees. BCT appealed the decision. On June 20, 2003 the Supreme Court of the Slovak Republic confirmed BCT's bankruptcy. Between 2001 and 2005, the courts registered 49<sup>1</sup> creditors of BCT, including the Tax Authority of Bratislava. In compliance with the relevant statute on bankruptcy and composition<sup>2</sup> (the "BCA"), the creditors resolved that BCT would be sold under a realization plan through an auction for a minimum price of 25% of the total value determined by an assessor *i.e.*, SKK 507,947,000. A contract of sale for BCT was concluded with a Slovak Republic registered company in September 2005 at a price of SKK 175,002,000. The bankruptcy trustee submitted its final report on the realization of the bankrupt estate on November 8, 2006, and April 9, 2008, the Regional Court decided how the proceeds from the liquidation would be allocated. Bankruptcy proceedings were closed on June 12, 2008 upon partial

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<sup>1</sup> Award ¶ 36, p.11.

<sup>2</sup> Act No.328/1991 on Bankruptcy and Composition, as amended.

settlement of claims accepted in those proceedings.

The Claimants filed a Notice of Arbitration on March 28, 2006 (prior to closure of the bankruptcy proceedings) under the Arbitration Rules of the United Nations Commission on International Trade Law of 1976 (the “UNCITRAL Rules”). On March 1, 2007, the Tribunal fixed Geneva as the place of arbitration and English as the language of arbitration. The Claimants filed their Statement of Claim on November 6, 2007 and on May 29, 2008, following unsuccessful settlement discussions, the Respondent filed its Statement of Defence, objecting to jurisdiction. Subsequently, the Tribunal<sup>3</sup>, in light of the Respondent’s jurisdictional objections and in accordance with Article 21(4) of the UNCITRAL Rules, decided to bifurcate the proceedings and determine the issue of jurisdiction prior to addressing the merits.

## 2. *Legal Issues Discussed in the Decision*

### (a) *Jurisdiction (paras. 52-66, 134-137)*

The Tribunal affirmed its jurisdiction in a separate Decision on Jurisdiction<sup>4</sup> (the “Jurisdiction Decision”) in April 2010.

### (b) *Law governing the merits of the dispute (paras. 138-146)*

With reference to Article 8(6) of the BIT, the Tribunal decided to apply, as the applicable law, the BIT, municipal law, and general principles of international law. With respect to the interpretation of the BIT, the Tribunal decided to resort to the Vienna Convention on the Law of Treaties, to which both the Claimants’ home State and the Respondent are parties and which is recognized as a codification of the customary international law governing treaty interpretation<sup>5</sup>.

### (c) *Burden of proof (paras. 146-148)*

The Tribunal decided to apply the principle of *actori incumbat probatio* and the Claimants were required to adduce evidence of the facts on which they based their claims<sup>6</sup>.

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<sup>3</sup> By Procedural Order No.14 of May 11, 2009, as described in Award ¶ 50, p.13.

<sup>4</sup> The Arbitral Tribunal’s Decision on Jurisdiction dated April 30, 2010, referenced in p.5 of the Award.

<sup>5</sup> Award ¶ 140, p.33.

<sup>6</sup> Award ¶ 148, p.35.

(d) *Attribution of responsibility to the State (paras. 149-163)*

The Claimants based their complaint on the alleged acts and omissions of the Judiciary of the Slovak Republic, its tax authorities, Ministers, the provisional and bankruptcy trustees and the alleged "financial mafia"<sup>7</sup>. In the Jurisdiction Decision, the Tribunal held that the actions of the State officials and judges appeared *prima facie* attributable to the State<sup>8</sup>. In light of Article 4 of the Articles on State Responsibility of the International Law Commission (the "ILC Articles") and also the fact that neither party disputed that the Judiciary of the Slovak Republic, its tax authorities and Finance Ministers are State organs, the Tribunal agreed that the State is responsible for the actions performed by them in their official capacity.

However, in concurrence with the view expressed in *Plama v. Bulgaria*<sup>9</sup>, the Tribunal held that under Slovak law, provisional and bankruptcy trustees are not State organs for whose actions the State is responsible under Article 4 of the ILC Articles<sup>10</sup>. Furthermore, with respect to Article 5 (Conduct of persons or entities exercising elements of governmental authority) and Article 8 (Conduct directed or controlled by a State), the Tribunal held, after reviewing the evidence, that the acts of the preliminary and bankruptcy trustees were neither carried out in exercise of governmental authority, nor on the instructions or under the direction or control of the State. This was because (a) both types of trustees are independent from the State in the performance of their functions as per §§ 8 and 9 of the BCA, and (b) under the Slovak bankruptcy law, the bankruptcy trustee, not the State, is liable for the damage inflicted on the parties to the bankruptcy proceedings or on third parties as a result of a breach of duties<sup>11</sup>.

The Tribunal also agreed with the Respondent that the State is not responsible for the acts of the so-called 'financial mafia' as "...none of the grounds for attribution embodied in Articles 4, 5 and 8 of the ILC Articles apply"<sup>12</sup>.

(e) *Fair and Equitable Treatment – Article 3.1 of the BIT (paras. 200-308)*

The Tribunal, at the beginning of its analysis, noted that previous Tribunals have

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<sup>7</sup> Award ¶ 149, p.36.

<sup>8</sup> Award ¶ 150, p.36.

<sup>9</sup> *Plama Consortium v Republic of Bulgaria*, ICSID Case No.ARB/03/24, Award, August 27, 2008.

<sup>10</sup> Award ¶ 155, p.37.

<sup>11</sup> Award ¶¶ 157, 158, pp.37, 38.

<sup>12</sup> Award ¶ 163, p.39.

emphasized that the fair and equitable treatment (“FET”) guarantee located in Article 3.1 of the BIT must be appreciated *in concerto*, taking into account the specific circumstances of each case<sup>13</sup>. In assessing whether Article 3.1 was breached, the Tribunal considered whether (i) the Claimants’ reasonable expectations were frustrated, (ii) the Claimants’ experienced a denial of justice, (iii) the State organs acted in bad faith, and (iv) all the acts of the Respondent taken together, were violative of Article 3.1.

The Tribunal closely considered the Claimants’ evidence of its alleged ‘reasonable expectation,’ as described in point 2(e)(i) above. Taking into account that it was not disputed that at the time of their investment BCT had substantial liabilities towards the tax authorities and that at the time of the purchase of shares in BCT, the Claimants were aware of the amount of BCT’s tax arrears, the Tribunal held that “In the absence of specific assurance, it does not appear reasonable or legitimate for a tax payer to expect to be relieved from tax liabilities. It is indeed one of the important functions of a State to collect taxes. Every tax payer should expect that his dues will be collected.”<sup>14</sup> The Tribunal also found no evidence of a discriminatory application of tax penalties.<sup>15</sup> Further, given that (a) the Claimants failed to comply with the conditions for tax relief that had been set in negotiations with the Respondent, (b) the tax debts of the Claimants continued to increase and (c) the traditional activity of BCT in the field of yarn and threads was abandoned, the Tribunal found the Claimants’ expectation that the authorities would continue to maintain a lenient attitude with regard to the collection of past due taxes to be unjustified<sup>16</sup>.

In relation to the FET claim based on the Tax Authority’s decision to file for bankruptcy and the timing of that decision (as opposed to realizing pledged assets) the Tribunal observed that “...it is the duty of tax authorities to collect taxes and it is their prerogative to choose the means to do so.”<sup>17</sup> As the Tax Authority was one of BCT’s largest creditors and the company had repeatedly failed to comply with its payment commitments in spite of repeated extensions, the Tribunal found that the Claimants’ could not question the means of tax collection.

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<sup>13</sup> Award ¶ 221, p.58.

<sup>14</sup> Award ¶¶ 234-236, pp.62-63.

<sup>15</sup> Award ¶ 241, p.64.

<sup>16</sup> Award ¶ 248, pp.66-67.

<sup>17</sup> Award ¶ 259, p.70.

In consideration of the above, amongst other points, the Tribunal held that the conduct of the Finance Minister and the Tax Authority was justified and not sufficient to be deemed to frustrate the legitimate expectations of the Claimants<sup>18</sup>. The Tribunal ruled that: “The flexibility showed by the administration over a certain period of time did not create a right in favour of the Claimants. The fact that the State’s lenient attitude ended at some point, did not constitute a treaty breach.”<sup>19</sup>

Regarding the question of “denial of justice” (Point 2(e)(ii)), the Tribunal noted that the claim for denial of justice under international law is a demanding one which implies the failure of a national system “as a whole” to satisfy minimum standards.<sup>20</sup> To establish a denial of justice, the burden of proof fell on the Claimants to demonstrate such a systematic injustice<sup>21</sup>. The Tribunal found that the claim for denial of justice failed because:

- the Claimants failed to provide sufficient proof of alleged missteps in the bankruptcy proceedings<sup>22</sup>;
- mere suggestions of illegitimate conduct, general allegations of corruption and shortcomings of a judicial system do not constitute a treaty breach or a violation of international law<sup>23</sup>;
- the Claimants failed to explain the asserted causal link between the alleged conduct of the Respondent and their alleged damage<sup>24</sup>;
- no proof was found that the State organs conspired with the so-called “financial” or “bankruptcy mafia” against the Claimants or their investment in BCT<sup>25</sup>.

The Tribunal also found that the State organs did not act in bad faith *vis-a-vis* the Claimants, as the action of collection of overdue taxes was undoubtedly legitimate<sup>26</sup> (Point 2(e)(iii)). Further, even if all relevant acts of the Respondent

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<sup>18</sup> Award ¶ 269, p.72.

<sup>19</sup> Award ¶ 270, p.72.

<sup>20</sup> Award ¶ 273, p.73.

<sup>21</sup> Award ¶ 274, p.73.

<sup>22</sup> Award ¶ 269, p.78.

<sup>23</sup> Id., pp.78-79.

<sup>24</sup> Id., p.79

<sup>25</sup> Award ¶ 297, p.79.

<sup>26</sup> Award ¶ 301, p.79.

were considered together, the conduct of the Respondent still did not amount to breach of the BIT<sup>27</sup> (Point 2(e)(iv)). Hence, it was held that there was no violation of Article 3.1 or Article 3.2 of the BIT.

(f) *Expropriation – Article 5 of the BIT (paras. 309-321)*

The Tribunal observed that the Claimants used the word “expropriation” in a confusing manner, including as a synonym of denial of justice<sup>28</sup>, and failed to discharge their burden of proving a treaty breach for expropriation<sup>29</sup>. The Tribunal concluded that “if no breach of Article 3 of the BIT was found, Article 5 was not violated either.”<sup>30</sup>

### 3. *Decision*

The Tribunal decided that the actions of the organs of the Slovak Republic, whether considered together or separately, did not amount to a breach of either Article 3 nor Article 5 of the BIT. The Claimants’ loss was a part of the risk that the investors assumed when they acquired the shares of a heavily indebted company in need of a substantial injection of capital<sup>31</sup>. The Tribunal ordered the Claimants to bear the arbitration costs amounting to EUR 796,523.93 and related VAT of EUR 69,985, to pay to the Respondent EUR 384,628.93 and related VAT expenses of EUR 34,992.75, and to pay EUR 2,000,000 to the Respondent towards its legal and other costs expended in connection with the arbitration, within thirty days of notification of the Award.

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<sup>27</sup> Award ¶ 304, p.80.

<sup>28</sup> Award ¶ 310, p.82.

<sup>29</sup> Award ¶ 321, p.85.

<sup>30</sup> Id.

<sup>31</sup> Award ¶ 323, p.85.