

*Ad hoc* Arbitration

Binder

v.

The Czech Republic

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**FINAL AWARD**

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*Members of the Arbitral Tribunal:*  
Justice Hans Danelius, Chairman,  
Professor Jürgen Creutzig  
Professor Emmanuel Gaillard

*Counsel for*

*Binder:*

*Counsel for The Czech Republic:*

*Place of Arbitration:* Prague

*Date of the Final Award:* 15 July 2011



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## FINAL AWARD

rendered on 15 July 2011 in an *ad hoc* arbitration between the following Parties:

**Claimant:** Binder,

**Counsel:** Vyroubal Krajhanzl Školout Law Firm, Na Příkopě 22,  
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**Respondent:** The Czech Republic, represented by the Ministry of Finance,  
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**Arbitral Tribunal:** Justice Hans Danelius, Chairman, Professor Jürgen Creutzig and  
Professor Emmanuel Gaillard

**Place of Arbitration:** Prague

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### I. General background

1. On 16 November 1990, Mr. Binder (hereinafter referred to as "*the Claimant*") formed a limited company in Czechoslovakia registered as CARGO Transport-Internationale Spedition, spol. s.r.o. (hereinafter called "*CARGO*") with its seat in Liberec and its principal business in Prague. The purpose of CARGO was to provide forwarding services and associated operations on behalf of international haulier and cargo owners.
2. On 1 January 1993, the Federation between the Czech Republic and the Slovak Republic was dissolved, and CARGO became a limited company of the Czech Republic.
3. In the period from June 1994 until April 1995, large quantities of oil products refined in the Slovnaft refinery in Slovakia were imported into the Czech Republic via the border station Břeclav-dálnice. In accordance with Czech law, they were admitted for transit by the customs authority at the border station, subject to subsequent presentation and clearance at an inland customs office. In order to ensure such presentation, an authorised customs agent was requested to issue a guarantee accepting responsibility in case the procedure was not finalised at the inland customs office. In its capacity of customs agent, CARGO issued such guarantees for a large number of shipments.
4. As from May 1995, the Czech customs authorities adopted 1,245 decisions in which they found that shipments had not been presented at an inland customs office for determination of excise tax and value added tax ("*VAT*") and ordered CARGO to make payments of altogether CZK 370 million on the basis of the guarantees it had issued for these shipments. CARGO considered these claims unjustified and lodged a large number of appeals. However, enforcement took place against CARGO in regard to a total amount of approximately CZK 45 million (about EUR 1.5 million).
5. On 19 March 2003, CARGO was declared bankrupt.

## II. The Treaty

6. The present arbitration is based on the bilateral Treaty of 2 October 1990 between the Federal Republic of Germany and the Czech and Slovak Federative Republic regarding the Promotion and Mutual Protection of Investments ("*the Czech-German BIT*" or "*the BIT*") which, in translation into English, provides, *inter alia*, as follows:

### Article 1

For the purpose of this Treaty,

(1) the term "investments" comprises every kind of assets that are acquired in conformity with the domestic laws, in particular:

- a) movable and immovable property as well as any other rights *in rem*, such as mortgages, liens and pledges;
- b) shares of companies and other kinds of interest in companies;
- c) claims to money which has been used to create an economic value or claims to any performance having an economic value and that relate to an investment;

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### Article 2

(1) Each Contracting Party shall in its territory promote as far as possible investments of investors of the other Contracting Party and admit such investments in accordance with its legislation. It shall in any case accord such investments fair and equitable treatment.

(2) Neither Contracting Party shall in any way impair by arbitrary or discriminatory measures the management, maintenance, use or enjoyment of investments in its territory of investors of the other Contracting Party.

(3) Investments and revenue arising hereof and in the event of their re-investment such revenue shall enjoy full protection under this Treaty.

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### Article 3

(1) Neither Contracting Party shall subject investments in its territory owned or controlled by investors of the other Contracting Party to treatment less favourable than it accords to investments of its own investors or to investments of investors of any third state.

(2) Neither Contracting Party shall subject investors of the other Contracting Party, as regards their activity in connection with investments in its territory, to treatment less favourable than it accords to its own investors or to investors of any third state.

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### Article 4

(1) Investments by investors of either Contracting Party shall enjoy full protection and security in the territory of the other Contracting Party.

(2) Investments by investors of either Contracting Party shall not be expropriated, nationalised or subjected to any other measure the effects of which would be tantamount to expropriation or nationalisation in the territory of the other Contracting Party except for the public benefit and against compensation. Such compensation shall be equivalent to the value of the expropriated investment immediately before the date on which the actual or threatened expropriation, nationalisation or comparable measure has become publicly known. The compensation shall be paid without delay and shall carry the usual bank interest until the time of payment; it shall be effectively realisable and freely transferable. Provision shall have been made in an appropriate manner at or prior to the time of expropriation, nationalisation or comparable measure for the determination and payment of such compensation. The legality of any such expropriation, nationalisation or comparable measure and the amount of compensation shall be subject to review by due process of law.

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Article 7

(1) If the legislation of either Contracting Party or obligations under international law existing at present or established hereafter between the Contracting Parties in addition to this Treaty contain a regulation, whether general or specific, entitling investments of investors of the other Contracting Party to a treatment more favourable than is provided for by this Treaty, such regulation shall to the extent that it is more favourable prevail over this Treaty.

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Article 9

(1) Disputes between the Contracting Parties concerning the interpretation or application of this Treaty should as far as possible be settled by the governments of the two Contracting Parties..

(2) If a dispute cannot thus be settled, it shall upon the request of either Contracting Party be submitted to an arbitration tribunal.

(3) Such arbitration tribunal shall be constituted *ad hoc* as follows: each Contracting Party shall appoint one member, and these two members shall agree upon a national of a third State as their chairman to be appointed by the governments of the two Contracting Parties. Such members shall be appointed within two months, and such chairman within three months from the date on which either Contracting Party has informed in writing the other Contracting Party that it intends to submit the dispute to an arbitration tribunal.

(4) If the periods specified in paragraph 3 above have not been observed, either Contracting Party may, in the absence of any other arrangement, invite the President of the International Court of Justice to make the necessary appointments.

(5) The arbitration tribunal shall reach its decisions by a majority of votes. Such decisions shall be binding. Each Contracting Party shall bear the cost of its own member and of its representatives in the arbitration proceedings; the cost of the chairman and the remaining costs shall be borne in equal parts by the Contracting Parties. The arbitration tribunal may decide on other allocation of costs. The arbitration tribunal shall determine its own procedure.

Article 10

(1) Disputes relating to investments between one of the Contracting Parties and an investor of the other Contracting Party should as far as possible be amicably settled between the parties in dispute.

(2) If a dispute cannot be settled within a time period of six months from the point in time when it was raised, it will be submitted to arbitration at the request of the investor of the other Contracting Party. Unless the parties in dispute have agreed otherwise, the provisions of Article 9(3) to (5) shall be applied *mutatis mutandis* on condition that the appointment of the members of the arbitration tribunal in accordance with Article 9(3) is effected by the parties in dispute and that, in so far as the periods specified in Article 9(3) are not observed, either party in dispute may, in the absence of other arrangements, invite the Chairman of the Arbitration Institute of the Stockholm Chamber of Commerce, if not otherwise agreed, to make the required appointments. The Arbitral Award shall be recognised and enforced according to the rules of the Agreement of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

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Article 13

(1) This Treaty shall be ratified; the instruments of ratification shall be exchanged as soon as possible in Bonn.

(2) This Treaty shall enter into force 30 days after the date of exchange of the instruments of ratification. It shall remain in force for a period of ten years and shall be extended thereafter for an unlimited period unless denounced in writing by either Contracting Party twelve months before its expiration. After the expiry of the period of ten years this Treaty may be denounced at any time giving twelve months' notice.

(3) In respect of investments made prior to the date of termination of this Treaty, the provisions of Articles 1 to 12 shall continue to be effective for a further period of fifteen years from the date of termination of this Treaty.

### III. The Customs Act and other relevant provisions

7. At the relevant time in 1994 and 1995, the customs clearance procedure for imports was regulated by the Customs Act No. 13/1993. The Customs Act contained at that time the following general provisions:

#### CHAPTER ONE – DEFINITION OF BASIC TERMS

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##### Section 2

For the purposes of this Act, the following definitions shall apply:

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(i) "customs debt" means the obligation of a person to pay the amount of the import duties (customs debt on importation) or export duties (customs debt on exportation),

(j) "customs supervision" means the complex of acts and measures for securing observance of laws and other generally binding legal regulations the implementation of which is within the competence of the customs authorities,

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(l) "customs approved treatment" means:

1. the placing of goods under a customs procedure,

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(m) "customs procedure" (hereinafter "procedure") only means:

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2. transit (Sections 139 *et seq.*),

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(n) "declarant" means the person making the customs declaration in his own name, or the person in whose name a customs declaration is made,

(o) "customs declaration" means the act made in the form prescribed by the customs rules, whereby the declarant indicates the wish to place goods under a given procedure or to terminate such procedure, and provides the data required by the customs authorities for the application of the given procedure in accordance with the customs rules,

(p) "release of goods" means the act whereby the customs authorities make goods available to an individually defined person for purposes stipulated by the procedure under which they are placed.

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#### CHAPTER TWO – CUSTOMS AUTHORITIES AND THEIR ORGANISATION, CONTROL AND TASKS

##### Section 3

(1) The customs authorities are authorities of state administration having jurisdiction in the area of customs, customs policy, customs tariff and customs statistics.

(2) The customs authorities shall also administer

- (a) the value added tax and excise taxes collected on importation,
- (b) charges relating to importation and exportation,
- (c) the road tax in the case of foreign persons.

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##### Customs offices

##### Section 10

(1) Customs offices shall be established and their territorial jurisdiction shall be defined by Ordinance issued by the Ministry [of Finance].

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##### Section 11

The customs office shall

- (a) make decisions on the release of goods under the proposed customs procedure,
- (b) assess and collect duty, taxes and charges on importation, exportation or transit,

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- (e) determine the customs value,

(f) grant deferral of payment of duty and payment of duty in instalments,  
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(h) enforce the payment of outstanding amounts of duty, taxes and charges levied on importation, exportation or transit,

(i) carry out direct supervision of the movement of persons, goods and means of transportation in the customs border zone as part of customs supervision,  
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(n) carry out control after the release of the goods,  
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8. The goods subject to customs duty were defined as follows:

#### CHAPTER SIX – CUSTOMS DUTY AND CUSTOMS TARIFF

##### Part One CUSTOMS DUTY ---

##### Section 55

Goods subject to customs duty

(1) All imported goods shall be subjected to import duty except goods explicitly designated as duty-free in the customs tariff.

(2) Exported goods shall be subject to export duty only if the customs tariff explicitly establishes such a duty.

(3) Goods explicitly designated as duty-free in international treaties shall not be subject to duty.

9. The following rules applied to the customs proceedings:

#### CHAPTER EIGHT – ENTRY OF GOODS TO THIS COUNTRY

##### Part One ENTRY OF GOODS ACROSS THE STATE BORDER

##### Section 80

(1) Persons who carry goods across the state border shall declare the goods at the border customs office and present therewith the documents relating to the goods.  
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(4) Transport of goods along a customs route shall be realised without delay, without a change in the cargo and without departure from the customs route.

(5) Customs checkpoint means a place designated for the movement of persons and transport of goods across the state border.  
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##### Part Two PRESENTATION OF GOODS FOR CUSTOMS SUPERVISION

##### Section 81

(1) Goods brought into this country shall be conveyed by the person bringing them into this country without delay with an intact customs seal and in accordance with instructions issued by the customs authorities:

(a) to the competent customs office or to a different place designated or approved by the customs authorities,  
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##### Section 82

(1) Any person who assumes responsibility for the carriage of goods after they have been brought to this country shall become responsible for the compliance laid down in Section 81.

(2) If so provided by an international treaty, goods shall be subject to customs supervision although still outside the customs territory of this country and shall be cleared in the same manner as goods already brought into the country.

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### Part Three PRESENTATION OF GOODS TO CUSTOMS

#### Section 83

(1) The person who brought goods to this country or the person who assumed responsibility for carriage of the goods in this country following their entry and who delivered them to the locations specified in Section 81 shall present the goods to customs.

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### CHAPTER NINE – CUSTOMS-APPROVED TREATMENT OR USE

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### Part Two CUSTOMS PROCEDURES

#### Section 99

The purpose of customs proceedings which are being held within the framework of customs supervision shall be to decide on placing the goods in question under the proposed customs procedure.

#### Section 100

##### Initiating customs proceedings

Customs proceedings shall be initiated by lodging a customs declaration proposing that the goods in question should be placed under a specified customs procedure.

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#### Section 102

(1) Customs proceedings shall be held at a customs office or in customs zones.

(2) Customs zones are marked sections or railway depots, ports, or airports and other areas specified by the customs authorities in agreement with the owners or authorised users of such areas.

(3) At the request and at the expense of the declarant, customs proceedings may also be conducted outside a customs zone.

(4) The Ministry shall lay down in an Ordinance the conditions under which proceedings are conducted outside a customs zone and set the amount of expenses to be charged for conducting such proceedings.

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(6) Customs proceedings shall be conducted in the presence of the declarant.

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#### Section 104

##### Decisions in customs proceedings

(1) The basic requisites of decisions issued in customs proceedings shall be:

(a) designation of the customs office which issued the decision,

(b) the serial number of the decision, the date of receipt of the customs declaration, the date of issue of the decision,

(c) the exact designation of the declarant,

(d) the designation of the goods in question,

(e) the subheading of the customs tariff and the rate of duty levied on the goods,

(f) the amount of the duty, tax and charge, and the number of the bank account to which this amount is to be paid,

(g) the signature of the authorised officer of the customs office which issued the decision, with his name, surname and official rank added, and the official seal.

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Part Three  
CUSTOMS DECLARATION

Division One  
Form and requisites of a customs declaration

Section 105

(1) The customs declaration shall be made:

- (a) in writing or
- (b) using a data processing and transmission technique where permitted by the competent customs authority, or
- (c) by means of an oral declaration or any other act whereby the holder of the goods expresses his wish to place them under the customs procedure in question.

(2) A customs declaration made in written form shall be always signed by the authorised person.

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Section 107

The declarant

(1) A customs declaration may be made by any person who is able to present the goods in question, or to have them presented, to the competent customs office together with all the documents which are required to be produced for the application of the rules governing the customs procedure in respect of which the goods were declared.

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Section 108

(1) The declarant may be only a Czech person.

(2) The provision of paragraph 1 shall not apply to cases where a person:

- (a) makes a declaration to place goods under a transit or temporary use procedure,
- (b) declares goods on an occasional basis, provided that the customs office considers this to be justified.

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Part Five

DISPOSAL OF GOODS

Section 123

At the declarant's request, the customs office may permit that the goods be disposed of prior to their release. The customs office shall grant the request in every case when the grounds for not releasing the goods are merely the necessity of determining the origin of the goods, the place of their dispatch, their tariff classification or their customs value. Security shall be provided for any customs debt which does or could arise.

Part Six

SIMPLIFIED PROCEDURES

Section 124

(1) Where the implementation of the procedures in question is properly ensured, the customs office may, in order to simplify completion of formalities and procedures, grant permission for

- (a) the written customs declaration made on the prescribed form (Section 105, para. 5) to omit all the prescribed particulars, or some of the prescribed documents not to be attached thereto or presented, or
- (b) the goods to be entered at the declarant's request for the procedure in question on the basis of a commercial or administrative document replacing the customs declaration.

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CHAPTER TEN – CUSTOMS PROCEDURES  
 Part One  
 RELEASE FOR FREE CIRCULATION

Section 128

Release for free circulation shall confer on foreign goods the status of Czech goods. Release for free circulation shall entail application of the pertinent commercial policy measures and other formalities laid down in respect of the importation of goods and the charging of any duties due.

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Part Two  
 SUSPENSIVE ARRANGEMENTS AND CUSTOMS PROCEDURES WITH ECONOMIC IMPACT  
 Division One  
 Provisions common to several procedures

Section 133

(1) The term "suspensive arrangement" is understood as applying to the following procedures:

(a) transit,

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(3) "imported goods" means goods placed under a suspensive arrangement and goods which, under the inward processing procedure in the form of the drawback system, have met the conditions laid down for release for free circulation and the conditions set in Section 175.

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Section 137

(1) A suspensive arrangement with economic impact shall be discharged when a new customs-approved treatment or use is assigned to the goods.

(2) The customs office shall take all the measures necessary to place the status of the goods in harmony with the conditions laid down for the procedure in question.

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Division Two  
 Transit

Section 139

(1) Transit means a procedure covering goods transported under customs supervision from one customs office to another customs office.

(2) Transit operation means the movement of goods in transit from the customs office of dispatch to the customs office of destination.

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(4) The customs office of dispatch means any customs office where the transit operation begins.

(5) The customs office of destination means any customs office where the transit operation ends.

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(9) Internal transit means transit from the customs office of entry to an inland customs office.

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Section 140

(1) Any person who is entitled to dispose of the goods may propose that the goods be released under the transit procedure. The customs office may require the declarant to prove that he is entitled to dispose of the goods.

(2) The declarant shall bear responsibility towards the customs office for fulfilment of the obligation arising from the transit procedure; he shall, in particular, ensure that the goods are produced under conditions laid down by the customs office of dispatch to the customs office of destination in an unaltered state, with an intact customs seal and with the accompanying documents.

Section 141

(1) Save where an international treaty or this Act provides differently, the proposal to releasing the goods under transit procedure shall be filed with the customs office of dispatch on a form issued or approved by the General Customs Directorate.

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(4) The customs office of dispatch shall decide whether and under what conditions it will release the goods and how their identity is to be secured. When the declarant fails to present a proposal for securing a customs debt, the manner of securing the customs debt shall be determined by the customs office.

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#### Section 144

(1) Before goods are released for transit procedure, the declarant shall provide security for any customs debt which may arise in respect of such goods.

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### 10. Other relevant provisions in the Customs Act were the following:

#### CHAPTER THIRTEEN – CUSTOMS DEBT

##### Part One

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#### Section 240

(1) A customs debt on importation shall be incurred through the unlawful removal from customs supervision of goods liable to import duty.

(2) The customs debt shall be incurred at the moment when the goods are removed from customs supervision.

(3) The debtor shall be:

(a) the person who removed the goods from customs supervision,

(b) any person who participated in such removal and who was or should have been aware that the goods were being removed from customs supervision,

(c) any person who acquired or held goods removed from customs supervision and who was or should have been aware at the time of acquiring or receiving the goods that they had been removed from customs supervision,

(d) the person required to fulfil the obligations arising from temporary storage of the goods or from the use of the customs procedure under which those goods were placed.

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#### Section 250

Where several persons are liable for payment of one customs debt, they shall be liable for such debt jointly and severally.

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#### Part Two

#### SECURITY TO COVER CUSTOMS DEBT

#### Section 254

(1) Where, in accordance with customs rules, the customs authorities may require security to be provided for ensuring payment of a customs debt, such security shall be provided by the debtor or by the person who may become liable for the debt.

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(3) The customs authorities may permit the security to be provided by a person other than the person from whom it is required.

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#### Section 259

The following shall be deemed equivalent to a cash deposit as security covering a customs debt:

(a) submission of a cheque the payment of which is guaranteed by a bank,

(b) submission of any other instrument recognised by the customs office as a means of payment.

#### Section 260

(1) The guarantor shall undertake in his letter of guarantee in writing to pay jointly and severally with the debtor the secured amount of a customs debt.

(2) The guarantor may be only:

(a) a bank,

(b) any person approved by the customs authorities.

(3) The customs authorities may reject or refuse to approve the proposed guarantor when they have warranted doubt that the customs debt will be paid within the prescribed term.

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#### Part Four

#### TIME-BARRING AND EXTINCTION OF CUSTOMS DEBT

##### Section 282

Time-barring of the right to claim outstanding duty

(1) The right to recover and enforce the payment of outstanding duty shall be time-barred after six years following the year when such duty became due.

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#### Part Five

#### REPAYMENT AND REMISSION OF DUTY

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##### Section 289

(1) Where no deception or obvious negligence can be attributed to the person concerned, the customs office may repay or remit import or export duty also for other reasons than those referred to in Sections 286 to 288, in particular if payment of the duty would seriously impair the livelihood of the debtor or of persons depending on him for their livelihood, or if enforcing the payment of the outstanding amount of duty would result in the economic ruin of the debtor.

(2) The customs office shall repay or remit the duty for the reasons stated in paragraph 1, if an application is submitted to it within twelve months of the day on which the amount of duty was communicated to the debtor.

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#### CHAPTER SEVENTEEN – JOINT, INTERIM AND FINAL PROVISIONS

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##### Section 318

Where an international treaty contains provisions differing from this Act or from regulations issued thereunder, the provisions of the international treaty shall apply.

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##### Section 320

Save where this Act provides differently, proceedings before customs authorities shall be governed:

- (a) in matters of customs transgressions by the general regulations governing transgressions,
- (b) in other matters by the general regulations governing administrative procedure.<sup>1</sup>

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##### Section 323

Securing and determining the customs debt and time-barring of the right to enforce payment of outstanding duty (Sections 254 to 282) shall also cover securing and determining the obligation to pay taxes and fees on importation and time-barring of the right to enforce payment of taxes and fees on importation.

11. Decree No. 92/1993 of the Ministry of Finance, dated 17 February 1993, contained the following provisions:

##### Section 16

Customs proceedings outside the customs area

(in relation to Section 102, subsection 4 of the [Customs] Act)

(1) If a declarant requests the realisation of customs proceedings outside the customs area, the declarant must make the request sufficiently in advance, inform the customs authority of the approximate amount of goods and the type of goods using the nomenclature which is common in commerce and propose the

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<sup>1</sup> Act 71/1967 on Administrative Proceedings.

time for the realisation of the customs proceedings; the declarant is obliged to inform the customs authority of any subsequent changes to this information and to do so without any undue delay.

(2) Customs proceedings may take place outside a customs area, if this is justified by reasons of economy, especially if it simplifies the transportation of the goods, or if it is otherwise imperative and does not breach the regular activities of the customs authority.

(3) Customs proceedings do not take place outside the customs area, if the customs authority designates that the customs supervision will only be realised by means of an inspection of the documents and written materials.

(4) the customs authority will realise the customs proceedings outside a customs area, provided that all of the necessary documents pertaining to the product and the means of transport, in which the goods are transported, are prepared in the period proposed by the declarant, so that the customs proceedings can be commenced immediately and concluded without delay.

(5) If the customs authority undertakes the customs proceedings outside a customs area, the declarant will defray the customs authority the costs of the proceedings as follows.

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#### Section 43

Upon application of the declarant, who proposes the release of goods into free circulation, the customs authorities may, subject to the conditions stated in Sections 44 to 46, permit the imported goods to be presented at the premises used for business by the declarant, or in other places outside the customs area as authorised by the customs authorities.

#### Section 44

(1) The customs authorities may issue an authorisation under Section 43, if

(a) the applicant's records enable efficient control by the customs authorities, in particular control after the release of the goods,

(b) the adherence to prohibitions and restraints and other provisions, which govern the release of goods into free circulation, can be assured.

(2) The customs authorities do not grant a permit under Section 43, if the person, who applies for the permit,

(a) repeatedly has violated customs regulations,

(b) only occasionally proposes the release of goods into free circulation.

#### Section 45

(1) If the customs authorities discover that the applicant has repeatedly violated customs regulations, they will withdraw the permit granted.

(2) The customs authorities may withdraw the granted permit, if they discover that the applicant only occasionally proposes the release of goods into free circulation.

#### Section 46

(1) A person, who is granted a permit, is obliged, after presentation of the goods at the location specified in Section 43,

(a) to inform the customs authorities immediately about delivery of goods, in the form and under conditions set by the customs authorities,

(b) to enter the delivered goods into its records which must, in particular, include data making it possible to determine the character of the goods and the date when it was entered into the register,

(c) to prepare such documents as are necessary for the release of goods into free circulation.

(2) If the proper execution of customs supervision is not effected, the customs authorities may authorise a person who is granted a permit pursuant to Section 43,

(a) to submit a declaration pursuant to paragraph 1 (a) already at the time of imminent delivery of the goods,

(b) in special cases, depending on the kind of goods and the frequency of imports, not to inform the customs authorities about each delivery of goods, if all data, which the customs authorities consider necessary for the performance of any possible customs control, are presented to the customs authorities.

The entry of the goods into the declarant's records in these cases is considered as an authorisation to dispose of the goods.

#### Section 47

An application for the permission listed in Section 43 has to contain the following information:

a) the exact denomination of the goods which it concerns,

- b) a proposal form of notification that the goods were delivered outside the customs area,
- c) a proposal for the mode of record of the goods delivered outside the customs area,
- d) a commitment to prepare documents that are necessary for the release of the goods into free circulation or into the regime of storing goods in the customs storage area,
- e) a proposal for the time-limit, within which the customs declaration will be submitted to the customs office,
- f) a proposal for the designation of the day from which it will be possible to consider the goods as released.

#### Section 48

A permission mentioned in Section 43 has to contain the information given in the application that was handed in according to Section 47.

12. Both Section 5(1)(b) of the Excise Taxes Act and Section 43(2) of the VAT Act, as in force in 1994 and 1995, stipulated that, when importing goods to the Czech Republic, a tax liability arises on the day the customs debt occurs. According to Section 2(e) of the Excise Taxes Act and Section 2(2)(i) of the VAT Act, the customs authorities were entrusted with the function of tax administrator in respect of imports, while in other cases the tax administrator was the regional revenue authority.

#### IV. The proceedings

13. On 29 March 2005, the Claimant, with reference to Article 10 of the Czech-German BIT, informed the Czech Republic (hereinafter called "*the Respondent*") that he requested the opening of proceedings against the Respondent, provided that no conciliation was reached within a six-month period in respect of his claim for compensation for damage he had suffered to his investment in the Czech Republic. As no settlement of the dispute was reached, the Claimant subsequently instituted arbitration proceedings against the Respondent. In these proceedings he alleges that the Respondent breached his rights as an investor under Articles 2(1),(2) and(3), 3(1) and (2), 4(1) and (2) and 7(1) of the BIT.

14. In accordance with Article 10 of the BIT, an Arbitral Tribunal was set up which is at present composed of Professor Jürgen Creutzig (appointed by the Claimant), Professor Emmanuel Gaillard (appointed by the Respondent) and Justice Hans Danellius, Chairman (appointed by the Arbitration Institute of the Stockholm Chamber of Commerce). The Arbitral Tribunal, after hearing the Parties, decided that the place of arbitration should be Prague.

15. The Arbitral Tribunal decided, on 29 October 2006, to deal separately with the Respondent's objections to jurisdiction in a first phase of the proceedings. On 15 December 2006, the Tribunal also decided, if it should find that it had jurisdiction in the case, to deal separately with the issues of liability and quantum.

16. In an Award of 6 June 2007, the Tribunal rejected the Respondent's objections to the Arbitral Tribunal's jurisdiction.

17. The Claimant, who had submitted a partial Statement of Claim on 2 October 2006, supplemented it with a full Statement of Claim in respect of liability on 3 September 2007, to which the Respondent replied in a Statement of Defence of 3 December 2007.

18. A Second Memorial was submitted by the Claimant on 10 July 2008 and by the Respondent on 31 January 2009.

19. The final hearing on the liability issue was scheduled to be held on 13-17 July 1999 but was postponed. Instead, it was decided, in May 2009, that the final hearing on liability should be held between 2 and 10 November 2009.

20. On 20 August 2009, the Respondent informed the Arbitral Tribunal that the Tribunal's Award of 6 June 2007 has been set aside on 22 June 2009 by a District Court in Prague which had found that the Claimant was a Czech permanent resident and therefore not entitled to initiate arbitration proceedings based on the Czech-German BIT. The Respondent requested the Tribunal to discontinue any steps in the arbitration proceedings.

21. On 28 August 2009, the Claimant informed the Arbitral Tribunal that he had appealed against the judgment of the Prague District Court. Nevertheless, the Claimant requested that the November hearing be cancelled and that re-scheduling of the hearing be made in consultation with the Parties.

22. On 1 September 2009, the Tribunal, having regard to the wishes of both Parties, decided to cancel the November hearing and not to determine for the time being any new date for a hearing. The Tribunal stated, however, that it remained open for any suggestions from the Parties regarding the further proceedings, including new dates for a hearing on liability.

23. On 20 November 2009, the Arbitral Tribunal proposed to hold a telephone conference with the Parties in order to be informed of any developments in the Czech court proceedings and to have the Parties' views on their expected further duration, including the possibilities of any further appeals to a higher court.

24. On 24 November 2009, the Respondent replied that it did not deem it necessary to organise a conference call to further elaborate on the issues addressed in the Arbitral Tribunal's letter.

25. On 4 December 2009, the Claimant's counsel informed the Arbitral Tribunal that the Claimant had fallen ill and could not, for the time being, discuss matters in connection with the arbitration. The Claimant's counsel therefore suggested that a conference call be scheduled at a later point in time and added that he would convey to the Tribunal and the Respondent whatever information on any development he would receive.

26. On 3 February 2010, the Arbitral Tribunal decided to declare the proceedings suspended, while indicating its readiness at any time to consider a request by either Party for the proceedings to be resumed.

27. In a letter of 11 October 2010 to the Parties, the Arbitral Tribunal, referring to a decision of 2 July 2010 by the City Court of Prague to annul the District Court's judgment of 22 June 2009, asked the Parties whether, in view of this development, it might be appropriate to resume the arbitration proceedings.

28. In letters of 19 October and 9 November 2010, the Claimant requested the Arbitral Tribunal to continue the proceedings. In a letter of 25 October 2010, the Respondent expressed the view that the proceedings should be further discontinued.

29. On 23 November 2010, the Arbitral Tribunal, noting that a request for resumption of the proceedings had been made by one of the Parties, found it appropriate, in conformity with its declaration in the decision of 3 February 2010, to grant this request.

30. Supplementary written briefs were submitted by the Claimant on 15 February 2011 and by the Respondent on 15 April 2011. Cost claims were submitted by the Parties on 10 June 2011.

31. The final hearing in the case was held in Prague on 23-27 May 2011. The Claimant, who was present in person, was also represented at the hearing by Mr. [redacted], Mr. [redacted], and Mr. [redacted] as counsel. The Respondent was represented by Mr. [redacted], Mr. [redacted], Mr. [redacted] and Mr. [redacted] as counsel. In addition to the Claimant, Mr. Binder, who was questioned at the hearing, the following persons were heard as witnesses or experts:

(a) *at the Claimant's request:*

Mr. [redacted]

Mr. [redacted]

Mr. [redacted]

Mr. [redacted]

Mr. [redacted]

Mr. [redacted]

(b) *at the Respondent's request:*

Mr. [redacted]

Ms. [redacted]

Mr. [redacted]

## V. The Parties' claims

32. The Claimant requests that the Arbitral Tribunal should issue:

(a) a declaration that the Czech Republic has acted in breach of the following provisions of the Czech-German BIT:

- (i) the obligation of fair and equitable treatment [Article 2(1)],
- (ii) the obligation not to impair investments by arbitrary or discriminatory measures [Articles 2(2), 3(1) and 3 (2)],
- (iii) the obligation of full protection and security [Articles 2(3) and 4(1)],
- (iv) the obligation not to deprive the Claimant of his investment [Article 4 (2)], and
- (v) the obligation to treat investments at least as well as required by international law [Article 7(1)],

(b) a declaration that the Tribunal retains jurisdiction and that the Tribunal, in a third phase of this arbitration, will address the appropriate redress for the Treaty breaches, including questions of

*quantum*, and

(c) an order that the Czech Republic pay the costs accrued in this arbitration, including the costs of the Tribunal and the legal and other costs incurred by the Claimant.

33. The Respondent requests that the Tribunal should:

(a) dismiss all the Claimant's claims pursuant to the Czech-German BIT,

(b) order the Claimant to pay all the costs and expenses of this arbitration, including the fees and expenses of the Arbitral Tribunal and the fees and expenses of the Respondent's legal representation, on a full indemnity basis, and

(c) award such other relief as the Arbitral Tribunal considers appropriate.

## VI. The Parties' arguments

34. The Parties' arguments in regard to the liability issues are mainly as follows:

### A. The Claimant:

#### (a) *Relevant background*

35. In connection with the separation of the Czech and Slovak Republics in 1993, a customs union was established between the two states. Consequently, export and import of goods between the Czech and Slovak Republics should be exempt from customs and similar levies. Nevertheless, all import and export of goods between the Slovak Republic and the Czech Republic were still to undergo customs proceedings in order to monitor flows of goods across the border for balance-of-trade and statistical purposes. There was no statutory basis at the relevant time for the assessment and collection of excise taxes within the framework of the customs proceedings, but these taxes had to be settled within the system of the internal tax administration.

36. According to the Czech Customs Act, the highest supervisory customs authority was the General Customs Directorate which, in its turn, constituted a division of the Finance Ministry. The General Customs Directorate was entrusted with general supervisory and regulatory functions.

37. Directly under the General Customs Directorate sorted Regional Customs Offices which were entrusted with a monitoring role in relation to lower customs offices, and with a variety of decision-making functions, such as granting authorisations for deferral of tax payments in the context of transit of goods.

38. Under the Regional Customs Offices sorted 18 lower-echelon customs offices (an example of such an office is Zlín). These customs offices were entrusted with the actual processing of the individual customs operations, such as decisions to release goods "under the proposed customs procedure" (Sections 10, 11(1)(a) of the Customs Act), to assess and collect customs due and to determine "customs value", to grant deferral of customs payments and enforce payment of outstanding amounts. They were also authorised to grant declarants the right to use a "simplified customs procedure".

39. Further, it was a duty of the customs offices to “carry out direct supervision of the movement of persons, goods and means of transportation in the customs border zone” as part of customs supervision and to carry out “control after the release of goods”, pursuant to Section 11(1)(i) and(n), respectively.

40. Customs supervision begins when customs proceedings are initiated, for instance – as of relevance in this case – when a transit customs declaration (“TCP”) is issued in respect of a specific shipment. Customs supervision terminates upon fulfilment of final customs clearance at an inland customs office. Upon that event, the goods “are released into free circulation”, which brings into operation Section 240(2) of the Customs Act. This Article stipulates that “[t]he customs debt shall be incurred at the moment when the goods are removed from customs supervision”.

41. There was no final customs clearance at the Slovak-Czech border crossings in respect of the import operations which are relevant in this case. Final customs clearance took place at inland customs offices (“customs offices of final destination”, in the terminology of the Customs Act) or – subject to specific authorisation by the customs authorities – at the location of the importer. A “customs debt” according to the Customs Act would arise if goods were unlawfully removed from customs supervision.

42. In practical terms, hauliers passing the borders of the Czech Republic were directed to a specified inland customs office for purposes of presenting the goods at that location (or, if authorised by the customs authorities, at the location of the importer in a “simplified customs procedure”). This arrangement, in its turn, prompted the necessity for the haulier to obtain a TCP for purposes of authorising movement of the goods from the customs office at the national Czech border (“customs office of dispatch”) to the inland customs office (“customs office of destination”). The TCP is issued by the customs agent. Part 5 of the TCP contains a larger portion which after final presentation of the goods is returned to the customs office of dispatch by internal routing within the customs administration and a smaller bottom part which is returned via the driver of the relevant tank truck to the customs agent.

43. As regards the shipments of oil products from the Slovnaft refinery, which are the subject matter of the present case, the following procedure was applied in practice:

(a) When arriving at the Czech border point Břeclav-dálnice, the driver of the tank truck, as a first step, reported to the local CARGO office, CARGO being a duly licensed customs agent. The driver handed in the bottom part of the Part 5 slip from any previous TCP, duly signed, numbered and stamped by the inland customs office. This document constituted proof that the haulier had complied with the procedure of presenting any previous shipment for final customs clearance at an inland customs office. The haulier then requested that CARGO prepare and deliver a TCP for the new customs transit procedure.

(b) The CARGO office of Břeclav-dálnice verified that the previous transport under the TCP regime, issued to that particular haulier, had been finally presented at the relevant inland customs office. This was done by inspection of the Part 5 slip and the customs stamp and signature affixed to it. The Part 5 slip was then retained by CARGO and filed for verification purposes. The CARGO office further verified that the requisite shipping documents were complete and in good order, *i.e.* the CMR way-bill together with a commercial invoice, packing lists/specification and an export customs declaration, including the necessary data

and seals. CARGO would also check the driver's identity on the basis of his passport and check his signature on the TCP under the text containing the haulier's guarantee undertaking:

(c) Provided that these shipping documents were found to be in order, the CARGO office would prepare the requisite TCP. The particulars of the TCP were also entered into CARGO's computer data base, and, additionally, transferred to the customs authorities' central data base (SLIGOS), which was accessible for all Czech border and inland customs offices. CARGO had its own intranet system, which was also linked to the customs authorities' database by way of a third party provider (Transoft). CARGO could – and did – enter data into SLIGOS but could not get access to information from that facility.

(d) The TCP was printed in hard copy and handed over to the truck driver for presentation at the adjacent customs office at the border crossing Břeclav-dálnice. At the same time, the TCP was communicated to that border customs office by intranet in electronic mode. As soon as the TCP had been received and accepted by the customs office, the specific customs transit operation would be accounted for as "open" in the customs administration's data base. At the same time, a hard copy of the TCP, duly signed and stamped, was issued by the customs office. It would remain "open" as long as presentation of the goods at the inland customs office had not taken place.

(e) Additionally, CARGO would print out and issue the so-called "*záruční listina*" – a surety bond – for the particular transit operation. The surety bond was printed out together with the TCP and the TCP number (at the bottom) was also printed out in full by the CARGO computer. The name of the particular "declarant" was added, as well as the date. The surety bond was additionally signed and stamped by CARGO.

(f) The truck driver, provided with an admission slip, would go to the customs desk of the Břeclav-dálnice Customs Office and hand over the TCP and the surety bond issued by the CARGO office, together with the shipping documents. The customs officer at the customs office would undertake an inspection of the documents to ensure their consistency and compliance with the pertinent requirements. As for the surety bond, the customs officer would add by hand the provisional assessment and sign and stamp the document. In addition, an optical inspection of the physical condition of the customs seal on the cargo would be made.

(g) Further, a time-limit for presentation of the goods at the inland customs office (two or a maximum of three days) would be noted, after which the customs officer would register the TCP in a binder, "Expedited deliveries", and, additionally, record the opening of the TCP prepared by CARGO electronically in the customs software data base.

(h) The driver would proceed to the passport control and then return to his tank truck with the TCP and associated shipping documents. He would continue to the physical checkpoint, present the documents and hand over his admission slip to the customs officer, who would authorise the onward transport in the customs transit regime. The driver would then leave the border crossing with the shipment, the TCP and the shipping documents.

(i) The customs officer at the Břeclav-dálnice Customs Office would then make a copy of the surety bond and return this copy to CARGO with the provisionally determined amount of customs charges (or, in this case, the amount of excise taxes) filled in. This would enable CARGO – as well as the customs authorities themselves – to continuously monitor the

aggregate amount of CARGO's potential guarantee exposure (and that of the hauliers/drivers) by reason of outstanding "open" shipments in the customs transit regime.

(j) The Břeclav-dálnice Customs Office sorted, after receipt of its mail, the Part 5 slips (upper part) in a specific file and also verified the computer-stored update of pending ("open") customs operations and their due finalisation.

(k) The truck driver would forward the shipment "under the customs transit regime" to the inland customs office (or to another place, if a "simplified customs procedure" had been authorised). There, he would present the goods indicated in the TCP transit document within the prescribed time-limit and in an unmodified condition to a customs official.

(l) The customs officer at the inland customs office would review the documents and inspect the condition of the customs seal affixed to the cargo. Having ascertained that the documents were in order and that the seal had not been tampered with, the customs official would confirm that the shipment had been duly presented at the "customs office of destination". This he would do by applying a customs stamp to the Part 5 slip of the TCP, together with his signature, and noting the serial number of the TCP concerned. Additionally, he would enter the arrival of the transit goods in an "incoming transit book" and in electronic mode.

(m) Moreover, the customs officer of the inland customs office would return the upper part of the Part 5 slip (return note) – by internal routing within the customs authorities' administration – and the driver would receive the bottom part of the Part 5 slip. This stamp constituted proof that the shipment had been presented at the customs office of destination, and that the liability of the haulier/driver and CARGO had come to an end.

(n) After having made the necessary verification of the accuracy and completeness of the shipping documents and an inspection of the cargo seals, the customs office would calculate and determine the amount of excise taxes payable. The Final Customs Declaration ("JCD") and the shipping documents would be handed out to the importer against payment of the determined amounts (or posting of security).

44. All the steps in the customs transit proceedings from the Czech border crossing to final customs clearance at the inland customs office were entered into and monitored in the computer network of the Czech customs authorities. The closing of the customs procedure was registered in the computer data base by the customs office.

45. Neither the haulier/driver nor CARGO had any responsibility for any "customs debt" which might arise after the goods had been presented to the customs office of destination in an unaltered state with an intact customs seal and with the accompanying documents. All the 1,839 shipments of oil products which were the subject of tax fraud had been presented for customs clearance at the relevant inland customs office, which means that the responsibility of CARGO (and the hauliers/drivers) in all cases had terminated.

46. In order to ensure that goods in transit were presented at the customs office of destination for purposes of ensuring final customs clearance, a system of guarantees was in place. The driver of the tank truck – on behalf of the haulier – signed a guarantee for the amount of customs duties which had been determined on a preliminary basis by the customs officer at the border crossing. By making the haulier's liability immediately enforceable on the basis of a guarantee undertaking, there was an effective disincentive in place for the haulier to dispose

of the goods – e.g. in collusion with the consignee of the goods – without ensuring that the shipment was properly forwarded and presented to the customs office of destination.

47. In order to provide security for any payment obligation that CARGO might incur, a bank guarantee was required. It was up to the customs agent to procure a bank guarantee for an agreed reference amount of potential indebtedness incurred by hauliers/drivers who retained the services of CARGO. In the case of CARGO, this bank guarantee was established at CZK 15 million (approximately EUR 0.5 million). The particulars of the guarantee were regulated by Section 259 of the Customs Act. This was also the reason why CARGO continuously verified – before issuing new TCPs – that the hauliers/drivers had properly terminated prior shipments under the transit regime.

48. The Československa Obchodni Banka, a.s., at the request of CARGO, initially issued a guarantee in the amount of CZK 5 million (approximately EUR 180,000) with a term of validity until 31 May 1993. In its confirmation letter of 2 July 1993, the Czech Ministry of Finance accepted the undertaking as a global security. In a letter of 27 October 1993, the guarantee was extended until 31 December 1994 on identical terms. After suggesting that the amount of the global guarantee should be increased to CZK 30 million (approximately EUR 1 million), the Ministry of Finance, on 31 March 1995, finally accepted that the security amount could be increased to CZK 15 million, as proposed by CARGO.

49. CARGO issued a surety bond for each transit operation, which accompanied the TCP and was handed over to the driver of the tank truck. By doing so, CARGO undertook joint and several liability together with the hauliers/drivers for any customs debt that might arise because of unlawful removal of goods under the transit regime from customs supervision.

50. When the amount of the surety bond was filled in, the bond already contained particulars regarding the relevant haulier/driver, the particular TCP number and the date of issuance, which had all been generated and printed on the form by CARGO's computer.

51. The TCP number is made up of 13 digits. The first digit (3) designates that it is a customs transit matter, the digits two to five indicate the relevant border customs office (Břeclav-dálnice = 0223), the digits six and seven identify the customs agent (CARGO = 51) and the last six digits designate in sequential order the number of issuance of the individual TCPs. The entire sequence of digits was generated by the CARGO computer system. The number was communicated to the customs authorities' intranet computer system and printed automatically on all relevant customs documents. It was also used by the intranet facility of the customs authorities and reiterated in the context of "customs operations" pertaining to the relevant shipment.

52. There is no way the customs authorities would have failed to notice the accumulation of surety bonds, if there had been one, exactly in the interest of ensuring that they did not exceed what the guarantor reasonably could be expected to discharge. It is, likewise, inconceivable that CARGO would issue surety bonds without ascertaining that prior transit operations had been duly finalised. The situation which finally presented itself was that the customs authorities advanced guarantee claims against CARGO not only in the amount of the bank guarantee – CZK 15 million – but one of CZK 370 million, i.e. an amount twenty-five times higher than the guaranteed limit.

53. The liability of the haulier arises only where there is a failure to present the goods at the inland customs office. If this requirement is complied with, the duty to pay the “customs debt” evolves upon the importer. This is why a security is also provided by the importer, *i.e.* in the event where the goods have been delivered *ex works* (as in the present case).

54. It was possible only for a customs officer of a “customs office of dispatch” at a border crossing – *e.g.* Břeclav-dálnice – to initiate a customs transit authorisation based on a TCP. However, it was also the duty of the customs official at the inland customs office, for instance Olomouc or Zlín, to ensure that the TCPs, which had been issued at the border crossing, were timely and properly finalised at the customs office of destination.

55. It is the Claimant's position that transit shipments have been duly presented and that goods (1,681 loads of oil products during a ten months period) were not illegally removed from customs supervision, at least not by CARGO. The transit shipments were properly performed, releasing CARGO from liability under its guarantee.

56. Even after the competent Czech court had set aside the guarantee claims, the customs authorities still did not release funds of CARGO that had been impounded. As a consequence, CARGO was forced into bankruptcy, and the Claimant's investment was lost.

57. If presentation of the goods has taken place, the liability of the hauliers/drivers provided in Section 140(2) of the Customs Act will have ceased and the sole responsible party for the payment of customs taxes and VAT will be the importer, in this case the company CWA spol. s.r.o (“CWA”). The customs authorities are in a position to ensure – and will ensure – that payment of customs duties, consumption taxes and VAT will be effected by requiring a guarantee or equivalent arrangement from the importer. It is evident that the Czech customs authorities never asked CWA to settle any customs debt, let alone post any guarantee in connection with being granted the simplified customs procedure by the České Budějovice Regional Customs Authority.

58. If illegal removal of the goods from customs supervision has occurred, all those persons who are shown to have carried out the removal, or those who took part in such measure and were aware or should have been aware of the removal, will become jointly and severally liable for the ensuing damage according to Section 240(3) of the Customs Act. Obviously, if the importer does not take part in the illegal removal, he will not incur liability in such a context. It rarely happens that the importer is involved in the illegal removal from customs supervision. The importer will be easily identified and therefore will not be able to avoid liability. In the present case all of the 1,839 shipments were actually delivered to CWA.

*(b) The tax fraud and the involvement of the customs authorities*

59. By the use of a number of sham companies and the involvement of a number of impecunious front men operating in cahoots with customs officials, it was possible for an individual by the name of \_\_\_\_\_ to import refined oil products (gasoline and diesel oil) into the Czech Republic from the Slovnaft refinery in Slovakia, acting in the guise of the patently insolvent company CWA, without paying the relevant excise taxes. The fraudulent scheme enabled the concerned individual to avoid excise taxes representing, according to certain media reports, a figure in the area of CZK 0.5 billion (approximately EUR 17.5 million).

60. What happened in the case of CWA and the other sham companies was that the inland customs office simply stamped and returned to the haulier the Part 5 slip, but without securing the payment of the relevant tax impositions (normally oscillating around CZK 300,000 or approximately EUR 10,000 per tank truck). It can also be established that the inland customs office entered into the computer records the fact that the relevant customs transit operation had been duly terminated.

61. Three of the impecunious front men taking part in the tax fraud ("*the Diesel case*") – [redacted] – were indicted by the public prosecutor already in 1996. [redacted] was given a 10 year prison sentence. The promoter of the entire tax fraud was [redacted] who was subsequently also prosecuted and sentenced to a term of imprisonment.

62. From a writ of prosecution of 13 April 1999 and the judgment of 18 January 2002 against [redacted], the following details appear:

(a) [redacted] succeeded in a two months period (13 June - 14 September 1994) to import and spirit off no less than 643 tank trucks fully loaded with oil products, thereby avoiding to pay a customs debt of almost CZK 200 million (approximately EUR 6 million). In the next few months (6 September - 29 December 1994), he also, through the entirely insolvent company HOREX Zlín s.r.o., managed to avoid payment of excise taxes by its failure to honour tax assessments relating to the import of 764 truck loads of oil products in the amount of approximately CZK 230 million (approximately EUR 8 million). He would not have been able to do this without the active involvement of the customs authorities.

(b) [redacted]'s participation in the tax fraud involved CZK 55 million (approximately EUR 2 million), and CZK 25 million (approximately EUR 1 million), respectively, rightfully due to the Czech treasury. [redacted] acted under the trading name [redacted], which carried out 207 shipments of oil products in the period 16 November - 5 December 1994. During the same period [redacted] ran up a tax debt of CZK 54.6 million (approximately EUR 2 million), more than fifteen times the amount of the required security. This bears witness of the inadequacy of the requested security and the complicity of the customs authorities in the tax fraud.

(c) [redacted], who in all likelihood was also involved in the tax fraud, was sentenced to a 10 year prison sentence by a judgment of the Brno District Court in the year 2000.

63. The oil purchases were carried out as follows. CWA placed orders with the Slovnaft refinery in Slovakia for diesel and gasoline consignments, usually by telephone or fax. The purchase orders were given by either [redacted] or his hired hand [redacted]. The customs invoices issued by Slovnaft identified Slovnaft as seller and CWA as purchaser. As final consignees of the shipments were indicated CWA itself or one or the other of a number of sham companies (Unitip, Kredit, [redacted], Horex, and others).

64. The "importers" who were granted the simplified procedure were manifestly insolvent companies, represented by impecunious front men with no professional record whatsoever, let alone in the oil trade (however, in the cases of Messrs [redacted] and [redacted] with a criminal record). There was never more than one importer, *i.e.* [redacted]. The other figure-heads were never observed by persons involved in the import operations. In flagrant breach of the statutory requirements, only nominal – if any – security for the customs debt was requested,

let alone provided. The various sham companies applied a rotating application scheme for window dressing purposes.

65. Already the fact that the Czech customs authorities extended open unsecured credits to a number of manifestly indigent companies in an aggregate amount of at least EUR 17.5 million during some nine months proves that the customs authorities were implicated in the illegal scheme.

66. What the Claimant needs to establish in this case is that the transit shipments have been duly presented and that the windfall gained by CWA by avoiding payment of taxes and VAT (according to the prosecutor amounting to the counter-value of approximately EUR 20 million) has been made possible by assistance or negligence from inside the customs organisation to provide a simplified procedure without proper safeguards and to cover up the consequences of the tax fraud or dysfunctionality of the supervision and control functions of the Czech customs administration at the time. In this case, the Claimant needs to show such involvement or, as a minimum, dysfunctionality in the Czech customs administration as having caused the loss of the Claimant's investment in the Czech Republic in order to establish a breach under international law.

67. There are circumstances of a general nature that conclusively support the Claimant's case.

68. During the period July 1994 - April 1995 almost two thousand tank trucks crossed one and the same border crossing and had TCPs issued by one and the same customs office of dispatch, the Břeclav-dálnice Customs Office. All the trucks went to one and the same place "en masse", *i.e.* to the "dispatching" of CWA. Although an average of almost ten trucks a day passed the Slovak-Czech border, week after week, no "missing" truck was suspected until at the very end of April 1995. One should add that even larger volumes of oil products that were imported by CWA came in by rail.

69. There would have been no incentive for CWA to carry on any unauthorised simplified procedure creating a situation where the goods would have been considered as unlawfully removed from customs supervision, as this would expose it to the adverse economic consequences of such removal.

70. CWA occupied a work force of some fifty people in order to deal with dispatching of a volume of, as an average, 200 tons of oil products each day. Lipová and Slušovice were located in the immediate vicinity of Zlín. There is no way that the customs offices in the region could remain ignorant of the occurrences at this major place of activities and they would have reacted if something sinister happened.

71. An important element of the tax fraud consisted in the indication in the customs invoices, the TCPs and the CMR waybills of a number of consignees based on an alleged "Consignments Agreement" of 24 March 1994 with supplements of 25 August 1994 and 12 September 1994. This setup was evidently driven by an intention to off-load the tax debt on insolvent front men. It is likely that the authorisations issued – legitimately or illegitimately – by the Zlín customs office for , , Horex and Unitip were also intended to promote this intent. Whatever the purpose was, it is beyond any doubt that the documents were fabricated by one or more customs officials at the Zlín customs office.

72. The tax fraud concerned exclusively the import of oil products into the Czech Republic

from the Slovnaft refinery in Bratislava in Slovakia. These oil imports were in all cases and at all times based on sales contracts concluded by Slovnaft as seller and CWA as buyer. The contracts were of a call nature within the limits of certain forecast preliminary quantities based on quarterly delivery periods. All deliveries of oil products were invoiced to CWA and CWA was the sole debtor in relation to Slovnaft in respect of deliveries of oil products.

73. The Slovnaft customs invoices in all cases also included particulars regarding a "consignee" ( , Horex, Unitip, , etc.). These "consignees" were irrelevant from a customs point of view. Orders for deliveries of oil products and their specific category were forwarded by fax from CWA. Slovnaft produced and prepared the deliveries thus ordered, issued a notice of readiness for delivery and issued an invoice to CWA. For each ready shipment, CWA issued a transport order to one of a large number of road hauliers, according to which the haulier was directed to Slovnaft to load the particular shipment. These transport orders were invariably issued by CWA, irrespective of whether the consignee was CWA, , Horex, Unitip or anyone else. The transport order also included particulars concerning the place of delivery and the customs formalities to observe (*i.e.* forwarding in transit regime and presentation in Lipová or Slušovice according to the simplified procedure granted to CWA). Payments for transports were in all cases executed by CWA (to the extent they followed).

74. Practically all transit shipments of oil products – irrespective of who the consignee was – proceeded to the CWA "dispatching" in Lipová or Slušovice. At these locations, authorised by the simplified procedure granted to CWA, the goods were presented by the hauliers and the documents, *i.e.* the TCP, the commercial invoice and the CMR waybill, were presented. CWA acknowledged receipt of the shipments in all cases on the CMR waybills and the Zlín customs office confirmed Part 5 of the TCP. The Part 5 slip was provided to the driver and Part 5 (upper part) of the TCP was returned by internal routing from the customs office of destination to the customs office of dispatch. The shipments with CWA as consignee and the ones with other fronts, were all customs cleared under the permit for a simplified procedure granted to CWA by the České Budějovice Regional Customs Authority.

75. The only exception from this procedure were deliveries where acted as consignee and front man. had, with the oil import business, managed to secure a simplified procedure at the customs office of Strání against the deposition of CZK 5 million (which funds had been put at disposal by CWA). However, irrespective of this different regime, transit shipments indicating as a consignee were also transported to the "dispatching" of CWA, where receipt of the shipments was confirmed by CWA.

76. Documents, *i.e.* the TCP, the CMR waybill, the customs invoice and specifications, were prepared and collected by CWA employees and brought over to the Zlín customs office on a regular basis. Consistent with relevant instructions, the Zlín customs office, *inter alia*, returned Part 5 (upper part) of the TCP to the Břeclav-dálnice Customs Office. The customs office checked Part 5 with the original page 1 of the TCP, which had been retained, and, having satisfied itself that these documents were duly completed, closed ("discharged") the transit operation in the hard copy and the electronic files of the customs office.

77. After the TCP and the goods under the simplified procedure allowed to CWA were presented at Lipová or Slušovice, the drivers were given onward delivery instructions to the final buyers/consignees of the oil products. The seller of the oil products to the final buyers was at all times CWA, and it was CWA which invoiced and collected payment from the final buyers for deliveries at all times.

78. The simplified procedure allowed CWA was granted by the České Budějovice Regional Customs Authority, which is situated some 300 km from Zlín. The authorisation must have been granted in contravention of the most basic requirements for such a step. Essentially, there had been no requirement imposed by the customs authorities that CWA should pose a guarantee for satisfying payments of accruing excise taxes and VAT.

79. There is no way that any customs office of any national customs administration in any reasonably developed country in the world could fail to notice that 90% of truck loads of oil products disappeared between its national border crossing along a motorway to a place of destination 80 km into the country within a period of 10 months. Neither did any such thing happen. One reason why it succeeded in this particular case is that "open" TCPs were successively presented to the Zlín customs office and so reported to the customs office of dispatch, *i.e.* the Břeclav-dálnice Customs Office, which discharged the TCPs.

80. Already this basic factual state creates a compelling *prima facie* case that customs offices have taken active part in shielding from customs control the circumstances by which CWA *et consortes* managed to steer through the Czech customs control more than two thousand truck loads of oil products, voiding to pay approximately EUR 20 million. It was up to the customs office of dispatch to monitor transit shipments and assure that these were properly finalised. In the cases relevant for this case, this task fell to the Břeclav-dálnice Customs Office. The way in which the control was ensured was by having the inland customs office forward all the Part 5 copies of the TCP (the upper, larger part) duly numbered, signed and stamped by an officer of that office and sent on a daily basis by mail to the originating customs office of dispatch. During the relevant period, the Břeclav-dálnice Customs Office received on a daily basis an average of around 50 such Part 5 forms, relating to incoming traffic, witnessing the termination of the relevant shipments. Among these Part 5 forms, 1,778 confirmations were received in respect of TCPs relating to the fraudulent CWA imports.

81. In order to monitor these incoming, "closed" TCPs against "opened" TCPs, the Břeclav-dálnice Customs Office had delegated four customs officers to work with collating and registering the status of TCPs.

82. The fact that all these copies arrived by mail, in envelopes originating from the Zlín Customs Office (and occasionally from other customs offices) and that, therefore, the Part 5 forms with the "forged stamps" originated from the Zlín Customs Office establishes either that customs officers at that customs office of destination were involved in the tax fraud or that, as the Claimant believes, all the shipments have been duly presented.

83. Of course, if the customs office of destination had not mailed to the dispatch office any Part 5 forms, confirming presentation of the goods at the inland customs office, that border customs office – as the office responsible for discharging TCP operations – would have intervened at an early stage and noted the traffic which was unaccounted for.

84. A computer printout of 27 May 1995 lists six open TCPs which shows that all the other TCPs had been registered as discharged at the time by the Břeclav-dálnice Customs Office on the basis of Part 5 forms returned from the Zlín Customs Office (and occasionally other inland customs offices). Indeed, the printout provides proof that the Břeclav-dálnice Customs Office had received all of the Part 5 confirmations from essentially the Zlín Customs Office (with the exception of four shipments). It is fully consistent with the fact that all TCPs have been

discharged (but six) and with the fact that the Břeclav-dálnice Customs Office at no relevant time initiated the statutorily required inquiry procedure.

85. The continuous surveillance and control of customs operations that take place on national territory is at all times a fundamental function of the customs administration of any country. On the occasion when a TCP is issued by the border customs office, in this case the Břeclav-dálnice Customs Office, a last date for presentation of the goods at the customs office of destination is stipulated. The closure of TCPs is monitored by the discharging office, i.e. the customs office of dispatch, on a daily basis. According to the internal directives applicable at the time, it was the duty of the customs office of dispatch to initiate a so-called inquiry procedure no later than 15 days after the last date of presentation had passed for the particular transit shipment if no Part 5 (upper part) copy had been received. This inquiry procedure was initiated by way of an inquiry letter.

*(c) The alleged forgery and the implication of customs officials*

86. The customs officials use specific stamps to confirm the authenticity of confirmations and to issue other statements made by the customs authorities. Of particular relevance in this case are the stamps affixed on the Part 5 slips in order to provide the haulier/driver with proof that goods have been duly presented at the inland customs office and that, as a consequence, the liability of the hauliers/drivers for due performance of the forwarding of the shipment in the customs transit regime has ended.

87. According to the rules in effect, each customs officer was assigned a specific stamp with the individual sequential number for which the concerned individual had to sign and carry responsibility.

88. The customs stamp with the personal number 12 was assigned to a customs officer at Zlín by the name of [redacted] who, according to the Brno judgment in the Diesel case, stated that he never used his stamp for stamping documents to confirm that certain goods imported into the Czech Republic from abroad were cleared at customs. The question therefore arises as to who used this stamp and for what purpose, and how and in what circumstances the theory arose that the stamp was forged. It should also be explained why the stamps, whether authentic or forged, were destroyed (if that is the case).

89. The other stamp with the personal number 21 was assigned to another customs officer at the inland customs office in Zlín by the name of [redacted] who, according to the Brno judgment, stated that his superior provided him with documents that were stamped with a forged stamp with the same number as the one assigned to him. One may ask oneself why the law enforcement agencies were satisfied with this astounding allegation and who was the superior engaging in such pursuits. It is also remarkable that [redacted] himself did not have any objection to someone using a forged stamp with the same number as the one assigned to him.

90. Forensic examinations carried out by the Czech police authorities as to the authenticity of the stamps used to confirm the prescribed presentation of goods at the customs office of destination on the Part 5 slips concluded that the stamps, which were subject to examination, having the identification number "Olomouc C 1366, personal number 21", when compared with an imprint of a purportedly authentic stamp (Olomouc C 1373, personal number 12), revealed differences "in the external dimensions of the impressions of the stamps". From this

observation, the forensic experts concluded that the first stamps were “forgeries”. However, this conclusion is, in the Claimant’s view, wrong. Firstly, the observation has not been made on the basis of the original stamps which, according to information from the customs authorities, had been destroyed. Instead, the conclusion was based on imprints from the stamps. It must be noted here that the stamps consist of natural rubber or an artificial resin, which will vary in its dimensions depending on the ambient temperature, the pressure with which the stamp is applied and the physical characteristics of the surface on which they are applied.

91. But, more importantly, it is not clear what would have been the point of using “forged” stamps. Final customs clearance did, after all, take place, excise taxes were calculated and determined, and the entire case against each and all of the importers CWA *et consortes* was based on the fundamental premise that they managed to bring the shipments of oil products through final customs clearance without providing security for payment of excise taxes, let alone making the requisite payments. None of the hauliers/drivers are accused of having failed to present the transit goods at the inland customs offices in the materials belonging to the prosecutions of *et consortes*.

92. What is problematic with the hypothesis concerning “forged stamps” is that these allegations were formulated in 1995, while the associated forensic examinations (not of the stamps, for some reason, but of the stamp imprints) did not take place until 1996 and 1998. What is even more problematic is that a very large number of Part 5 slips relate to transit operations which, also in the view of the Czech customs authorities, have been duly terminated. These were provided with the same “forged” stamps.

93. The decision by the customs offices to raise guarantee claims against CARGO and some of the hauliers/drivers was dictated by an effort on the part of the customs authorities to cover up for the fraud in which they had participated, a fraud by which the Czech treasury has incurred damages in an amount in excess of CZK 0.5 billion. If the customs authorities, hypothetically, had not taken part in the sham, it would not have been necessary for them to seek to cover up the deficit caused by the tax fraud.

94. Czech customs officials must have been implicated in the tax fraud. In any event, the contention of the customs authorities that the shipments had not been presented at the inland customs office cannot be correct. In all the 1,839 cases (irrespective of whether the importer occasionally may have paid the excise taxes or not), the inland customs office assessed the amount of excise taxes on the basis of JCDs, payable by the various sham companies that figure in the tax fraud and these figures have subsequently formed the basis for the public prosecutor’s charges against the collaborators in the tax fraud.

95. From this follows that the hauliers/drivers must have presented the goods at the inland customs office and, by so doing, caused the expiry of their (and CARGO’s) guarantee undertakings, because, if they had failed to do so, the customs authorities would not have been able to calculate and determine the amounts of excise taxes payable on each shipment. It is also a fact that the sham companies are accused of having removed the goods from customs supervision. In fact, this was the entire case of the public prosecutor in the prosecutions of *et consortes*. This would not have been possible, if the hauliers/drivers had already illegally removed the goods from customs supervision.

96. But even if the customs authorities were innocent of any wrongdoing and simply the victims of a major fraud, the Respondent would still carry responsibility under the Czech-German BIT for what transpired. If these had been the facts of the case, it would imply that the customs authorities had opted for a course of conduct which consisted in the illegal enforcement of at least 1,245 guarantee claims against CARGO and a number of hauliers/drivers for purposes of indemnifying themselves for damage caused to them by a third, unrelated party.

*(d) The consequences for CARGO*

97. The transiting of oil shipments from the Slovnaft refinery in Slovakia to the Czech Republic were carried out on a routine basis essentially during the time period June 1994 - April 1995 in compliance with the customs regulations. The CARGO office at the Břeclav-dálnice border-crossing routinely and regularly prepared TCPs on behalf of hauliers/drivers of oil products, and it was routinely and regularly provided with the Part 5 slips from the hauliers/drivers, returning from the customs office of destination (or the place authorised by the customs authorities under the simplified customs procedure). There was, obviously, no reason for CARGO (or the individual hauliers/drivers) to doubt that their obligation to present the shipments at the "customs office of destination" had been duly complied with and that their potential liability under their guarantee undertakings had expired.

98. In respect of the 1,839 shipments of oil products, imported by CWA *et consortes*, there was, strictly speaking, no question of "unlawful removal from customs supervision". There was simply a situation where certain customs officials allowed the shipments, after properly conducted customs clearance proceedings, to be "released into free circulation", although excise taxes had not been paid nor security been posted. In all cases - except three of a total number of 1,839 - the Part 5 slip was returned to CARGO (as well as to the originating customs office of dispatch, *i.e.* in these cases the Břeclav-dálnice Customs Office) as a confirmation of presentation of the shipments at the inland customs office. For more than a year the Břeclav-dálnice Customs Office also continuously received the larger portion of the Part 5 slips, finally amounting to around 7,700 copies in total for 1994-1995 (not limited to CWA-related shipments), without pretending that the stamps affixed on these confirmations were "forgeries". It was also notified of the closure of TCPs by way of the customs authorities' computer intranet facility.

99. Not until much later - the first indications came from the Břeclav-dálnice Customs Office at the end of April 1995 - was there any indication that something irregular was happening. At that time CARGO was told by an officer at that "customs office of dispatch", that shipments had not been presented at the inland customs offices (or any alternative, duly approved location). In response, CARGO presented copies of the Part 5 slips, showing the relevant customs stamps. When comparing the copies of the Part 5 slips filed with the Břeclav-dálnice Customs Office, it was possible to establish that those stamps were identical with the ones provided to CARGO, and that also the Břeclav-dálnice Customs Office had accepted these as authentic confirmations and closed all the relevant TCPs. In response to this observation, the customs authorities declared that the stamps were "forgeries", however, without proffering any explanation or supporting evidence for such an astounding proposition.

100. In the context of the first oral allegations that shipments forwarded in the customs transit regime - even those having taken place as early as 8-9 months earlier - had not been duly

presented at the inland customs offices (or alternative locations), the customs authorities also initiated a practice of methodical harassment of hauliers/drivers being serviced by CARGO.

101. Apart from false guarantee claims which were sent to CARGO, there was a systematic stoppage of hauliers not only at the Břeclav-dálnice border crossing but also at other border crossings (not only bordering on Slovakia) such as Mosty u Jablunkova, Hodonín, Sudoměřice, Mikulov, Cinovec, Folmava, Pomezí nad Ohří, Rozvadov, Dubí, Brno, Praha-Nupaky, Praha-Ruzyně, Ostrava and Český Těšín. These stoppages created in each instance delays of three or four days, during which CARGO had to undertake extraordinary measures to clear the shipments with the General Directorate of Customs by making direct solicitations to \_\_\_\_\_, who was the head of its legal department. The stoppages of shipments at the border crossings were linked to the trumped-up guarantee claims and would not have occurred but for the fact that the customs authorities elected to pursue such illegal guarantee claims.

102. Information about the singling out of CARGO for this discriminatory treatment of shipments immediately spread among the hauliers involved in the international haulage business into the Czech Republic. As a consequence, the principal business of CARGO, the international forwarding and freight operations, went into steep decline. Business plummeted from CZK 105 million (approximately EUR 3.7 million) in 1994 to a middling CZK 3 million (approximately EUR 100,000) in 1995.

103. Up to the year 2000, there seemed to be prospects to rehabilitate CARGO to ensure its survival. However, beginning in 1999 and picking up momentum in the year 2000, the customs authorities embarked on the route of enforcement of customs decisions, impounding CARGO's bank accounts and other assets. By impounding, during the period 1999-2001, a total amount somewhat in excess of CZK 45 million (approximately EUR 1.5 million), the customs authorities totally paralysed CARGO's entire operations in the year 2000. After that time, hopes were entertained by the Claimant to resolve the existing deadlock by negotiations with representatives of the Czech Ministry of Finance and other officials. However, this was unsuccessful, and CARGO's bankruptcy could not be avoided.

104. The customs authorities were fully aware that the false guarantee claims against CARGO and certain hauliers/drivers lacked foundation. They were issued solely with the intent to cover up the deficit, which had accumulated as a result of the endemic failure of the customs authorities to collect excise taxes from CWA *et consortes*, the illegal scheme which the customs authorities had knowingly aided and abetted. In all these cases the customs authorities falsely declared that the Czech state treasury had incurred losses because shipments forwarded in the transit regime had not been presented at the customs offices of final destination. However, the true cause of losses was that the customs authorities had implicated themselves in the tax evasion scheme.

105. CARGO ultimately, after many years, obtained the setting aside of all those impositions in the Regional Court of Brno. However, no release of previously impounded property or reimbursement of attached funds was effected by the customs authorities.

*(e) No tax liability in 1994-1995 when importing goods from Slovakia*

106. The term "customs debt" specified in Section 2(i) of the Customs Act, in its version effective in 1994-1995, represented a duty to pay import customs duties only and no

obligation to pay the corresponding excise taxes and VAT collected upon import. Accordingly, the Customs Act did not provide for the obligation to pay excise taxes and VAT. This tax liability was directly governed by the Excise Taxes Act and the VAT Act.

107. In accordance with Section 55(3) of the Customs Act, goods that were explicitly designated as duty-free goods in international treaties (which applies to importing of goods from Slovakia, with which the Czech Republic had a customs union) were not subject to import duties. As a result, a customs debt could not arise on importing goods from Slovakia to the Czech Republic.

108. Both Section 5(1)(b) of the Excise Taxes Act and Section 43(2) of the VAT Act, which were in effect at the relevant time, stipulated that, when importing goods to the Czech Republic, a tax liability arose on the day the customs debt occurred. These provisions should be interpreted as stipulating that the occurrence of a tax liability was materially conditional on the occurrence of a customs debt (*i.e.* a tax liability could only arise where there was a customs debt) as well as specifying the time on which a potential tax liability would arise. The interpretation that a tax liability represented an integral part of the customs debt, *i.e.* that a tax liability arose even where goods were not liable to customs duties, cannot be accepted, as such a conclusion cannot be inferred from the relevant tax legislation. Only later on (specifically in 1997) the relevant amendments to the legislation were approved, explicitly determining the occurrence of a tax liability on importation of duty-free goods. This amendment confirms the correctness of the interpretation, according to which a tax liability in 1994-1995 under the given circumstances did not arise.

109. In addition, it should also be noted that both the Excise Taxes Act and the VAT Act covered the import of goods as a taxable event in provisions preceding the provisions on the occurrence of a tax liability (such as Section 4(1) of the Excise Taxes Act or Section 1 of the VAT Act). It should be inferred from these provisions that a tax liability was conditional on the occurrence of a customs debt. Neither the Excise Taxes Act nor the VAT Act provided for the occurrence of a tax liability when importing goods that were duty-free in accordance with international treaties (such as the treaty on the establishment of the customs union between the Czech Republic and the Slovak Republic). When interpreting Section 5(1)(b) of the Excise Taxes Act and Section 43(2) of the VAT Act, it must be concluded that neither excise duty nor VAT could have been assessed on importing goods from Slovakia in 1994-1995 and, as a result, tax liability could not have arisen under the legislation effective at that time. Consequently, as the tax liability did not arise, the Claimant's guarantee relating to this liability could not have been claimed.

110. Another important fact to consider is that the Customs Act at that time clearly determined the method by which a procedure with conditional exemption from customs duties (in this particular case a transit procedure under Section 133(1)(a) of the Customs Act) could be terminated. The Customs Act provided that this procedure was deemed terminated on the moment the goods concerned were assigned another customs-approved procedure. If, in the present case, the goods that were released for a transit procedure by the Břeclav-dálnice Customs Office were not assigned another customs-approved procedure, these goods were not released for any other customs procedure.

111. In connection with this, it seems crucial that, under the Excise Taxes Act and the VAT Act effective in 1994-1995, goods liable to tax were only the goods liable to customs duties and that importation of goods was understood to be, only and exclusively, the release of goods

for procedures specified in the law, in particular the release of goods for free circulation, the release of goods for inward processing and the release of goods for temporary use. Moreover, these acts did not include any provisions which would consider the removal of goods from customs supervision as an import of goods. Nor did they refer to the relevant provisions of Section 240 of the Customs Act.

112. This means that, in accordance with the Excise Taxes Act and the VAT Act as well as general constitutional principles, a tax liability occurred only where goods were released for specific procedures and could not have occurred in other instances. This interpretation is also supported by the fact that only by Act No. 208/1997 with effect from 1 January 1998 Section 43(2) of the VAT Act was amended to stipulate that import VAT liability also arises upon the breach of conditions stipulated for the customs procedure under which the goods are placed under customs supervision. Before this date the occurrence of VAT liability on the import of goods was exclusively bound, from both material and time perspective, upon the occurrence of a customs debt. If this legislative amendment was aimed at extending the tax liability (the fact that the amendment was aimed at extending the tax liability was explicitly confirmed by the wording of the explanatory report of the Act amending the VAT Act), it is obvious that, before the amendment became effective, VAT liability could not arise where no import as defined by the VAT Act took place.

113. Consequently, when the goods under the transit procedure were removed from customs supervision, they were not released for free circulation (as the customs declaration for the release of goods for free circulation was not accepted) nor were they imported as defined in the Excise Taxes Act and the VAT Act. In such a case, a tax liability could not have occurred as the liability was exclusively connected with importation of goods, and only imported goods were liable to customs duties.

114. The fact that, despite the said facts, customs authorities assessed tax on imports from Slovakia implies that they fundamentally breached the Constitution of the Czech Republic and the Charter of Fundamental Rights and Freedoms. Section 2(3) of the Constitution states that state authority may only be exercised in the cases, to the extent and by procedures set out by the law. Section 4(1) of the Charter provides that duties can be imposed only under the law and within its limits and only in compliance with fundamental rights and freedoms. Section 11(5) of the Charter states that taxes and charges can only be imposed under the law.

*(f) The customs offices not authorised to assess and collect taxes*

115. A further fundamental problem for the resolution of the whole case is whether the customs office was entitled at all in 1994-1995 to assess and collect excise tax and VAT on the relevant imports, *i.e.* whether it was within their substantive authority to take such decisions.

116. Section 3(2)(a) of the Customs Act provided that customs authorities also perform administration of excise tax and value added tax collected “upon import” and this provision was specified in Section 11(1)(b) in such a manner that this administration, *i.e.* the assessment and collection of such taxes upon import, is performed by customs authorities. The Customs Act did not define the term “import” in more detail.

117. Section 2(e) of the Act on Excise Taxes stated that customs authorities were entrusted with the function of tax administrator in respect of “imports”. In other cases the tax administrator was the relevant regional revenue authority. The VAT Act contained a similar

provision and in Section 2(2)(i) stated that customs authorities were the tax administrator only in connection with "imports" and that in other cases the tax administrator was the relevant regional revenue authority.

118. The Act on Excise Taxes defined the term "import". At the decisive time, *i.e.* in 1994, the term "import" was defined in Section 2(d) of this Act in such a manner that import was understood to be only the release of selected products into free circulation, with reference to Section 128 *et seq.* of the Customs Act, or into the regime of active treatment contact in the return system, with reference to Section 163 *et seq.* of the Customs Act. The Act on Excise Taxes did not consider anything else to be imports.

119. The VAT Act defined the term import slightly differently, but according to this definition it was not possible to regard any entry of goods into the Czech Republic as an import. According to Section 43(1) only imported goods were subject to tax, whereas import was understood to only concern goods released into the following regimes:

- (a) free circulation regime – reference to Sections 128 to 132 of the Customs Act,
- (b) active treatment contact regime in return system (EU terminology: inward processing relief) – reference to Sections 163 to 178 of the Customs Act,
- (c) imported back into free circulation from the passive treatment contact regime (EU terminology: outward processing relief) – reference to Sections 197 to 213 of the Customs Act,
- (d) temporary use (EU terminology: temporary import) – reference to Sections 238 to 253 of the Customs Act.

120. This indicates that, in addition to what was specified in the Act on Excise Taxes, the VAT Act regarded as imports only releases into free circulation during re-import from passive treatment contact regime and release into temporary use regime.

121. According to the payment assessments issued by the Břeclav-dálnice Customs Office, the customs debt arose in accordance with Section 240, and did not arise upon release into the free circulation regime, or the active treatment contact regime in the return system, or the temporary use regime, or release into the free circulation regime upon re-import of goods upon the termination of the passive treatment contact regime, so, according to both tax acts, it was not an import but a transit. As customs authorities were the administrators of such taxes only in connection with imports, the Břeclav-dálnice Customs Office was not the administrator of such taxes, *i.e.* it was not materially competent to assess and collect such taxes. The assessment and collection of such taxes in these cases was within the power of the relevant revenue authority. The payment orders, which are individual administrative acts, suffer from a fundamental and inherent defect, since they were issued by a customs office that was not materially entitled to issue them.

122. The Customs Act, the Excise Taxes Act and the VAT Act, in their versions effective in 1994-1995, stipulated that at import of goods the customs authority shall be responsible for the administration of the excise taxes and import VAT. As a result, the answer to the question whether the Customs Office was authorised to assess the excise tax and VAT depends on whether in the relevant case import of goods was realised or not. There was no specific definition of the term "import" in the Customs Act. The term was defined for the purpose of the Excise Taxes Act and the VAT Act in Section 2(e) of the Excise Taxes Act and Section 43(1) of the VAT Act.

123. Consequently, the given case did not concern import as defined in the respective tax regulations since the goods were not released for free circulation. It follows that the customs authorities did not have subject-matter jurisdiction for assessment and enforcement of tax liabilities under the valid legal regulations, *i.e.* they were not the “tax administrator”.

124. As in the relevant cases the taxes were assessed by a customs office, without the law giving it the authority to do so, this procedure fundamentally breached the Constitution of the Czech Republic and the Charter of Fundamental Rights and Freedoms, which provide that state power can be applied in the cases, within the limits and in the manners stipulated by the law. In contrast to this, individuals and legal entities can do what is not prohibited by the law, and nobody can be forced to do what is not imposed by law.

*(g) Void administrative acts*

125. Legal theory distinguishes between defective administrative acts that are unlawful or materially incorrect, formally defective acts and void administrative acts. There is a presumption of correctness for unlawful or materially incorrect administrative acts and formally defective administrative acts. These acts are regarded as free of error, unless the opposite is found officially (by an administrative body or a court), *i.e.* until they are changed or cancelled by the relevant administrative body or court. These defective administrative acts should be distinguished from cases of nullity (voidness, non-existence). Nullity occurs when defects reach such a level that it is no longer possible to regard them as administrative acts, and where such activity is not regarded as authoritative administrative activity, such acts do not bind anybody and nobody is under an obligation to comply with them. Nullity is usually caused by an absolute lack of material jurisdiction of the administrative body that issued the relevant act.

126. Since it is not possible in this case, in view of the definition of “import” in the Act on Excise Taxes and the VAT Act, to speak about the import of goods and the customs office was therefore not the tax administrator, *i.e.* it did not have material jurisdiction to assess and collect the taxes, it is necessary to regard all payment assessments, and also related decisions of the customs directorate, as bad acts (void, null acts), and therefore as acts which do not produce the effects intended by them. Such acts cannot be regarded as administrative acts and are not binding. All legal acts by the customs office which were based on such bad acts are therefore unlawful.

*(h) Guarantee for the customs debt in the guarantee certificate*

127. According to the guarantee certificates, CARGO provided a guarantee for the securing of the customs debt and undertook to settle the guaranteed amount of the debt jointly and severally with the debtor.

128. Since the definition of the term “customs debt” in Section 2(i) of the Customs Act, in its version effective in 1994-1995, included only an obligation to pay import customs duty and not an obligation to pay excise tax and VAT, it is necessary to infer that CARGO only provided a guarantee for the payment of the customs duty and not for the payment of excise tax and VAT by the debtor in the guarantee certificate.

129. Subject to evaluation from a legal perspective should also be the issue what was the actual will of the parties in respect of the extent of the guarantee, whether it was intended only to include the customs duty payment or whether it also related to payment of tax liabilities. In this respect it is necessary to infer that if it was not the will of the parties also to secure the tax liabilities of the primary debtor by the relevant guarantee certificate, then the customs authority was not entitled to assert the guarantee in this relation. The Claimant submits that CARGO's will in respect of the extent of the guarantee covered only securing of the customs duty payment, if any.

*(i) Liability of the drivers for the customs debt*

130. The customs authorities evaluated the facts of the case in question as illegal removal of goods from customs supervision and, in accordance with Section 240(3) of the Customs Act, they declared CWA and the customs declarants as debtors in relation to the customs debt.

131. No guarantee for a customs debt could have been claimed from CARGO as no customs debt in connection with removal of goods from customs supervision arose for the drivers who acted as customs declarants in the relevant customs proceedings and for whom CARGO provided a guarantee.

132. From decisions of the Constitutional Court it appears as follows:

(a) In cases where the driver is formally stated in a customs declaration as the customs declarant it cannot be automatically inferred that this person really is the customs declarant, as in some cases the driver acts on behalf of his employer on the basis of a power of attorney. When investigating whether the driver actually is the customs declarant, all relevant means of evidence must be considered.

(b) The obligation of the driver to pay the customs debt cannot be imposed automatically and based only on a formal application of the appropriate provisions of the Customs Act to the data and information included in the customs declaration, if the circumstances indicate that someone else might have committed an unlawful action resulting in failure to deliver the goods to the customs office of destination.

133. As the criminal proceedings in the case of \_\_\_\_\_ who was found guilty of tax evasion in connection with the respective diesel oil imports from Slovakia was not closed until many years after the final and conclusive decisions on the liability of the drivers for the customs debt had been issued, it is obvious that the customs authorities based their decisions in all cases on insufficiently investigated facts as they had not reflected the findings resulting from the conclusions of the investigating, prosecuting and adjudicating bodies. This was especially so in a situation where \_\_\_\_\_ (or CWA, the company controlled by him) was subsequently declared by the criminal court as the sole debtor in connection with the relevant taxes. The decisions on the liability of the drivers for the customs debt must thus be considered unlawful.

134. If the customs authorities of the Czech Republic asserted the claims against CARGO based on unlawful decisions to impose the obligation to settle the customs debt on persons to whom the guarantee of CARGO related, then asserting the claims against CARGO to meet this guarantee must also be considered unlawful.

*(j) Absence of CARGO in the customs proceedings with the drivers*

135. In the period between 1 January 1993 and 30 June 1997, in compliance with Section 320 of the Customs Act (in the version then effective), the Act No. 71/1967 on Administrative Procedure (in the version then effective) was to be applied to proceedings before customs authorities in so far as the Customs Act did not contain special rules. The relevant issues included the specification of the basic rules of the proceedings, the definition of the participants to the proceedings and their procedural rights and obligations.

136. The basic rules of the proceedings included the duty of the administrative body to proceed in close cooperation with citizens and organisations (*i.e.* with natural persons and legal entities) and to give them the opportunity to defend their rights and interests in an effective manner (Section 3(2) of the Administrative Procedure Act).

137. Section 14(1) of the Administrative Procedure Act defined “participant in the proceedings” as a person whose rights, interests protected by the law and obligations shall be subject to hearing in the proceedings or whose rights, interests protected by the law and obligations may be directly affected in the proceedings. Further a participant was also a person/entity who/which claimed that he or it could be directly affected in his or its rights, legal interests or obligations by the decision.

138. The procedural rights of the participants in the proceedings were reflected in the obligation of the administrative body to give the participants an opportunity to provide their opinion on the underlying facts of the decision as well as the manner in which they have been identified or, if appropriate, to propose other facts to be added to the existing underlying facts (Section 33(2) of the Administrative Procedure Act).

139. The Supreme Administrative Court has stated (case no. 7A 112/2002, ruling of 14 November 2003) that the purpose of Section 33(2) of the Administrative Procedure Act is to enable a party to proceedings to be able, “before a decision is issued”, to make objections or procedural requests so as to ensure, *inter alia*, that the decision is genuinely based on a reliably ascertained state of affairs.

140. The Constitutional Court has stated (ruling II. ÚS 329/04 of 3 March 2005) that “[i]t is a breach of the principle of the rule of law, which is anchored in Section 1 of the Constitution of the Czech Republic and the right to court protection and judicial review, protected by Section 36(1) and (2) of the Charter [of Fundamental Rights and Freedoms], if an administrative body does not give a complainant the option of expressing its opinion on the source documents for the ruling and the method in which they were ascertained in accordance with Section 33(2) of the Administrative Procedure Act, and the court, as a part of its review of administrative decisions, did not have regard to such circumstance”. The procedure of the Respondent and the Czech Customs Directorate is in direct conflict with this case-law. It was only from the second instance decision of the Customs Directorate Brno (and before that from the District Customs Office in Břeclav) that CARGO learned that a customs debt was to arise under Section 240(1) of the Customs Act, *i.e.* because the goods were unlawfully removed from customs supervision, and the declarant was designated the debtor under Section 240(3)(d), because it did not meet its obligation under the transit regime.

141. Based on the guarantee certificates concerned, issued for the purpose of securing the customs debt of the customs declarants, CARGO took over the guarantee for any customs

debt that arose for the customs declarants from the transactions concerned. The decision in which the customs debt was assessed to the individual customs declarants had a direct impact on the substantive position of CARGO as its obligation as guarantor was activated by this decision. CARGO was therefore, according to Section 14(1) of the Administrative Procedure Act, a participant in the customs proceedings in which the customs debt of the customs declarants was assessed and was entitled to use the procedural rights provided by the Administrative Procedure Act.

142. Since the customs authorities did not deal with CARGO as a participant in the proceedings regarding the assessment of the customs debt of the declarants, they did not provide CARGO with an opportunity to express its opinion on the facts underlying these decisions and on the manner they had been established and, in general, did not proceed in close cooperation with CARGO during the proceedings. Consequently, the decisions on assessment of the customs debt to the customs declarants were based on material procedural errors.

143. CARGO did not get the opportunity to defend its rights and interests in an effective manner, which resulted not only in a breach of the Administrative Procedure Act but primarily also in a breach of the fundamental constitutional right of CARGO to a due process according to Section 38 (2) of the Charter of Fundamental Rights and Freedoms.

144. When CARGO was not invited to participate in the administrative proceedings and was not informed about any auditing acts of the customs authorities, including examinations on site, examinations of witnesses, etc., and when it was not given the opportunity to give its opinion on this procedure and to propose supplementary means of evidence, this was a very serious breach of its procedural rights, and the manner in which the customs authorities proceeded towards CARGO when assessing and enforcing the guarantee liabilities must be considered unlawful and unconstitutional.

*(k) Time bar*

145. At the time when the alleged customs debt arose, i.e. in 1994-1995, no time-limits for customs debt assessment were set out in the Customs Act.

146. Since at the relevant time no time-limit was defined in the law, it could be argued that no time-limit at all applied to the assessment of the guarantor's customs debts. However, such interpretation, taking into account the elementary principles of a democratic state respecting the rule of law, is not permissible.

147. It is therefore necessary to find an interpretation that would be in conformity with the Constitution. The only solution consistent with the Constitution is to apply the provisions of other regulations that govern time-limits for assessment, despite the fact that the Customs Act did not explicitly refer to them. Such regulations include Section 47 of the Act on the Administration of Taxes and Fees and Section 4 of the Act on the Tax System, which provide for the same three year time-limit. If, within this three year time-limit, an act is made to assess tax, the three year time-limit starts running again from the end of the calendar year in which the taxpayer was informed accordingly. Each of the said provisions has a rather different wording, but the basic facts such as the rules for the running and the length of the time-limit for tax assessment are consistent.

148. It should be noted that Czech courts have fully resolved the issue concerning the nature of the decision on the obligation to settle the guaranteed customs debt and the determination of legal regulations under which, in this particular case, the running and the length of the time-limit for asserting claims towards the guarantor in connection with the guarantee for the customs debt should be considered.

149. The act under which the guarantor is invited to settle the customs debt for the debtor represents, in terms of the relevant case-law, a decision under the substantive law, determining the amount of the customs debt to be settled by the guarantor.

150. In the period from 1 July 1997 to 30 June 2002 customs authorities issued a notice to the guarantor requiring payment of outstanding amounts pursuant to Section 73(1) of the Act on Administration of Taxes, while in the period from 1 July 2002, pursuant to a new provision in the Customs Act, customs authorities issued payment assessments, *i.e.* decisions determining customs and taxes to the guarantor. As the approach to notifying the guarantor about the payment duty changed over time, the court decisions contain inconsistent terminology for the tax administrator's act through which the guarantor is invited to settle a customs debt on behalf of the debtor and references to different provisions of tax or customs legislation. However, this does not affect the substance and the nature of the customs authorities' act through which claims from the customs guarantee have consistently been raised against the guarantor. Taking this into consideration, the principles contained in the court decisions should be fully applicable to the present case.

151. The proceedings are regarded as assessment proceedings in relation to the guarantor and during such proceedings the guarantor's payment obligation, including reasons and amount, is assessed for the first time. Accordingly, the decision must be delivered to the guarantor within the time-limits determined for assessing the duty, *i.e.* within the three year lapse period, not within the time-limit for recovering outstanding customs duties. If no decision is issued by the customs authority within this time-limit, the right to demand the guaranteed amount ceases to exist.

152. The six year time-limit laid down in Section 282 (1) of the Customs Act should not be applied. This has been rejected repeatedly and explicitly by the Supreme Administrative Court and the Constitutional Court. In accordance with the relevant case-law, such application would infringe the rights of a guarantor in an unacceptable and unconstitutional manner.

153. In order to preserve the time-limit for tax assessment, it is necessary that tax is assessed finally and conclusively. After the end of the lapse period, the right to assess tax ceases to exist. If a decision on tax assessment is made after the end of the lapse period, such decision shall be regarded as unlawful and it is the official obligation of each public authority (*i.e.* administrative authorities and courts) to consider this unlawfulness *ex officio*.

154. A decision of the Supreme Administrative Court (No. 1 Afs 15/2009-105 of 19 February 2009) points out that the stated elements can be inferred from Czech legislation and should also be considered as legal standards and principles valid in an international context. The Supreme Administrative Court's decision contains the following legal conclusions:

(a) The interventions of a public authority in the private sector are significantly restricted by the running of time. If the law tends to create a special group of state receivables that are not

subject to any time limitation, the legal certainty of those addressed by the legislation is threatened (Section 1(1) of the Constitution).

(b) The purpose of applying the time bar is to enhance the legal certainty of those participating in legal relations, stimulating creditors (regardless of whether it concerns a private or a public entity) to assert their rights within the required time period. For a public authority's claims, the time bar reduces the possibility of wilfully intervening in the legal rights of individuals and legal entities.

(c) Since the Customs Act did not determine the lapse period for customs assessment and with respect to Section 320(b) of the Customs Act, it is necessary to follow Section 4(2) of Act No. 212/1992 on the Tax System, according to which tax can neither be assessed, nor be recovered, after a period of three years from the end of the calendar year in which the taxpayer or a person responsible for the tax must file a tax return or in which the debtor is liable to withhold tax or make a relevant tax prepayment.

155. Consequently, the time-limit within which customs authorities were entitled to issue a final and conclusive decision on the obligation to settle the guaranteed customs debt incurred in 1994-1995, expired after three years as from the end of the year in which the customs debt arose. As during this time-limit customs authorities took no measures to assess the guaranteed customs debt, the time-limit expired on 31 December 1997. As final and conclusive decisions on the duty to settle the guaranteed amount of the customs debt were issued after the end of the time-limit, such decisions are unlawful and public authorities were obliged to consider this unlawfulness automatically as part of their official duties. Even if a tax liability had arisen in this case, together with the guarantor's liability, the customs authorities would not have been entitled to claim the guarantees considering the expiry of the lapse period.

#### *(l) Application of the principles of interpretation in favour of the Claimant*

156. The legislative situation regarding the excise taxes and the VAT was thus inconsistent in the years in question and no clear cohesion existed among the individual public law provisions in this area. The terms establishing the tax liability were not laid down unambiguously and there were numerous loopholes in the legislation which allowed an arbitrary interpretation of the relevant provisions by the Czech authorities.

157. In this connection, it is necessary to concentrate on two fundamental principles, which are a permanent part of the constitutional order of the Czech Republic and are aimed at protecting those persons or entities towards which state power is exercised. First, the *in dubio mitius* principle creates an obligation for the public authorities, when the legislation is ambiguous, to opt for an interpretation of the law favourable to the individual. Secondly, the legality principle indicates that state power may be exercised only in cases, within the limits and in the manner stipulated by the law. As the Constitutional Court has stated on many occasions, these principles and the fundamental rights of the participants to the proceedings derived from these principles apply especially in relation to the administration of taxes and customs duties.

158. It follows from these principles that, where there are two possible interpretations of tax law leading to different results, it is necessary to apply the interpretation which is more favourable to the taxpayer, *i.e.* the interpretation which affects the taxpayer's property to a

lesser degree. Moreover, in the present case the problem was not two conflicting interpretations of tax law but the absence of legislation providing for tax liability.

159. Based on these principles it is evident that, if the tax legislation did not explicitly and unambiguously provide for the occurrence of tax liability, the governmental authorities were not entitled to raise any claims against the taxpayer or its guarantor.

*(m) The obligation not to expropriate*

160. Article 4(2) of the BIT includes a broad provision on expropriation. It does not require that actual expropriation occur, merely measures “tantamount - - - to expropriation”, which sometimes are referred to as “indirect” or “*de facto*” expropriation. Such expropriations may be deemed to have occurred regardless of whether the state “takes” or transfers legal title to the investment. It is also immaterial whether the state itself economically benefits from its actions.

161. It is also generally recognised that expropriation does not necessarily result from a single act of the state. It could result from a series of acts, eventually resulting in expropriation. This situation is known as “creeping” expropriation or “constructive” expropriation.

162. It is a well established principle that state interference with an investor’s use of property should be deemed actionable regardless of the form that the interference takes.

163. The conduct pursued by the Respondent does not constitute an expropriation, but it is “a measure the effects of which [are] tantamount to expropriation or nationalisation”. The conduct amounting to such a breach consists in the failure of the Czech prosecution to conduct any examination into the role of the customs authorities in the tax fraud – which could easily have been established at the time by means of even a summary investigation – and their pursuance, without legal justification, of CARGO and other persons with a view to collecting the resultant shortfall of excise tax and VAT to the Czech treasury. Specifically, the prosecution could easily have established that transit shipments had been duly accounted for at the Břeclav-dálnice Customs Office and discharged on the basis of internally routed customs documents. The Respondent’s manifest failure to take any such action but instead, on a massive scale, pursue collection measures against CARGO and a large number of hauliers/drivers constitutes acts having the effect of expropriation.

*(n) The obligation of fair and equitable treatment*

164. Article 2(1) of the BIT further provides that investments are to be ensured “fair and equitable treatment”.

165. The broad concept of fair and equitable treatment imposes obligations beyond customary international requirements of good faith treatment. The BIT makes this plain by separating the requirement of fair and equitable treatment in Article 3(1) from the obligation to adhere to “obligations under international law” in Article 7. The obligation of fair and equitable treatment is a specific provision that may prohibit actions that would otherwise be legal under both domestic and international law.

166. In the present case, the BIT standard is not in any way qualified. It should therefore 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. In this regard the BIT preamble makes it clear that the parties are "intending to create favourable conditions for reciprocal investments". Moreover, Article 2 of the BIT provides that "[e]ach Contracting Party shall in its territory promote as far as possible investments of investors of the other Contracting Party". Therefore, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment.

167. This requires, as a most basic requirement, that the investor will not suffer the consequences of corrupt practices in any branch of government administration nor the adverse effects of governance dysfunctionality. It falls squarely within the legitimate expectations of the investor that, for instance, a customs administration exercises reasonably efficient control of movement of goods over national boundaries in order to ensure that investors are not exposed to entirely uncontrollable and incalculable business risks in any administrative environment.

168. CARGO did not benefit from a fair and equitable treatment, since the guarantees issued by CARGO were enforced without a legal basis, and the legal remedies at CARGO's disposal were inadequate. It should be pointed out that until 1 January 2003 the Czech Republic lacked a Supreme Administrative Court which meant that the judicial protection in administrative matters, including customs matters, was clearly insufficient.

*(o) The obligation not to impair the enjoyment of investments by arbitrary or discriminatory measures*

169. Article 2(2) of the BIT similarly provides that a state shall not "in any way impair by arbitrary or discriminatory measures the management, maintenance, use or enjoyment of investments".

170. The arbitrary or discriminatory measures are listed as alternatives in the BIT and, therefore, it is sufficient that a measure is either arbitrary or discriminatory to constitute a breach of the treaty.

171. As to discriminatory measures it is submitted that the definition of this notion is to be found in the BIT itself, where it is stated in Article 3(1) and (2) that neither Contracting Party shall subject investments or investors to less favourable treatment than it accords to "investments of its own investors or to investments of investors of any third state".

172. The obligation not to impair the enjoyment of investments by arbitrary or discriminatory measures is intimately related to the fair and equitable standard of protection. In the present case, the Czech prosecution authorities behaved in an arbitrary manner by failing to investigate the circumstances that led to the failure of the customs authorities to ensure payment of at least 1,861 transit shipments of a total of 2,054 involved in tax fraud. The conduct was also discriminatory in that the Respondent failed to pursue claims against the primarily responsible party for carrying out the tax fraud – CWA and its owner – and instead targeted its efforts on innocent bystanders.

*(p) The obligation to provide investments with full protection and security*

173. Article 2(3) of the BIT further requires that “[i]nvestments and revenue arising hereof and in the event of their re-investment such revenue shall enjoy full protection”, and Article 4(1) of the BIT provides that “[i]nvestments by investors of either Contracting Party shall enjoy full protection and security in the territory of the other Contracting Party”. Under these provisions each state is required to take all steps necessary to protect investments, regardless of whether its domestic law requires or provides a mechanism for it to do so, and regardless of whether the threat to the investment arises from the state’s own actions or from the actions of private individuals or others. The obligation extends beyond an obligation to protect physical property and includes the obligation to protect the legal security of investments. It means that the state must exercise reasonable due diligence to protect foreign investments.

174. The Respondent’s conduct also breaches the standard of full protection. While this standard has been used predominantly in the context of physical protection, it has also been extended to the duty to protect an investor from claims pursued by state organs which have not been properly vetted for their legal justification.

*(q) The obligation of treatment in accordance with standards of international law*

175. Article 7(1) of the BIT contains a broad provision requiring the contracting parties to treat investments at least as well as required by “obligations under international law existing at present or established hereafter between the Contracting Parties - - - whether general or specific”. Thus, in addition to all obligations under treaties or otherwise, general principles of international law require host states to provide a certain minimum protection to international investments.

176. It is universally accepted that the minimum protection afforded investors under international law generally includes, but is not limited to, requirements of due process, transparency, obligations of natural justice, exercise of good faith, due diligence and fair dealing, and the protection of economic rights. The Respondent has failed in all these respects in relation to the Claimant’s investment.

*(r) Breaches of the BIT*

177. The Czech Republic’s breach of its international obligations under the Czech-German BIT consists of the following elements:

(a) the imposition of illegal guarantee claims leading to the destruction of the Claimant’s investment in the Czech Republic caused by a tax fraud made possible by the complicity of public officials or by failure to provide a functional customs administration as regards supervision and control,

(b) imposition of illegal guarantee claims on hauliers/drivers – and, hence, on CARGO – without providing the primarily indebted persons with protection of their fundamental rights of due process in respect of matters relevant to Section 240(3) (a) and (b) of the Customs Act,

(c) failure to heed domestic court decisions by enforcing guarantee claims in cases not yet set aside by a Czech court in the presence of analogous cases which have been set aside, and

(d) enforcing guarantee claims for unpaid excise taxes and VAT on the basis of CARGO's guarantee undertaking, covering "customs debt" only.

178. The Respondent's breach of international law consists of the prosecution of illegal claims, which ultimately destroyed the Claimant's investment in the Czech Republic. In all the relevant 1,245 cases, the shipments forwarded under the customs transit regime had been duly terminated pursuant to Section 140(2) of the Customs Act. Additionally, the hauliers/drivers had been provided with proof to such effect. Finalisation of the transit operations had also been reported to the relevant customs office of dispatch, Břeclav-dálnice, and had been duly entered into the computer records of the customs authorities.

179. A guarantee undertaking under the Customs Act at the time constituted liability in respect of a "customs debt" only, while excise taxes and VAT did not qualify as "customs debt" in the meaning of the law.

180. Irrespective of the fact that shipments in the transit regime were actually presented at the relevant inland customs locations, all the guarantee claims directed against CARGO (and the hauliers/drivers) were illegal in all circumstances. A person can be declared liable for a "customs debt" as defined in the Customs Act only if he is found guilty of "the unlawful removal from customs supervision of goods subject to import duty". However, the excise taxes which are of relevance in the present case, *i.e.* consumption tax and VAT, do not constitute a "customs debt" in the meaning of the Customs Act as then in effect.

181. The guarantee claims were therefore lacking a legal basis, and their enforcement amounts in its own right to a breach of international law.

182. It should be noted that the Customs Act was amended in this respect by Act No. 113/1997, which entered into effect on 1 July 1997. At that time a new provision was added in the form of Section 323 of the Customs Act, which provided that "customs duty" should include taxes and fees collected during import and export. This is confirmed by the Czech Ombudsman who pointed out that on this matter "it is necessary to proceed from what the legislator stated in the Act and not from what the legislator did not embody in the Act".

183. There can be no doubt that the treatment to which the Claimant's investment in the Czech Republic has been exposed constitutes the most egregious breach under international law and that it represents, in particular, an unbridled violation of the Respondent's obligations under the Czech-German BIT.

184. In consideration of the excessive and blatant nature of the breach and the obviousness of its departure from even minimum standards of treatment required under international law, it would seem that a discourse on its implications for the Respondent's responsibility under international law would not be called for.

## ***B. The Respondent:***

### ***(a) Relevant background***

185. Acting as a customs agent, the company CARGO, incorporated by the Claimant in 1990 under Czech law, guaranteed proper performance of shipments transiting in or through the Czech Republic. During the years 1994-1995, CARGO accepted to guarantee the proper

performance of 2,054 transit shipments of oil products imported from the Slovnaft refinery in Slovakia by several companies, *i.e.* CWA, HOREX, and UNITIP.

186. In April 1995, the Czech Customs Administration found out that, among these 2,054 transit operations guaranteed by CARGO, 1,245 transit shipments for which HOREX and UNITIP were the consignees had been fraudulently completed through the use of forged customs stamps. Accordingly, the Customs Administration raised and enforced CARGO's guarantees in respect of these 1,245 transit shipments in an amount representing approximately EUR 13 million.

187. According to the Claimant, the 1,245 guarantee claims raised against CARGO were "false" as any and all of the 2,054 transit shipments would have been properly performed, therefore releasing CARGO from any liability under its guarantee undertakings. The Respondent submits that this position is based on an intentional confusion of the facts that gave rise to CARGO's guarantee claims as well as on a false interpretation of the legal background to these claims. Indeed, all these relevant 1,245 shipments were performed under an identical fraudulent scheme. The goods and the transit documents were handed over in the absence of any customs officer at the premises of CWA, where the transit documents were affixed with a stamp of the customs authority which later appeared as being forged.

188. The Respondent therefore argues that, since these 1,245 transit procedures were fraudulently completed, they gave rise, as a matter of Czech law, to a customs debt for which CARGO, as the guarantor for the proper completion of the transit procedures, was jointly and severally liable together with the drivers/hauliers. Czech courts have unanimously confirmed that, on the merits, the enforcement of CARGO's guarantees was in full accordance with the Czech legal order.

*(b) Transit customs procedures*

189. When goods enter a country, the local customs authority typically demands payment of import duties and other charges and, where appropriate, applies commercial policy measures such as, for instance, anti-dumping duties. If the goods are only meant to pass through that country on their way to another country, these payments are due, even if taxes and charges paid may be reimbursed when the goods leave that country. If the goods have to be released into the market of their country of destination, these payments are typically made at the customs office located on the border crossing. In both cases, this solution implies that the goods may have to undergo a series of administrative procedures at border crossings before reaching their final destination.

190. Transit is a customs facility available to operators who move goods across borders (international transit) or territories (internal transit) without paying the charges due in principle when the goods enter the territory, thus requiring only one final customs formality when the goods arrive at their final destination. It offers an administratively simple and cost advantageous procedure to carry goods across borders and territories.

191. Instead of clearing the products at the border crossing directly, with all the administrative and practical difficulties that this solution would imply, goods moved under a transit procedure are declared at the customs office located at the border crossing and finally cleared at another customs office located inside the customs territory. This situation is extremely

widespread in international commerce and was in force in the Czech Republic in the period 1994-1995 when the Diesel case occurred and well before.

192. Under the internal transit procedure as applicable during the period 1994-1995 in the Czech Republic, customs duties, excise taxes, VAT and other charges on imported goods were suspended during their movement from one customs office (the customs office of dispatch) to another customs office (the inland customs office of destination).

193. Under Czech law as applicable from 1993 onwards, *i.e.* at the time of the Diesel case, transit procedures were governed by Sections 139 to 144 of the Customs Act. Section 139(9) of the Customs Act defined internal transit as follows: "internal transit is transit from a customs office of entry to an inland customs office".

194. During the transit period, the goods are placed "under customs supervision", the payment of all dues that may accrue on such goods being guaranteed either by the declarant himself by way of a deposit in cash or, more generally, by a third party approved by the customs authorities. In the Diesel case, the declarants were mostly the drivers of the tank trucks shipping oil from the refinery of Slovnaft in Slovakia to CWA in the Czech Republic. Security for payment in case goods were removed from customs supervision was offered by CARGO.

195. Internal transit procedure is one of several customs procedures existing under Czech law. All customs proceedings have in common that they are "initiated by submitting a customs declaration proposing that the goods in question should be placed under a specified customs procedure". Accordingly, when a declarant wishes goods to be placed under the internal transit procedure, he has to propose that the goods be released into the transit procedure by submitting a customs declaration to this end, a TCP.

196. Another important feature common to all customs procedures is the declarant's duty to be present during the customs proceedings. Indeed, according to Section 102(6) of the Customs Act, "customs proceedings shall be conducted in the presence of the declarant". The attendance of the declarant in person to all steps of the customs procedure aims at limiting the risk of fraud and corruption.

197. Internal transit started when the goods were declared at the customs office of dispatch – in the present case, the Břeclav-dálnice Customs Office. It ended when the goods and transit declaration were presented to a customs officer at the customs office of final destination or, under certain circumstances and subject to a proper authorisation being granted by the relevant customs authority, at the premises of the importer. Then, an officially stamped and signed copy of the TCP was returned by the customs office of destination to the customs office of dispatch which would discharge the transit procedure and the declarant's liability in the transit, unless an irregularity had occurred.

198. The transit procedure implied the completion of three mandatory successive steps, to which an additional possible one may be added, *i.e.*:

- (a) formalities at customs office of dispatch and beginning of transit procedure (step 1),
- (b) end of transit and customs clearance at customs office of destination (step 2) or at importer's location (step 2 bis),

(c) discharge of transit procedure by customs office of dispatch (step 3), and

(d) inquiry procedure (step 4) in case of suspected breach of conditions of transit regime.

199. The whole transit procedure was paper based in 1994-1995, in the Czech Republic like in all countries of the European Union. The basic document for transit was the TCP, which the declarants (in the present case the drivers, which was rather unusual) had to present to the customs office of dispatch together with a guarantee offered by a customs agent, such as CARGO. The purpose of this guarantee was to make sure that the goods would not escape customs supervision.

200. Copy 1 of the TCP was kept by the customs office of dispatch. Copies 4 and 5 were accompanying the goods in transit. Copy 4 was kept at the customs office of destination at the end of the transit procedure. The upper part of copy 5 was returned by the customs office of destination to the customs office of dispatch.

201. At each of the stages, the TCP was affixed with a stamp of a customs office. In the present case, it is proven that the stamps were forgeries.

202. The procedure of transit was discharged by the customs office of dispatch comparing copies 1 and 5 of the TCPs for each given transit procedure. Unless irregularities were discovered *a posteriori*, the discharge of the transit procedure amounted to the release of the liability of the declarant/guarantor.

203. Inquiry procedures were to be initiated, either when there was no proof that the goods reached their customs office of destination, or when the relevant documents happened to be falsified or invalid.

204. In the period 1994-1995, no system of electronic exchange of data was in force in the Czech Republic. The Břeclav-dálnice Customs Office therefore had to deal with a total of 500 TCPs on paper in average per day in 1994-1995. No computer network existed at that time between customs offices in the Czech Republic and information was exchanged through the use of floppy disks. Therefore, neither CARGO nor the Břeclav-dálnice Customs Office would have been able to exchange information via an intranet network with the customs office of destination of the goods, as alleged by the Claimant.

205. Inherent in any transit shipment is the risk that the transported goods are diverted out of their way and dumped into the local market without customs dues, taxes and all other measures accruing on the import of such goods being paid by the importer, hence the need for specific safeguard techniques. In the past, transporters were obliged to have a customs officer accompanying any shipment in transit. The modern safeguard technique is the putting into place of a guarantee mechanism: the guarantor is liable to pay any customs debt due to the customs authorities as a result of the removal of a transit shipment from the supervision of the customs authorities.

206. The customs authorities' financial interest to be safeguarded during the transit procedure is the proper payment of dues accruing on imported goods. If the goods happen to "disappear" while the internal transit procedure is not closed and then are dumped on to the black market, these dues will not be paid and the customs administration will have suffered damage to an

equivalent amount. This notion is traditionally defined as the "customs debt". Under Czech law, it was defined under Section 240(1) and (2) of the Customs Act.

~~207. The declarant is liable for each and every time a transit procedure is not closed according to the law and a security has to be provided for the payment of this customs debt.~~

208. The declarant's liability is defined in Section 140(2) of the Customs Act. The declarant shall bear responsibility towards the customs office for fulfilment of the obligations arising from the transit procedure. He shall, in particular, ensure that the goods are produced under conditions laid down by the customs office of dispatch (i.e. any customs office where a transit operation begins) to the customs office of destination (i.e. any customs office where a transit operation ends) in an unaltered state, with intact customs seal and with accompanying documents.

209. There is no doubt that the declarant's liability may be engaged each and every time a transit procedure is not closed in accordance with the law. In the present case, the procedure was not closed with respect to any of the 1,245 transit shipments that gave rise to CARGO's guarantee claims and the goods were "removed from customs supervision" for each of these shipments.

210. Two other provisions of the Customs Act are of relevance, even if they did not allow the transit procedures to be terminated at the importer's premises. The first is Section 124 which was entitled "simplified customs procedure" and was aimed at facilitating the customs procedures through the use of "simplified" customs documentation. The second is Section 123 of the Customs Act ("Disposal of the goods") which played an important role in the Diesel case. Section 123 did not allow the goods to be driven to the importer's location but only allowed the goods to be disposed of prior to their release into free circulation by the importer. This procedure, which was granted on a case by case basis, was not applicable to transit as it took place after the end of the transit procedure at the inland customs office, if any. This is the reason why this approval had to be granted by the inland customs office and not by the border customs office which fully dealt with and granted all relevant transit procedures and relevant approvals. Yet, the documents relied on by the Claimant in support of his contention pursuant to which so-called simplified procedures were used in the Diesel case were "authorisations" granted under Section 123 of the Customs Act, which appeared to be falsified.

211. Therefore, only an authorisation granted in accordance with Section 102(3) of the Customs Act would allow the goods to be driven directly to the importer's location where final customs clearance could be conducted by a customs officer.

212. One of the fundamental allegations raised by the Claimant is that the 1,245 transit procedures had been discharged since the oil shipments at issue had been presented to the customs office of destination or to an authorised alternative place. Indeed, according to the Claimant, the TCP is "opened" by the relevant customs office of dispatch and is "closed" at the customs office of destination. This contention is incorrect. Indeed, it is a well established principle that the termination of the transit procedure at the customs office of destination does not amount to the discharge of the transit procedure.

213. Under Czech law applicable at that time, it was the customs office of dispatch that decided whether the transit procedure could be discharged. Indeed, the transit procedure is discharged by the customs office of dispatch (in the present case the Břeclav-dálnice Customs

Office) based on the comparison of the data relating to the transit operation, as established at the customs office of dispatch and as recorded and certified by the customs office of destination. Discharge of the transit procedure is generally implicit and does not involve any formal decision by the competent authorities at the customs office of dispatch. Therefore, assuming that information appearing in the upper part of the TCP copy 5 matched with the copy 1 retained by the customs office of dispatch, the transit procedure could be considered as discharged by the customs office of dispatch.

214. The Claimant further contends that there is definitive evidence of such discharge, since the drivers were provided with a bottom part of TCP, copy 5, allegedly affixed with an official stamp of the Czech customs authorities. The Respondent submits, however, that the bottom part of the TCP, copy 5, is no evidence that the transit procedure was terminated under Czech law. The reason for this rule is that the bottom part of the TCP, copy 5, may be forged and such forged document cannot be opposed to the customs office of dispatch.

215. In the present case, the only documents which the Claimant relies on in order to "demonstrate" that the transit procedures were closed are the bottom part of the TCPs, copy 5, with forged stamps affixed on them. This is obviously no evidence that the transit procedure was terminated. In the absence of any evidence that the procedure has ended, none of the 1,245 transit operations that gave rise to CARGO's guarantee was ever discharged.

216. National customs authorities typically launch inquiry procedures in the event of absence of proof of the end of the transit procedure after a specified time period or as soon as the relevant authorities are informed of or suspect that the procedure has not come to an end. This is what the Czech customs authorities have accomplished when they discovered that a number of oil transit shipments were irregular, in April 1995, when bottom parts of TCP copy 5, instead of upper parts, were erroneously returned to the customs office of dispatch by the fraudsters.

217. It was fully normal for the customs administration to start an inquiry procedure when they discovered that the stamps affixed on copy 5 of the TCPs were forged. The procedure of inquiry is engaged as soon as the competent authority discovers *a posteriori* that the proof presented to it has been falsified and that the procedure has not been ended. The competent authority of the customs office of dispatch will then determine whether or not the procedure has ended and whether it can be discharged. It will also determine whether or not a customs debt has been incurred, as well as the person(s) responsible for the debt. The practice in the Czech Republic in 1994-1995 was first to approach the inland customs office which was stated on the TCP as the customs office of destination. If this customs office did not provide any satisfactory response, the customs office of dispatch would then approach all customs offices, in case the driver/declarant made the clearance at a different customs office than the one mentioned on the TCP. In the absence of a satisfactory answer, it would ask the declarant to show evidence that the transit was terminated. The Czech Customs Administration was clearly entitled to launch an investigation in April 1995, when it first suspected the transit shipments to be unlawfully performed through the use of forged stamps on the TCPs.

*(c) The security*

218. The Customs Act obliged the declarant to secure any potential customs debt, either by way of a deposit in cash or through a security offered by a third party. The declarant was not allowed to release the goods into the procedure of transit absent such a security. This appears

from Section 144(1) of the Customs Act.

219. The Customs Act contained a particular chapter devoted to the "security to cover customs debt". Its basic provisions were as follows:

(a) The security for the customs debt had to be provided by the declarant, in the present case the drivers, by way of a deposit in cash. The customs authorities could also permit a customs debt to be secured by a person other than the declarant, *i.e.* a customs agent like CARGO.

(b) The amount of the security should be either the precise amount of the customs debt in question or the maximum amount estimated by the customs authorities. In the present case, the amount of the customs debt was calculated by reference to the quantity of oil imports declared by the drivers with respect to each of their transit shipments.

(c) When the customs debt was secured by a guarantor, the latter should undertake in his surety bond to pay jointly and severally with the debtor the secured amount of a customs debt.

220. According to Section 260(2) and (3) of the Customs Act, the guarantor must be a bank or a person duly approved by the customs authorities, it being specified that the customs authorities could reject or refuse to approve the proposed guarantor provided they had warranted doubt whether the customs debt would be paid within the prescribed term.

221. The guarantee relationship between the customs agent and a declarant originates from a surety bond issued by the customs agent in order to secure jointly and severally the customs debt with the declarant. Given the peculiarity of the situation of the professionals of the freight forwarding and of guarantors for the customs debt potentially arising out of a transit operation accomplished by a third party, customs agents had a central role to play in the internal transit procedure.

222. Indeed, beyond their duty to pay the customs debt, customs agents are in charge of assisting clients such as importers and exporters in complying with customs formalities and other applicable procedures and requirements. They perform a double function. On the one hand, they assist importers and exporters in complying with customs formalities and procedures. On the other hand, they guarantee that goods will be moved from a customs office of dispatch to an inland customs office of destination and that applicable taxes will be duly paid. This latter function, namely the guarantee, applies to any and all events of non-payment, including, without limitation, in the event of diversion of use or non-delivery of the relevant goods to the corresponding inland customs office and irrespective of who is ultimately liable.

223. In addition, customs agents have an obligation to report irregularities and deviations from established customs procedures. Common examples of these deviations or irregularities include, but are not limited to, false or inconsistent documentation and any suspicious activities of non-compliance. Customs authorities rely, and the whole system is based, on the customs agents having the highest professional and ethical standards.

224. In light of their particular role in the transit procedure, customs agents should be particularly vigilant before participating in any transit procedure, and accepting to secure such operations.

*(d) The tax fraud*

225. The Diesel case was a customs fraud that took place in the Czech Republic in the years 1994-1995 and involved a number of individuals – [redacted] and [redacted] – who were all prosecuted, and those who were found guilty were later sentenced. More particularly, these individuals, directly or through CWA, Horex, UNITIP and [redacted], were involved in the fraudulent importation to the Czech Republic of shipments of oil products from the refinery Slovnaft in Slovakia. The customs administration raised CARGO's guarantee claims in respect of the 1,245 transit procedures that were fraudulently completed through the use of two customs stamps that were later on established as being forgeries. The 1,245 transit procedures in respect of which the customs administration raised CARGO's guarantee claims involved CWA as importer and Horex and UNITIP as consignees (none of the 1,245 transit procedures involved [redacted] as consignee).

226. The Respondent points out that the fraudulent scheme in the Diesel case, namely the use of a forged stamp on the TCP, copy 5, is a typical example of a fraudulent completion of the transit procedure. CARGO must have been aware that such mechanisms were classical for fraudsters in transit procedures. Given the peculiar circumstances – new border, new customs office, large quantities of refined oil migrating at the Břeclav-dálnice border crossing – CARGO should have been very cautious before accepting to guarantee such transit shipments. Yet, the Claimant feigns to be surprised by such a fraudulent mechanism. It is the Claimant's position, firstly, that the seals were not, in fact, forged, and, secondly, that such circumstance would not be opposable against a guarantor.

227. The Respondent submits that the following facts are established with respect to the 1,245 transit shipments for which CARGO's guarantee has been claimed:

(a) Fraudsters involved in the Diesel case started importing oil from the Slovnaft refinery in the month of February 1994, first in small quantities (16 shipments between February and May 1994). Starting in June 1994, relatively large quantities were imported (215 shipments in June 1994, 173 in July, 283 in August, 406 in September).

(b) Among the 259 transit shipments performed between February and 7 July 1994, only six were fraudulent and led the customs administration to raise CARGO's guarantee. This technique is classically implemented by fraudsters so as to initiate a climate of confidence with the customs agent before starting their unlawful activities.

(c) Between 7 July 1994 and 2 May 1995, a total of 1,805 oil shipments imported by fraudsters in the Diesel case were accepted for internal transit procedure from the Břeclav-dálnice Customs Office, the vast majority of these shipments taking place before 31 December 1994.

(d) A large number of these transit procedures were fraudulently closed by two stamps on the TCPs, copy 5, *i.e.* one stamp of the inland customs office of Olomouc 1366, with the sequential number 21, and one stamp of the inland customs office of Olomouc 1373 with the sequential number 12.

(e) A report from the Institute of Criminology Prague dated 20 March 1996 has established that these stamps were forged. This conclusion was confirmed in a police report of the Section

of Technical Expertise in the Area of Documents and Communications in Writing dated 22 July 1996. A total of 1,245 transit shipments were concerned by such fraud and remained open.

(f) Despite extensive criminal investigation including the examination of a large number of witnesses such as representatives and employees of CWA, Horex, UNITIP, CARGO and the customs authorities, no evidence was ever found that the customs administration was implicated in the fraud.

*(e) Claiming the guarantee*

228. Confronted with a total of 1,245 transit procedures that were fraudulently completed, the Břeclav-dálnice Customs Office rightly decided to claim the guarantees issued by CARGO with respect to these shipments, decisions that CARGO in almost all cases challenged before the competent courts and administrative bodies, without achieving a final success.

229. The Claimant contends that the guarantee claims issued by the customs authorities "were false". In support of this contention, the Claimant relies on (i) a computer printout dated 27 May 1995 and (ii) a guarantee claim case, which is alleged to be illustrative of all the 1,245 guarantee cases against CARGO.

230. While denying any evidentiary force to the computer printout, the Respondent considers that the guarantee claims case referred to by the Claimant is a perfect example of the Břeclav-dálnice Customs Office's right decision to claim CARGO's guarantee.

231. In essence, the Claimant contends that the Břeclav-dálnice Customs Office could not validly claim CARGO's guarantee because it was in possession of the TCPs, copy 5 issued with respect to all the transit shipments at issue. The Respondent considers this contention to be false, since CARGO's TCPs, copy 5, were forgeries based on false customs stamps.

232. The case which the Respondent will address is one of the 1,245 claims that were raised against CARGO by the Břeclav-dálnice Customs Office. The sequence of facts is as follows:

(a) On 4 November 1994, a shipment of diesel oil exported by Slovnaft and imported through Horex was presented at the Břeclav-dálnice Customs Office. The declarant was a driver. This shipment was released into the internal transit procedure under cover of CARGO's guarantee.

(b) On the same day, the bottom part 5 of the TCP was stamped with the false stamp Olomouc 1373, serial number 12. This stamp is one of the two stamps that were later established to be forged. In other words, the transit procedure was fraudulently completed. The goods in question were never submitted to the customs office of destination and were instead dumped on the market without excise taxes being paid.

(c) On 7 March 2000, the Břeclav-dálnice Customs Office issued a payment order against CARGO to fulfil the guarantee claim in the amount of CZK 341,721.

233. Confronted with the fraudulent completion of a customs debt, the Břeclav-dálnice Customs Office was perfectly right to consider that the transit procedure was not closed and to claim CARGO's guarantee that was precisely aimed at protecting the Czech treasury's

interests in such cases.

234. CARGO had the possibility to appeal decisions of the Břeclav-dálnice Customs Office within 15 days from their notification before the Regional Customs Office Břeclav, which CARGO did in many cases. Yet, the Regional Customs Office Břeclav, as well as all other administrative and judicial bodies seized by CARGO, constantly held that, on the merits, the guarantee claims were well-founded.

235. In the case of the shipment of 4 November 1994, CARGO appealed the decision on the guarantee claim before the Customs Directorate Brno and the decision was set aside but merely for procedural reasons. The matter was returned to the Břeclav-dálnice Customs Office for issuance of a valid decision.

236. On 4 April 2002, the Břeclav-dálnice Customs Office re-issued a valid decision against CARGO. On 16 April 2002, CARGO appealed this decision before the Customs Directorate Brno which, on 8 August 2002, confirmed the decision.

237. On 30 April 2004, the Regional Court of Brno rejected the claim for annulment of the administrative decision (at this time CARGO was already represented by the bankruptcy trustee).

238. On 28 June 2006, the Supreme Administrative Court confirmed the challenged decision of the Regional Court of Brno.

239. The Claimant contends that the customs administration simply refused to comply with final court decisions that allegedly ordered the Czech state to reimburse sums that were unduly withheld. The Respondent points out that this statement is completely false for the following reasons:

(a) Firstly, the true meaning of the decision of the Regional Court of Brno was that the guarantee claims were reasoned on the Customs Act as amended in 1997, whereas this legal text was not in force when the facts complained of took place in 1994-1995. Never did the Regional Court of Brno rule that the guarantee claims lacked merit.

(b) Secondly, the Regional Court of Brno never ordered the customs administration to reimburse any sums to CARGO. Far from that, the Regional Court of Brno returned the matter to the Břeclav-dálnice Customs Office "for further procedure", *i.e.* it invited the customs office to issue a new decision based on the Customs Act as applicable in 1994-1995.

(c) Thirdly, the customs administration was perfectly right in refusing to reimburse any sums to CARGO between the day of the judgment returning the matter to the customs office and the day a new decision was issued by this customs office. The reason is that the state was entitled under Czech law to set off any amounts due by the state to a private party against any amounts due to the state by this private party. These explanations were made clear to CARGO on numerous occasions, for instance in a decision dated 22 February 2003 by the Břeclav-dálnice Customs Office that was confirmed by the Customs Directorate Brno on 16 April 2003.

(d) Finally, on the merits, the Regional Court of Brno has ruled that "the issue of the existence of a customs debt had been solved by another decision of the customs organs that entered into

force". In other words, the Czech court ruled that, on the merits, the existence of a customs debt may no longer be challenged.

240. The Claimant contends that CARGO's bankruptcy was the result of the Respondent's intentionally illicit action through the prosecution of illegal claims. However, CARGO's bankruptcy was not the result of an internationally illicit action of the Respondent which also acted in full compliance with Czech law when it enforced CARGO's guarantee claims.

*(f) CARGO's liability in respect of the 1,245 transit shipments*

241. The Respondent does not agree to the Claimant's contention that 1,245 transit shipments which gave rise to CARGO's guarantee, were properly performed. On the contrary, the Respondent maintains that the 1,245 transit shipments at stake were not properly performed as they were unlawfully removed from customs supervision, therefore justifying the enforcement of CARGO's guarantees.

242. The Respondent notes that it is not disputed between the Parties that the 1,245 transit shipments at stake were driven directly to CWA's warehouses in Lipová or Slušovice. However, what remains disputed is whether the drivers were effectively entitled to do so. While the Claimant is of the view that there was an authorisation allowing them to deliver the goods directly to CWA's premises, the Respondent maintains that this was not the case and that, as a consequence, the goods were illegally delivered to these locations. As a result of the delivery of the 1,245 transit shipments to CWA's warehouses in Lipová or Slušovice without any authorisation to do so, it was impossible for the customs office of destination specified on the TCPs to confirm their due presentation. What occurred is that, after the arrival of the goods at CWA's warehouses, the TCPs were illegally collected by CWA's employees and never brought to the customs office of destination specified on the TCPs. The Respondent submits that this is why, finally, no customs clearance had ever been performed in relation to the 1,245 transit shipments which gave rise to CARGO's guarantee.

243. The Respondent cannot accept the Claimant's assertion that the drivers were entitled to deliver the goods directly to CWA's premises on the ground of:

(a) the permits allegedly granted to Horex and UNITIP by the Zlín Customs Office on 1 May 1994, 1 June 1994 and 7 April 1995 respectively, and

(b) the permit granted to CWA by the Customs Office České Budějovice on 27 June 1994.

244. Indeed, the Respondent maintains that the documents which, in the Claimant's opinion, attest that the drivers were effectively entitled to deliver the goods directly at CWA's warehouses when performing transit shipments for the consignees Horex and UNITIP were falsified. In any event, even if they had been genuine, they could not have entitled the drivers to deliver the goods directly to the importer's location.

245. The Respondent points out that, while who was supposed to have issued these "authorisations", was not in a hierarchical position which would have entitled him to issue such kind of permits, it also appears that the signatures on these three documents are not his. This results from a mere comparison between specimen signature and the initials on the documents.

246. In any event, the Respondent submits that these “authorisations” would never have entitled the drivers to deliver the goods directly to CWA’s premises. Only an authorisation granted in accordance with Section 102(3) of the Customs Act as applicable at the relevant time would have allowed goods to be transported directly to the importer’s location in order for the customs clearance to be performed at that place. However, the “authorisations” relied on by the Claimant only allowed their “beneficiaries” to dispose of the goods prior to their release into free circulation in accordance with Section 123 of the Customs Act. This provision was of no relevance in case of transit procedures since it only allowed the goods to be disposed of prior to their release into free circulation. As a consequence, the special treatment of goods allowed under this provision could only apply after the end of the transit procedure. In other words and irrespective of their authenticity, these “authorisations” could not have entitled the drivers to deliver the goods directly to CWA’s premises since they were not “granted” on the ground of Section 102(3) of the Customs Act.

247. The question remains as to whether the drivers were entitled to deliver the goods at CWA’s premises by virtue of the simplified procedure granted to CWA by the Customs Office České Budějovice. This authorisation was issued in accordance with Section 124(1)(b) of the Customs Act. The Respondent finds it irrelevant for the present case for the following reasons:

(a) Section 124(1)(b) of the Customs Act was aimed at simplifying the customs procedures from an administrative point of view by allowing a declarant to release goods into a customs regime on the basis of a commercial/administrative invoice only. Of critical importance here is the fact that such simplification of customs declarations applied to any customs regimes except transit. This is what the Regulation SPČ 126 (OS-35) clearly states: “Under the permitted simplified procedure a declarant may submit a customs declaration for the release of goods into a relevant regime, except for the transit regime - -”.

(b) Goods presented to a border customs office under the umbrella of the simplified procedure of Section 124(1)(b) were released into free circulation on the basis of a commercial invoice instead of a TCP. However, such simplified procedure allowed the importer to present such goods accompanied by commercial invoice only to the customs office which granted such procedure. In other words, a simplified procedure granted by the Customs Office České Budějovice could never be used for deliveries of goods elsewhere (neither the Zlín/Otrokovice Customs Office nor CWA’s premises). The authorisation granted to CWA may therefore not apply to the present case where CARGO’s guarantee was enforced as a result of the unlawful removal of transit shipments from customs supervision.

(c) A simplified procedure granted in accordance with Section 124(1)(b) of the Customs Act also implied that no customs agent was involved in the procedures performed under the umbrella of such permit. Indeed, in accordance with the terms of Section 124(1)(b), simplified procedures implied that no TCP was issued since it did not apply to transit operations. Furthermore, no specific surety bond had to be issued either, since the authorisation for the simplified procedure under Section 124(1)(b) required another type of securing of the customs debt. In the case of CWA, this was done by the Agreement on Securing Customs Debt concluded between CWA and the Customs Office České Budějovice on 29 June 1994, which is an inseparable part of the decision of the Customs Office České Budějovice allowing CWA to use the simplified procedure.

248. The Respondent therefore contends that the reason why the Břeclav-dálnice Customs

Office requested the drivers to submit TCPs and surety bonds was that the 1,245 transit shipments which gave rise to CARGO's guarantee were not – and could not be – performed under the umbrella of a permit for the simplified procedure under Section 124(1)(b) of the Customs Act.

249. It is thus clear, in the Respondent's opinion, that the simplified procedure under Section 124(1)(b) of the Customs Act granted to CWA did not apply to transit operations and did not require the services of any customs agent, including CARGO.

250. The Respondent also finds it clear that the drivers were not entitled to deliver the goods directly to CWA's warehouses by virtue of Section 102(3) of the Customs Act. The fact that the drivers delivered the goods directly at CWA's warehouses, which they were not entitled to do, is by itself an illegal removal of goods from customs supervision which gave rise to an obligation for which CARGO is liable and accepted the risk. However, other occurrences confirm that the 1,245 transit shipments at stake here were not properly performed and therefore entitled the customs authorities to raise CARGO's guarantees.

251. The Claimant has explained that when arriving at CWA's warehouses the drivers were directed to hand over their TCPs to an employee of the importer. Although this behaviour is a clear infringement of the drivers' obligations as declarants of the goods, the Claimant maintained that it was normal for CWA's employees to collect the TCPs from the drivers upon their arrival at CWA's premises in Lipová or Slušovice. The Respondent finds this position unworkable, for the two following reasons:

(a) First of all, even if there was an authorisation to deliver the goods directly to CWA's premises in accordance with Section 102(3) of the Customs Act, a customs officer would still have had to be present at CWA's premises in order to confirm the presentation of the goods and to have the customs clearance performed at that place. The absence of any customs officer at CWA's premises is corroborated by some drivers who testified that they never dealt with any customs officer upon their arrival at Lipová or Slušovice.

(b) Secondly, by handing over the TCPs to CWA's employees and believing they would attend the customs proceedings instead of them, the drivers clearly breached their duties as declarants of the transit shipments. Indeed, by virtue of Sections 140(2) and 102(6) of the Customs Act, the drivers acting as declarants of the transit shipments were under a duty to "ensure that the goods are produced under the conditions laid down by the customs office of dispatch to the customs office of destination in the unaltered state, with an intact customs seal and with the accompanying documents" and to attend the customs proceedings. As a result of their non-compliance with their duties as declarants of the goods, the drivers allowed the unlawful removal of the goods from customs supervision by CWA's employees, thus giving rise to an obligation for which they were jointly and severally liable with CARGO acting as the guarantor for these transit shipments.

252. The Respondent also contests the Claimant's affirmation that CWA's employees – after illegally collecting the TCPs from the drivers – brought them over to the Zlín Customs Office on a regular basis, since it is not supported by any evidence and is mistaken for the two following reasons:

(a) First of all, the documents issued for transit shipments where Horex and UNITIP were the "consignees" were systematically handed over to the head of the

dispatching of CWA, *i.e.* . . . and not to the customs office of destination specified in the TCP as prescribed by the Customs Act. The fact that the transit declarations were kept by . . . : and that no one, neither at CWA nor at the Zlín Customs Office, ever saw him attending the customs proceedings, necessarily leads to the conclusion that those documents were never handed over to the customs office of destination specified in the TCP.

(b) Secondly, one may also note that the Claimant's assertion that CWA's employees brought the customs documents to the customs office of destination cannot be reconciled with the Claimant's position in this arbitration. According to him, the goods were delivered and cleared directly at CWA's premises by virtue of a simplified procedure. However, since the customs clearance had to be performed in the presence of a customs officer (even under the simplified procedure), the Respondent does not understand why CWA's employees would have to bring the customs documentation to the Zlín Customs Office when these documents could have been directly taken over by the customs officer who was supposed to attend the customs clearance at CWA's locations.

253. Both Parties concur in saying that final customs clearance, which as a rule must be performed at the customs office of destination, is in the present case materialised by the issuance of a JCD on which the amounts of customs duties – if any – and indirect taxes (*i.e.* excise taxes and VAT) due for a specific transit shipment are assessed. However, the Parties are in disagreement concerning the question whether such customs clearance occurred in respect of the 1,245 transit shipments for which CARGO's guarantees have been issued.

254. It is the Respondent's case that the 1,245 transit procedures could not have been duly discharged since it was discovered in late April 1995 that the upper parts of the TCPs, copies 5, received at Břeclav-dálnice were fraudulently filled in and were affixed with a forged customs stamp, a falsified signature and a fictitious number.

255. The Claimant tries to establish the complicity of the customs administration in the perpetration of the fraud. According to him, the number of shipments that evaded the customs supervision is an overall indicator of the involvement of customs officers in tax fraud. In the Claimant's opinion, no customs office in any reasonably developed country could fail to notice that 90% of truck loads of oil products disappeared between the national border crossing and a place of destination 80 km into the country within a period of six months.

256. The Respondent notes, however, that there are examples showing that this may be possible. In 1994, transit procedures related to fifteen lorries of computer products were fraudulently completed by the Russian mafia using a falsified stamp. Large quantities of alcohol and cigarettes in transit from Portugal to Germany were removed from customs supervision thanks to the use of a forged stamp in 1994, giving rise to the claim of a customs agent's guarantee in the amount of 37 million euro. Approximately 1,000 lorries of live animals and 300 lorries of meat in transit were removed from customs supervision in 1995, to such a level that the market price for meat inexplicably fell down at that time. Apart from these examples available to the public domain, all practitioners active in the field of customs during the period 1990-2000 have been confronted with similar cases of fraud, including those dealing with petroleum products.

257. In any event, the Respondent considers that the customs officers dealing with the discharge of the transit shipments at the Břeclav-dálnice Customs Office could not have known that the documents that were mailed to them were falsified. Several circumstances

made it impossible to detect the forgery on the sole basis of the control performed on that occasion. Firstly, the Claimant has purportedly and significantly minimised the number of copies 5 of the TCPs which were received on a daily basis at Břeclav-dálnice. Instead of 50, as affirmed by the Claimant, approximately 400 upper parts of the TCPs coming from the 134 other customs offices in the Czech Republic had to be checked daily. As a result, only the absence of the copy 5 of the TCP within the prescribed time or its blatant falsification could be detected through the monitoring performed by customs officers in charge of discharging the transit shipments at Břeclav-dálnice. However, copies 5 of the TCPs in question on their face complied with the required specifications. They had a customs stamp which, at first sight, was similar to an authentic stamp. They bore a signature the authenticity of which the customs officer could not have verified. They finally had a TCP registration number which complied with formal requirements and was generated so that no overlap with authentic numbers was possible.

258. A professional involved in the transit sector, such as, for instance, CWA, may have learned how the TCP numbers were structured. It was therefore possible for CWA, or any other person involved in the Diesel case, to fabricate TCP numbers that presented the appearance of authenticity and would not conflict with a genuine TCP number. If the customs officers at Zlín had been involved in the tax fraud, the Respondent submits that they would have affixed an authentic TCP number on the copies 5 of the TCPs in order for the fraud to be entirely undetectable.

259. Finally, in the Respondent's view, the fact that the transit shipments were considered by the customs office of dispatch to be "discharged" does not at all prove that the customs officers were involved in perpetrating tax fraud. It only confirms that the perpetrators managed to maintain appearances that everything was normal and to thwart the vigilance of the customs administration.

260. The Claimant is also of the opinion that the absence of any inquiry procedure is proof of the complicity of customs officers. The Respondent points out, however, that the Břeclav-dálnice Customs Office started inquiry procedures immediately after the fraud was suspected, in late April 1995, by issuing inquiry letters to some of the customs offices of destination possibly affected by the Diesel case in order to find out whether the shipments had been presented to them or not. For instance, the Zlín Customs Office answered these inquiry letters by ascertaining that the shipments had not been presented, which later gave rise to guarantee claims against CARGO. Further, such alleged delays in the inquiry procedures do not prove any complicity.

261. The Respondent also made its best efforts to collect the customs debt from CWA and the drivers/declarants prior to initiating proceedings against CARGO or in parallel with these proceedings.

262. The Respondent considers that the Claimant has failed to demonstrate any involvement of the customs officers in the perpetration of tax fraud and has even been unable to create a mere presumption in this regard.

263. In the absence of any involvement or negligence on the part of the customs administration in the tax fraud, the Respondent validly raised CARGO's guarantee claims. By acting as a customs agent, CARGO accepted to cover the proper performance of the transit customs procedure, thereby undertaking the risk associated with liability deriving from the

unlawful removal of the transit shipments from customs supervision.

264. The Respondent adds that CARGO's bankruptcy is in no way associated with any wrongdoing or negligence of the customs authorities, but a mere result of the business risk taken by the customs agent's business in the Czech Republic in the period 1994-1995.

*(g) The use of the forged stamps*

265. The Claimant contends that the use of customs stamps necessarily involved customs officers at Zlín. According to him, the stamps – although authentic – have not been used in a legitimate context but were used as a cover-up for the ongoing tax fraud. However, the Respondent points out that the stamps used during the course of the transit shipments in question were scientifically qualified as being forgeries.

266. Moreover, although the customs stamp number "1366.21" was cancelled on 1 September 1994, it was used in relation to transit shipments performed by Horex until 6 October 1994, *i.e.* one month and a half after its cancellation. If a customs officer had effectively been involved in the tax fraud, the Respondent considers that he or she would have paid closer attention in order to warn the perpetrators to stop using the stamps "1366.21" as of 1 September 1994.

267. The Respondent submits that, if customs officers at the Zlín Customs Office had been effectively involved in the fabrication of the authorisations, they would have been anxious to make the signatures on them similar to the signature of the person who had allegedly issued them. Furthermore, the similarity of these authorisations and an authorisation the authenticity of which has not been questioned is not as striking as the Claimant argues.

*(h) CARGO's lack of vigilance*

268. The Respondent argues that, in light of their particular role in the transit procedure, customs agents should be particularly vigilant before participating in any transit procedure, and accepting to secure such operations. Commercial risks deliberately and knowingly assumed by the investor cannot be compensated by the BIT.

269. In the Respondent's opinion, a customs agent acting as a guarantor, such as CARGO, should particularly make efforts:

- (a) to assess the financial situation of the declarants it accepts to guarantee,
- (b) to have as large a number as possible of drivers ensuring transit shipments, in order to avoid some drivers being accountable for a customs debt they could not support,
- (c) to verify the notoriety of the importers, especially when large quantities of goods are regularly imported,
- (d) to be particularly cautious when transit shipments concern goods that are subject to high excise rates (cigarettes, alcohol, oil), and that are known to be more fraud-sensitive than other items,
- (e) when large quantities of goods are imported, to verify that other customs agents also

guarantee their transit, so as to divide the possible customs debt with as large a number of customs agents as possible, and

(f) when a driver frequently carries the same goods, to check with him that the transit procedure went well and that no irregularity was noticed.

270. The Respondent considers these conditions to be the *quid pro quo* in order to protect CARGO's own financial interests, not mentioning those of the Czech treasury. CARGO did not perform any risk management and this duty of vigilance was not complied with in the Diesel case.

271. The standard practices applied by reputable customs agents active in the Czech Republic in the relevant time period allowed them to avoid being involved and harmed in the Diesel case. Among the measures which were implemented in order to prevent risk of providing significant security for fraudulent transit shipments of oil products, the following should be highlighted:

(a) Only haulier companies were acting as acceptable declarants in the transit procedure. In other words, customs agents did not secure customs debts for individual drivers.

(b) Surety bonds were issued only on the basis of the guarantee contract between haulier, company and the customs agent.

(c) The drivers were required to sign a declaration obliging them to return the TCP Part 5 slip to the customs agent.

(d) Customs agents were issuing "black lists" containing names of hauliers which had transits that were not closed, and those which did not pay their customs debts.

(e) Customs agents issued a list of "sensitive goods". Securing transit of such sensitive goods required signature of the customs agent's director. Oil products were always considered as "sensitive goods".

(f) It was not usual practice during the relevant period to establish exclusivity between a customs agent and a haulier or driver.

272. The Respondent considers that the Diesel case contains a great deal of evidence that CARGO was manifestly negligent in the fulfilment of its professional duties.

273. Indeed, CARGO was the only customs agent implicated in the Diesel case, although other customs agents providing the same kind of services were established at the Břeclav-dálnice border crossing in 1994-1995. Shipments of fraudulent imports of oil products amounted to a significant portion of CARGO's own activity at Břeclav-dálnice in 1994.

274. In view of this situation, the Respondent argues that CARGO should have been all the more cautious and alarmed by the following elements:

(a) Shipments of goods with special excise tax regime (oil, cigarettes, alcohol) are well known to be more fraud-sensitive than others, especially in the peculiar circumstances of the present case (new border, new customs office, enormous quantities of oil migrating through the

Břeclav-dálnice border crossing). Contrarily, CARGO guaranteed these shipments as if it was “business as usual” on apples or pears.

(b) Shipments of enormous quantities of oil products were set up by entities which the Claimant acknowledges were unknown, ruled by very young, inexperienced and insolvent persons. Manifestly, CARGO has offered its guarantee to the transit on such shipments without more investigation.

(c) Shipments of these oil products were declared by the drivers, *i.e.* natural persons with limited financial resources, mostly in their own name. Given the risk of such declarants’ insolvency, CARGO should obviously have been more vigilant towards them as opposed to institutional clients. Additionally, these shipments were performed by a limited number of drivers (approximately 60), some of them performing up to 75 shipments each. Yet, CARGO accepted to guarantee these drivers in full knowledge that they would not be capable of supporting the customs debts in case something went wrong.

(d) Parts 5 TCPs of all fraudulent shipments were actually stamped by only two stamps (the stamp of [redacted] (No. 1366.21) and the stamp of [redacted] (No. 1373.12). This very unusual situation did not attract CARGO’s attention. It later happened that these stamps were proved to be forgeries.

(e) CARGO often issued surety bonds to drivers/hauliers before it received the bottom part 5 of TCPs related to previous shipments performed by the same driver/haulier. For instance, CARGO issued 69 surety bonds to Četrans after 9 August 1994 although it never received the bottom part 5 TCP of the transit procedure opened by Četrans on 9 August 1994. The same situation occurred with [redacted] (29 shipments after 2 November 1994) and Transpolar Hope (27 shipments after 23 November 1994).

(f) CARGO did not verify the notoriety of the consignees – especially [redacted] and his company Horex, although they all of a sudden started to import a very large number of tank trucks. It later appeared that [redacted] was notoriously insolvent.

(g) Transit always ended in the same surprising way, namely the drivers were asked to stay outside the importers’ premises and never met any customs officer at the end of the transit, as the drivers have repeatedly declared during the criminal proceedings. The Claimant has never provided a piece of evidence nor any declaration that the drivers had informed CARGO of this very astonishing situation. This means either that CARGO did not especially enquire with the drivers about the way the transit terminated, or that CARGO knew that something unusual was afoot. In both cases, it is not for the Czech Republic to suffer the consequences of such behaviour.

(h) The bottom parts 5 of TCPs were not delivered to CARGO by the declarants but by two CWA employees (Mr. [redacted] and Mr. [redacted]), even though the drivers were doing their more or less regular shuttles. This should have been an indication for CARGO that the drivers did not fulfil their obligations within the transit regime.

275. The Respondent considers all these elements as obvious evidence of CARGO’s negligence in the sequence of facts that ultimately gave rise to guarantee claims against it.

*(i) CARGO's liability for excise taxes and VAT*

276. The Claimant contends that CARGO's surety bonds did not provide that it was liable for the payment of excise taxes and VAT and that, as a consequence, CARGO was not liable to pay such taxes. However, the Respondent points out that CARGO had accepted to guarantee payment of excise taxes and VAT.

277. In paragraph 2. of all surety bonds issued by CARGO during the years 1994-1995, the guarantor undertook, within the time-limit of ten days from the notification of the amount of customs duty, tax and fees by the relevant customs authority, forthwith to pay the requested amount.

278. The Respondent finds the wording of CARGO's surety bonds fully consistent with the relevant provisions of the Customs Act. Under Section 323 of this Act, as applicable in the years 1994-1995, excise taxes and VAT were part of the customs debt.

279. The Respondent also considers that the Claimant's argument is contrary to any sense of logic. The scope of CARGO's obligations was consistent with the purpose of such engagement within the framework of goods imported within a customs union. If excise taxes and VAT were not covered within the notion of "customs debt", this would have amounted to depriving the guarantees of the customs agents of any effect in the particular context of the Czech-Slovak commercial relationships. If the Claimant's argumentation were accurate, the Czech customs administration would not have requested any guarantee at all in case of transit shipments coming from the Slovak Republic.

280. The Respondent argues that CARGO, when securing the proper performance of the 1,245 transit shipments, was perfectly aware of the fact that its guarantees could be enforced for the payment of excise taxes and VAT, such as those accruing on the import of oil products.

281. The Respondent points out that the drivers and CARGO were jointly and severally liable for the customs debt. This obligation is clearly stated in Section 260 of the Customs Act.

282. The Claimant also contends that CARGO, as guarantor of the customs debt, was not liable to pay excise taxes and VAT for the unlawful removal of goods from customs supervision. According to the Claimant, the laws of the Czech Republic in force from 1994 to 1997 did not contain any provision under which excise taxes and VAT could be assessed on goods imported from the Slovak Republic, in case such goods were illegally imported into the Czech Republic. In the Respondent's opinion, these contentions are erroneous.

283. The Respondent finds the question as to whether excise taxes and VAT are part of the customs debt to be largely irrelevant for the present discussion. Indeed, what matters is not the definition of customs debt but the extent of the surety bond provided by the customs agent. In this respect, there is no doubt under Czech law as applicable in 1994 and 1995 that this guarantee encompassed the obligation to pay excise taxes and VAT. The Respondent considers that Section 323 of the Customs Act as applicable at that time made it absolutely clear that excise taxes and VAT were secured by the customs agent.

284. Moreover, the Respondent argues that all Czech laws and regulations also made it clear that the notion of secured customs debt encompassed excise duties and VAT.

285. The Act on Excise Taxes and the Act on VAT set forth that tax liability arose “on the day a customs debt arises”.

286. The Respondent argues that the Claimant is wrong when contending that goods imported from Slovakia were exempt from customs duty. Under the Agreement on the Customs Union between the Czech Republic and Slovakia no goods were exempt from customs duty, but the goods were just subject to a customs preferential system. Under this preferential regime, import duties were assessed but not collected. Therefore, when importing goods from Slovakia, a customs debt clearly arose.

287. Moreover, Section 8 (1) of the Act on Excise Taxes made it clear that products imported from the Slovak Republic, as goods freed from customs duty due to the general system of customs preferences, were subject to excise tax. The same regime applied also to VAT.

288. Contrary to what the Claimant contends, the Respondent submits that the term “import” included the unlawful removal of goods from customs supervision (Section 240 (1) of the Customs Act). And again, sequentially, the Act on Excise Taxes and the Act on VAT stipulated that tax liability arises upon import, *i.e.* the tax liability arose at the moment when the goods were unlawfully removed from customs supervision in the regime of transit.

289. Moreover, the Treaty on the Customs Union between the Czech and Slovak Republics provides that “[g]oods exported from one of the Parties to the other Party could not be in a favourable position due to the return of the national tax duties over the indirect taxes cast upon such goods”. The Respondent considers that the only logical interpretation of this provision is that the imported goods must be subject to the same tax in the importing state as they were in the exporting state.

290. In addition, the Claimant relies on the Supreme Administrative Court judgment No. 7 Afs 149/2004-159 dated 23 March 2006 which in his opinion shows that the term “customs debt” shall be understood only as an obligation to pay import duties. However, the Supreme Administrative Court judgment in reality supports and confirms the Respondent’s argument that excise taxes and VAT were part of the customs debt secured by CARGO’s surety bonds and that the customs administration had the authority to assess and collect excise taxes and VAT at the relevant time. The judgment also makes it clear that the drivers could be debtors of the customs debt notwithstanding that other people also participated in removing the goods from customs supervision in the transit regime. Indeed, many Czech court decisions show that excise taxes and VAT are part of the customs debt, and that the customs authority is entitled to collect and assess excise taxes and VAT.

*(j) The competence of the customs offices*

291. On a subsidiary basis, the Claimant argues that the Czech Customs Administration was not entitled at all to assess and collect excise taxes and VAT on the relevant imports. The arguments are as follows:

(a) Section 3(2)(a) of the Customs Act, Section, 2(e) of the Act on Excise Taxes and Section 2(2)(i) of the Act on VAT entrusted the customs authorities with the function of tax administrator in respect of excise taxes and VAT payable upon imports of goods.

(b) "Import" is defined in both the Act of Excise Taxes (where it only designates the release of goods into free circulation or active treatment contact in return system) and the Act on VAT (where it designates the release of goods into free circulation regime, active treatment contact regime in return system, temporary use and goods imported back into free circulation from the passive treatment contact regime).

(c) In the present case, since the payment assessments occurred in relation to a customs debt which had arisen in accordance with Section 240 of the Czech Customs Act, the customs debt did not arise upon the release into the free circulation regime or any other regime constituting "import" and, since customs bodies were the administrators of excise taxes and VAT only in connection with imports, the Břeclav-dálnice Customs Office was not the administrator of such taxes, i.e. it was not materially competent to assess and collect such taxes.

(d) Due to the lack of material competence of the Břeclav-dálnice Customs Office, the administrative acts issued in relation to payment assessments in this case are void and not binding.

292. The Respondent considers that this argumentation cannot stand for the following reasons. The relevant law is the Customs Act which defines the notions of "import" and "imported goods". According to Section 133(3), "[i]mported goods" means goods placed under a suspensive arrangement", and according to Section 133(1), "[t]he term 'suspensive arrangement' is understood as applying to the following procedures: (a) transit [- - -]". While Section 2(e) of the Act on Excise Taxes stated that customs authorities are entrusted with the function of tax administrator in respect of imports and the Act on VAT contained a similar provision and in Section 2(2)(i) stated that customs authorities serve as tax administrator only in connection with import, this does not mean anything more than the simple fact that in the case of imports (defined in the Customs Act as *lex specialis*) the customs authorities are entitled to assess and collect excise taxes and VAT. The legislation of the Czech Republic formed a logically interconnected nexus and complex corpus, whereby customs officers were undoubtedly empowered to assess and collect excise taxes and VAT in the situation at issue.

293. The removal of goods from customs supervision was defined as import under Sections 133 and 240(1) of the Customs Act, and the customs offices were entitled to assess and collect excise taxes and VAT also upon transit. This followed from Sections 3 and 11 of the Customs Act, Section 2 of the Act on Excise Taxes and Section 2 of the VAT Act.

294. Accordingly, in the present case, excise taxes and VAT were assessed and collected in the amounts and under the conditions stipulated in the Act on Excise Taxes and the Act on VAT. CARGO was very well aware of this as it calculated the amounts of taxes in order to complete surety bonds.

295. The Respondent concludes that goods placed under the regime of transit are imported goods within the meaning of the Customs Act, for which the customs authorities are therefore perfectly entitled to assess and collect excise taxes and VAT by virtue of Section 3(2)(a) of the Customs Act.

296. The Czech Customs Administration's claims against CARGO were upheld and confirmed by a number of decisions of courts of the Czech Republic, including the Regional Court of Brno and the Supreme Administrative Court as well as in at least 18 cases decided by the Constitutional Court.

297. The Respondent points out that in no such proceedings did CARGO or the Claimant raise those arguments based on Czech customs law which the Claimant now requests the Arbitral Tribunal to reassess. Nor did any courts apply this argumentation by themselves, although they could have done so (based on the *iura novit curia* principle). The simple reason is that those arguments are completely groundless, fabricated just for this arbitration.

298. The Respondent also argues that the Claimant is estopped from sustaining arguments not raised before Czech courts or contrary to what he or his witnesses have sustained before.

299. Based on his arguments, the Claimant alleges that the actions of the customs authority, by which it assessed and collected the customs debt, were void. In the Respondent's view, this conclusion is wrong as based on incorrect arguments. In any case, the acts of the customs authority regarding the assessment and collection of the customs debt (including VAT and excise taxes) could not be considered as void, inasmuch as there was no fundamental and clear defect, and as they were indeed not issued by an administrative body that was lacking material jurisdiction.

300. The Respondent argues that the administrative acts of the customs authority must be presumed to be correct, unless the relevant administrative bodies and/or courts of the Czech Republic change or cancel them. To the best knowledge of the Respondent, nothing like this occurred.

301. The Claimant also brings argumentation which leads to the asserted conclusion that CARGO was entitled to participate in the administrative proceedings against the individual drivers. The Respondent contests this for the following reasons.

302. The Czech legislation did not embody a single provision stipulating the necessity to carry one single proceeding in a situation where several persons were participating in the customs debt evasion or where several persons are liable for a customs debt originating in non-delivery of identical products to a customs office of destination. Correspondingly, the Claimant does not refer to any Czech statutory provision stipulating such duty to conduct one proceeding with all debtors, nor any case which would deduce such duty from principles of administrative law.

303. It has to be noted that proceedings conducted against the individual drivers led to individual decisions issued to and binding on the drivers only. These decisions were neither enforceable against CARGO nor had they *res judicata* or any other impact on CARGO and its rights. The decisions against CARGO were issued in separate proceedings in which it could have freely proposed any evidence, including, for instance, interrogation of the drivers as witnesses or reference to the files of the proceedings conducted with the drivers. CARGO had standard opportunities to defend its rights in numerous proceedings carried out before Czech administrative bodies and, later, Czech courts.

*(k) Time bar*

304. The respondent submits that the Claimant uses various means, e.g. citing unrelated court decisions and misinterpretations of the Czech legislation in the given time period, in order to persuade the Arbitral Tribunal that the assessed (and partially collected) customs debts have been time-barred. The argumentation is incorrect and misleading for the following reasons.

305. The Customs Act did not contain any provision about a time-limit for assessing the customs debt. CARGO's debts were not time-barred when they were assessed and enforced, because the relevant laws of the Czech Republic did not contain any provision which would stipulate such a time-limit.

306. The Claimant, well aware that the Customs Act cannot provide any basis for his argumentation, is trying to persuade the Arbitral Tribunal about the applicability of either Section 47 of the Act on Administration of Taxes and Fees or Section 4 of the Act on the Tax System.

307. However, the Customs Act applicable at that time limited the applicability of the administrative laws to those specifically referred to in Section 320, and neither the Act on Administration of Taxes and Fees nor the Act on the Tax System was listed there. Later, effective as of 1997, the Customs Act stipulated in Section 320 the applicability of general regulations on administration of taxes and fees, while explicitly excluding the applicability of Section 47 of the Act on Administration of Taxes and Fees. The Customs Act in Section 320 in the wording applicable before 1997 did not even refer to the "general regulations on administration of taxes and fees".

308. Therefore, the applicability of both Acts upon which the Claimant has alternatively based his argumentation was excluded by the Customs Act.

309. The Claimant has not indicated any relevant laws of the Czech Republic, which were effective at that time and which would demonstrably stipulate a time-limit for assessing the customs debt in customs proceedings. As a consequence, the Claimant has failed to prove the ~~existence of a time limit for assessing the customs debt in the legislation of the Czech Republic.~~

310. Nor is it correct that any court decisions have formulated a new position on the issue of a time-limit. First of all, it should be pointed out that the Czech legal system is not based on precedents. Court decisions pertain to particular cases and do not have any force as precedents. Secondly, the court decisions referred to by the Claimant can easily be distinguished from the Claimant's case. They relate to customs debts which arose after 1 July 1997. In other words, all the presented judgments are based on the wording of the Customs Act following an amendment to the Customs Act implemented by Act No 113/1997. Only after the said change, i.e. after 1 July 1997, did the Customs Act allow for the subsidiary use of the laws on tax administration. Based on the general reference to the laws on tax administration, the Supreme Administrative Court held that the Customs Act allowed for the applicability of Act No. 212/1992 on the Tax System.

311. It is not clear why the Claimant relies on Section 4 of Act No. 212/1992 on the System of Taxes when the Customs Act contained specific provisions devoted to the time bar in respect of the right to claim outstanding duties. Indeed, Section 282(1) provided in this regard that "[t]he right to recover and enforce the payment of outstanding duty shall be time-barred after six years following the year when such duty became due". At the same time, the Customs Act did not contain any time limitation for the imposition of customs debts. Therefore, the payment orders issued in 1999 and 2000 were not time-barred since they were issued to CARGO within the time-limit prescribed by Section 282(1) of the Customs Act. Moreover pursuant to Section 282(3) of the Customs Act, the time bar shall be taken into account only if

an objection is raised by the debtor.

312. Therefore, the applicability of both Acts upon which the Claimant has alternatively based his argumentation was excluded by the Customs Act.

313. It should be added that the Břeclav-dálnice Customs Office issued notifications on non-delivery of goods and consequently decisions on the payment of the customs debt by CARGO, *i.e.* within the initial deadline prescribed by Section 4 of Act No. 212/1992. As a result, a new deadline of three years started to run. Therefore, payment orders notified to CARGO in 1999 and 2000 could not be time-barred under the said Section 4.

314. It should also be pointed out that the application of Section 282 of the Customs Act leads to exactly the same result since its second paragraph provides for a mechanism similar to Section 4 of Act No. 212/1992.

315. The Respondent concludes that the guarantee claims were not time-barred.

*(l) No refunds to CARGO*

316. The Claimant also argues that the Czech customs administration abusively refused to grant CARGO's request to have its funds reimbursed as a consequence of the setting aside of some of the guarantee claims. The Respondent strongly disagrees with this allegation. The procedure before the Czech customs bodies was fully in compliance with the applicable law. At the time when CARGO asked for a refund of the financial means based on the cancellation of the payment order, other receivables existed due to the Czech customs authority by CARGO. Based on this the Czech customs authority could, in full compliance with the applicable law, set off such financial means against the oldest unpaid underpayment of CARGO towards the Czech customs authority. In case of decisions set aside by the relevant courts on the basis of appeals of CARGO, the Břeclav-dálnice Customs Office indeed decided according to the Act on Administration of Taxes and Charges on the return of the overpayment and, also according to the same Act, on the setting-off of such overpayment against other unsettled obligations of the Claimant. This was challenged by CARGO but upheld by the District Court of Brno and subsequently also by the Supreme Administrative Court. None of the decisions listed by the Claimant resulted in an irrefutable seizure of CARGO's assets. However, CARGO did not meet the requirements for a refund under Section 289 of the Customs Act.

*(m) No harassment*

317. The Respondent opposes the Claimant's contention according to which CARGO would have been harassed. The Claimant's description of the circumstances that allegedly constituted a "harassment" against CARGO is simply inconsistent, and neither CARGO nor the Claimant ever filed any complaint in this regard before the Czech customs administration. The Claimant also failed to demonstrate any detrimental effect on CARGO's activity resulting from such alleged harassment.

318. Moreover, the Claimant has admitted that there is no causal link between the alleged harassment and the loss of revenues related to CARGO's lost opportunity to continue to prepare TCPs. In the Respondent's view, this must be interpreted as a renunciation by the Claimant of his claim relating to an alleged harassment, since it is well known that, for a state

to incur international liability, a causal link must be demonstrated between the damage suffered and the facts constituting a violation of the state's obligations. Since the Claimant himself acknowledged that, even if demonstrated, the alleged harassment had no causal link with the damage suffered by the Claimant through CARGO, it may not lead to the Czech Republic's international responsibility under the BIT.

319. The Claimant has not reverted to the alleged harassment and may indeed have dropped this argument. In any event, *i.e.* if the Claimant had not abandoned this claim, the Respondent considers that he has still not provided the Arbitral Tribunal with any evidence supporting his serious grievances, and his argumentation in this regard must therefore be rejected.

(n) *No right to review domestic court decisions*

320. The Respondent has demonstrated that the fate of the Claimant's investment in the Czech Republic was not the result of the Respondent's illicit action. This demonstration is sufficient to establish that the Czech Republic incurs no liability towards the Claimant under the BIT. However, as the Claimant is invoking that the Respondent pursued the 1,245 guarantee claims illegally under internal Czech law, the Respondent will answer such wrongful contention on a subsidiary basis by emphasising that the interpretation and application of Czech law is a matter for the Czech courts whose decisions cannot be reviewed in the present proceedings.

321. The Claimant raises several arguments based on Czech law. All in all, based upon such regulation, the Claimant requests the Arbitral Tribunal to sit as the Czech supreme administrative or constitutional court and decide whether the 1,245 guarantee claims were validly pursued.

322. The Claimant omits to refer to the fact that the guarantee claims which were enforced against CARGO have in fact already been upheld by Czech courts. Consequently, the Claimant has no standing under international law to ask an Arbitral Tribunal to rule on the validity of such claims, unless the Claimant was denied justice which is not the case here.

323. For example, in the case of Mr. [redacted] - one of the 1,245 claims that were raised against CARGO by the Břeclav-dálnice Customs Office - CARGO had the possibility to appeal the decision made by the customs office within 15 days from its notification before the Břeclav Regional Customs Office, which CARGO did. Yet, the Břeclav Regional Customs Office, as well as all other administrative and judicial bodies seized by CARGO, constantly held that, on the merits, the guarantee claim was well-founded.

324. Since CARGO used its right to appeal the customs office decisions, the Czech courts ruled on the legality of those claims. The respondent considers that the Czech court decisions have *res judicata* effect.

325. CARGO even challenged the decisions before the Constitutional Court of the Czech Republic. In all cases CARGO's constitutional complaints were rejected as groundless.

326. The Respondent considers that, by challenging the validity of the 1,245 claims in this arbitration, the Claimant seeks to create a new degree of jurisdiction before the Arbitral Tribunal. However, the role of international courts or arbitral tribunals is not to be a substitute for domestic courts in assuming the role of a domestic court of appeal or cassation. CARGO's claims, based on the alleged misinterpretation or misapplication of Czech customs law and

regulations by Czech courts, therefore logically fall outside the determination of an international arbitral tribunal sitting under the auspices of a BIT.

327. The Respondent argues that the Czech customs authorities acted in a manner validated by the domestic Czech courts when they pursued the 1,245 guarantee claims. There is therefore no legal ground for a liability of the Respondent, on the basis of guarantee claims confirmed by the Czech courts.

328. In the Respondent's view, the only ground that could have justified for the Claimant to have the courts' decision reviewed was denial of justice. However, this argument was not raised by the Claimant, the reason being that the Claimant was not denied justice by the Respondent.

329. Denial of justice may arise out of either procedural or substantive deficiencies in judicial processes. For example, a denial of justice argument could be raised if the courts refused to entertain a suit, if they subjected it to undue delay, or if they administered justice in a seriously inadequate way. The Respondent considers that no such procedural irregularity or deficiency occurred in this case for the following reasons.

330. First of all, each of the intervening Czech courts and customs offices made CARGO aware of its procedural rights. In each decision made by the intervening courts or authorities, CARGO was reminded of its right to appeal the relevant decision and the conditions for filing any such appeal. CARGO also enjoyed full freedom to appear before the courts for the protection of its rights and to bring any action provided or authorised by Czech law. CARGO had a right to be represented by counsel and, in fact, engaged a law firm. In addition, CARGO was not subject to a refusal by the relevant courts to entertain the suit or to an inadequate administration of justice. Indeed, every court or authority it referred to accepted to hear its claim. The Customs Directorate Brno even set aside the decision of the Břeclav-dálnice Customs Office for procedural reasons, and the Břeclav-dálnice Customs Office re-issued a valid decision against CARGO. Finally, CARGO's claims were not subject to undue delay.

331. Consequently, CARGO has never been denied procedural justice before Czech courts and was indeed treated on a footing of equality with Czech nationals. The fact that the Supreme Administrative Court was not set up until 2003 does not mean that CARGO lacked judicial protection before that time.

332. Nor was the Claimant substantively denied justice. The Claimant alleges that the guarantee claims were made by the Respondent without legal basis under Czech law. In other words, according to the Claimant, the Respondent allegedly did not comply with Czech law when raising CARGO's guarantee claims and thus breached international law. However, the mere violation of internal law never justifies an international claim. Consequently, even if the Czech customs offices and courts wrongly held that the 1,245 guarantee claims were valid, that would not entail a violation of the Czech-German BIT. To prove such a violation, the Claimant must show that he was substantially denied justice. Such a demonstration has not been made.

333. The Czech courts did not act with bad faith, bias, fraud or partiality, nor were they subject to external pressures or violated clear legal precepts. On the contrary, the courts took into account CARGO's arguments and based their decisions on a clear and comprehensive

legal reasoning. Thus, in the absence of denial of justice, the rights created under Czech national law are final.

*(g) The BIT claims:*

334. The Respondent argues that BITs are not aimed at protecting individuals or companies against the occurrence of the inherent risk of their business profession, should they be foreign investors. The decisions of the Czech customs authorities to claim the guarantees of CARGO were taken in full compliance with the Customs Act as applicable in 1994-1995. Hence, the Czech Republic cannot be held liable for the losses which CARGO has sustained as a result of these guarantee claims since any private entity would have been exposed to exactly the same guarantee claims in similar circumstances. As a matter of Czech law, the enforcement of CARGO's guarantee in cases where transit procedures were fraudulently completed through the use of a forged stamp was part of the business risk inherent in its activity as a customs agent. In no way may the Czech Republic be held liable if CARGO's guarantee was claimed as the result of its bad business judgments consisting in not having an efficient risk management system.

335. The Respondent points out that, in the present case, in its capacity as customs agent, CARGO undertook a risk consisting in being liable for the customs debt due to Czech customs authorities in case the transit shipments it secured were not properly performed and unlawfully removed from customs supervision. Therefore, it is the Respondent's case that since the 1,245 transit shipments at hand were fraudulently closed, CARGO's guarantee was validly invoked. On a subsidiary basis, the Respondent maintains that the tax fraud did not involve any complicity or negligence of the Czech customs administration.

336. The Respondent has demonstrated that the treatment which CARGO has been subject to in the Czech Republic was fully consistent with Czech rules applicable to the guarantees provided by customs agents in order to secure the transportation of goods under the procedure of transit from a border customs office of dispatch to an inland customs office of destination. This demonstration is sufficient to establish that the Czech Republic incurs no liability towards the Claimant under the BIT at issue.

337. The Claimant contends that the Czech Republic would be in breach of the following obligations stipulated in the BIT:

- (a) not to deprive the investor of its investment [Article 4(2)],
- (b) to treat investments fairly and equitably [Article 2(1)],
- (c) not to impair the enjoyment of investments by arbitrary or discriminatory measures [Articles 2(2), 3(1) and 3 (2)],
- (d) to provide investments with full protection and security [Articles 2(3) and 4(1)], and
- (e) to ensure treatment of investments that complies with the standard of international law [Article 7(1)].

338. The Respondent points out that in this regard the Claimant's argumentation has significantly evolved during the course of these proceedings. Initially, the Claimant did not

invoke the duty not to expropriate, the obligation of fair and equitable treatment and the treatment of investments in compliance with international law. Instead, the Claimant restricted his claim to the allegation that his investment (i) suffered discriminatory measures and (ii) did not enjoy full protection and security. In the Respondent's opinion, this conclusively shows the importance which the Claimant himself devotes to all other alleged "breaches" which the Claimant tries to substantiate at the final stage of the proceedings.

339. As a preliminary matter, the Respondent draws the Arbitral Tribunal's attention to the very particular context within which the Claimant made his "investment" in the Czech Republic

340. First of all, the Claimant registered the company CARGO in November 1990, *i.e.* exactly one year after the "Velvet Revolution" by which the former Czechoslovakia emancipated from the former Eastern bloc. Shortly thereafter, in January 1993, the country split into two independent states, namely the Czech Republic and Slovakia. Already at this time, both countries had the ambition to undertake economic reforms with the intention of creating capitalist economies and to join the European Union. After more than 40 years of a state-oriented economy, the Czech Republic undertook huge administrative, political and economic reforms which implied the setting up of new administrations and the implementation of new regulations which were unknown in the country at that time. The Břeclav-dálnice Customs Office was established at a border that was created *ex nihilo* on 1 January 1993. Needless to say, investing in the Czech Republic at the beginning of the 1990s was undoubtedly a more risky business than investing in France, Germany, Great Britain or Switzerland in the same period. The Claimant was perfectly aware of these circumstances when he decided to invest in the Czech Republic with the reasonable aim to benefit from the liberalisation of the economy.

341. Secondly, the Claimant did not only choose to invest in a renascent State. He also decided to perform the highly risky business of securing the performance of transit procedures as a customs agent. Especially in those years and in Central Europe, the field of transit customs operations was particularly risky. The Claimant was also perfectly aware of that.

342. The Arbitral Tribunal should have these factual elements in mind when assessing the Claimant's contentions.

*(p) No expropriation*

343. Article 4(2) of the BIT provides that "[i]nvestments by investors of either Contracting Party shall not be expropriated, nationalised or subjected to any other measure the effects of which would be tantamount to expropriation or nationalisation in the territory of the other Contracting Party except for the public benefit and against compensation". The Claimant contends that measures "tantamount to expropriation" encompass not only measures whereby the state takes or transfers title to the investor's property, but also the state's interference with the use of such property or with the enjoyment of its benefits ("indirect expropriation"). The Claimant further alleges that according to a well-established principle, the state's interference with an investor's use of property should be deemed actionable regardless of the form that the interference takes. In addition, the Claimant bases his claims on the contention that expropriation (or any other measure that would be tantamount thereto) may either take the form of a single state act or a series of state acts (known as "creeping" or "constructive" expropriation).

344. The Claimant contends that the Respondent's breach of international law consists in the pursuance of illegal claims, which ultimately have destroyed the Claimant's investment and that the guarantee claims were without legal basis and the enforcement thereof amounts in its own right to a breach of international law.

345. The Respondent considers that the Claimant's submissions have failed to explain in reasonable detail how the Czech Republic may have breached the BIT rules and (more importantly) how the Claimant may have been deprived of his investment by the Respondent's interference.

346. In any case, the Claimant cannot contend that the Respondent undertook an indirect or creeping expropriation. Firstly, the guarantee claims were pursued in compliance with Czech customs regulations applicable at the relevant time. Secondly, losses incurred by an investor may not qualify as expropriation if they are the result of bad business decisions and/or of the commercial risks deliberately and knowingly assumed by the investor, especially in case the latter is well experienced in the field in which he has decided to invest.

347. The Respondent points out that the Claimant had a long-standing experience in the field of customs proceedings all across Europe. He was therefore perfectly aware of the risks borne by customs agents, especially when undertaking guarantees for transit shipments, a business which was reputed as particularly risky in former COMECON countries during the years 1990-1995. It is also not surprising that the Claimant's careless approach to his business activities in the Czech Republic led to bankruptcy of multiple Czech legal entities controlled by the Claimant.

348. In the Respondent's opinion, CARGO's bankruptcy had nothing in common with the Respondent either. Firstly, the bankruptcy proceeding was not initiated by the Respondent or any Czech government bodies, but by an individual who was a former employee of CARGO. Secondly, the total value of CARGO's debt (other than obligations to the state) exceeded CARGO's assets determined by the bankruptcy trustee in the course of the bankruptcy proceedings. Consequently, CARGO would have been over-indebted (*i.e.* legally and factually bankrupt) even in case all receivables of any state entity were omitted. This appears clearly from the summary of receivables registered within CARGO's bankruptcy proceeding. In other words, the value of due receivables of third parties, other than the state, exceeded at the relevant time the value of CARGO's assets and led to CARGO's bankruptcy.

349. Finally, the Respondent argues that that, contrary to the Claimant's allegations, the alleged failure of the Czech prosecution to conduct an examination into the role of the customs authorities in the tax fraud does not constitute an expropriation. First of all, such allegation is inaccurate since all customs officers related to the Diesel case were heard by the Czech police during the criminal investigations, and all parties involved in the Diesel case gave evidence in the related criminal proceedings. Then, the alleged failure of the Respondent to investigate on the role of the customs authorities in the tax fraud cannot in any way be assimilated to expropriation.

350. Exercise of the Respondent's rights arising out of the guarantees issued by CARGO or any other act of the Respondent cannot therefore amount to a breach of Article 4(2) of the BIT.

*(q) No unfair treatment*

351. In the Respondent's opinion, the fair and equitable treatment standard under Article 2(1) of the Czech-German BIT must be interpreted as an incorporation of the customary international law minimum standard of treatment, and not as a new standard binding upon the parties to the BIT. The BIT has to be interpreted very strictly. The idea of a stand-alone fair and equitable treatment standard independent from customary international law is very marginal and must be rejected. Therefore the Claimant's allegation according to which the obligation of fair and equitable treatment is a "specific provision" cannot be accepted. In any event, the question as to whether the fair and equitable standard is, or is not, the equivalent of the minimum standard of protection under customary law is of limited relevance when assessing whether the Respondent breached Article 2(1) of the BIT, since the Czech Republic complied with all requirements resulting from this standard.

352. Contrary to the Claimant's argumentation, the Respondent acted in a consistent manner as of the day the first guarantee claims were raised against CARGO. The Respondent never changed its legal justification in order to justify the enforcement of CARGO's guarantee undertakings. To the contrary, the Respondent always invoked one single legal concept, *i.e.* the unlawful removal of the guaranteed shipments from customs supervision within the meaning of Section 240 of the Customs Act. It may therefore not be seriously disputed that the Respondent has acted in a consistent manner towards the Claimant and CARGO.

353. Regarding the alleged failure to observe due process requirements, the Claimant contends that the decision in which the customs debt was assessed in regard to the individual customs declarants had a direct impact on the substantive position of CARGO as the guarantor as its guarantor's obligation was activated by this decision and CARGO did not get the opportunity to defend its rights and interests in an effective manner, which resulted in a breach not only of the Administrative Procedure Rules but also of the fundamental constitutional right of CARGO to have due process. The Respondent considers that the argument is wrong for the following reasons:

(a) CARGO was never deprived of judicial recourse before Czech courts in order to object to the enforcement of its guarantee undertakings. To the contrary, CARGO seized Czech courts in order to challenge the decisions taken by the Břeclav-dálnice Customs Office ordering CARGO to pay the customs debt due by the drivers by virtue of CARGO's guarantee undertakings. Furthermore, it cannot be seriously sustained that the outcome of these proceedings and the way in which they were undertaken were inequitable. If a limited number of decisions taken by the Břeclav-dálnice Customs Office were set aside because they were based on legal provisions that were then inapplicable, new decisions were subsequently adopted in accordance with the relevant provisions and submitted to CARGO which still had the opportunity to challenge them on other grounds.

(b) Finally two principles of international law are important. The first one is that the standard of due process and procedural fairness applicable in administrative proceedings is not the same as in a judicial process. Hence, even if one were to see administrative irregularities in the decision taken by the Břeclav-dálnice Customs Office (which is not the case), it would not reach a sufficient level of gravity to breach the fair and equitable treatment rule. The second one is that acts that would amount to a breach of the minimum standard of treatment under customary international law are only those that constitute a gross denial of justice or manifest arbitrariness falling below acceptable international standards.

354. Consequently, the Respondent finds that the Claimant's contention according to which the Respondent would have breached due process requirements must be rejected.

355. The Claimant also argues that the legislative situation regarding excise taxes and import VAT was inconsistent in the years in question and that no clear cohesion existed between the individual public law provisions in this area. He considers that the terms establishing tax liability were not unambiguous and that there were numerous loopholes in the legislation, which made the interpretation of the relevant provisions by the Czech authorities arbitrary.

356. The Respondent considers that this claim is baseless and must be entirely rejected by the Arbitral Tribunal. Indeed, Czech customs regulations applicable during the years 1994-1995 were deliberately and closely inspired by customs regulations in force in the European Union since the entry into force of the Community Customs Code through Council Regulation No. 2913/92 dated 12 October 1992. This was the consequence of the Association Agreement concluded by the Czech Republic on 4 October 1993 with the final aim of membership in the European Union.

357. As a result, customs regulations applicable in the years 1994-1995 in the Czech Republic were mainly in line with regulations applicable all across Europe. It cannot therefore be sustained – and the Respondent understands that the Claimant does not – that Czech customs regulations failed to comply with the duty to grant and maintain a stable and predictable legal framework comprised in the fair and equitable treatment standard.

358. Moreover, even if one should find some imperfections in the execution of the state's obligation of predictability of the legal regime, the Respondent argues that this is not enough to constitute a breach of the fair and equitable treatment standard. Indeed, an investment treaty cannot be invoked each time the law is flawed or is not fully and properly implemented by a state.

359. The Claimant lays emphasis on the obligation of the state to answer to the legitimate expectations of the foreign investor and to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor. However, the Respondent submits that the Claimant gives no clue as to how the Respondent frustrated his legitimate expectations.

360. The Respondent points out that, according to international case-law, the investors' legitimate expectations are grounded, *inter alia*, on the legal order of the host state as it stands at the time when the investors made their investment. In other words, a claim based on legitimate expectations cannot prevail when the investor fails to explain how its legitimate expectations, as measured at the time when the investor made the investment, were not satisfied.

361. In the Respondent's view, the Claimant has failed to demonstrate that he received any explicit promise or guarantee from the Czech Republic or that, implicitly, the Respondent made assurances or representations that the Claimant took into account in making the investment. As a matter of fact, the Czech Republic did not make any promise or guarantee. The Claimant has also shown no proof of warranty as to particular characteristics or qualities of the Czech legislation and court system, nor has he demonstrated any significant change for the worse since the implantation of CARGO in the former Czechoslovakia. Quite to the

contrary, due to the fact that the Customs Act (which was already in force in the period 1994-1995) was directly inspired by the regulations in force in the European Union, Czech law was perfectly in compliance with the European standards at the time when the Claimant made his investment.

*(r) No arbitrary or discriminatory measures*

362. The Claimant contends that the Czech Republic also breached Article 2(2) of the BIT which provides that investments shall not be subjected to arbitrary or discriminatory measures. He argues that the Respondent's conduct was arbitrary in that its prosecution authorities patently failed to investigate the circumstances that led to the failure of the customs authorities to ensure payment of at least 1,861 transit shipments of a total of 2,054 involved in tax fraud. In other words, the Claimant sees arbitrary measures within the meaning of Article 2(2) of the BIT in the Czech Republic's alleged failure to ensure payment of the customs debt from the fraudsters themselves, as opposed to the drivers and their guarantor, CARGO.

363. First, however, the Respondent considers that there is no doubt that the drivers, as the declarants of the transit shipments, were debtors according to Section 240(3) of the Customs Act. Several persons can be debtors of one single customs debt, and in the case at hand, CWA and the drivers were those who removed the goods from customs supervision, who participated in the removal and who were or should have been aware that the goods were being removed from customs supervision and/or were required to fulfil the obligations arising from the use of the customs procedure under which the goods were placed. This is the reason why the customs authorities enforced liability both against the drivers and CWA.

364. Second, as regards CWA, the Respondent points out that the customs administration raised numerous claims against the declarants (*i.e.* the drivers), their guarantor (*i.e.* CARGO), the consignees (*i.e.* , Horex, UNIIP) and the importer (*i.e.* CWA). The Respondent therefore finds it clear that it used its best efforts to collect the customs debt from CWA and the drivers/declarants prior to initiating proceedings against CARGO or in parallel with such proceedings.

365. It follows, in the Respondent's opinion, that the Czech customs administration took all available steps in the course of its investigation regarding the tax fraud scheme in order to identify the people and/or entities that were involved in it, and that finally in no way the Respondent treated the Claimant in an arbitrary manner. It must also be highlighted that the allegation of "arbitrariness" is groundless from the point of view of international law. Indeed, arbitrariness is wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety. In the present case, the Claimant has been unable to adduce any evidence that the Respondent's acts were performed as a result of some form of impropriety or capricious, despotic or irrational conduct.

366. The Respondent considers that the Claimant's position regarding the alleged discriminatory conduct is equally ill-founded. It is now well established in investor-state arbitration case-law that for discrimination to be established, the investor who invokes treaty protection has to demonstrate that (i) other investors, be they national or originating from a third country, placed under the same circumstances, (ii) were better treated than the first investor (iii) without any justification. The Respondent submits, however, that none of these three requirements is fulfilled in the case at hand for the following reasons:

(a) CARGO and CWA were not in comparable situations as they were performing very different functions in the Diesel case. In its capacity as customs agent, CARGO had very specific duties which cannot be compared with those carried out by CWA and other entities involved in the tax fraud scheme, such as the consignees.

(b) More generally, CARGO cannot be deemed to have been placed in a situation comparable to that of any other economic operator in the Czech Republic. CARGO was the only customs agent involved in the Diesel tax fraud scheme. It could therefore not have been discriminated against, in the absence of any other investor placed in the same circumstances.

(c) The Claimant's statement according to which CARGO was treated less favourably than CWA is simply not true, since the Respondent took all measures it had at its disposal against CWA in order to collect the amounts of unpaid excise taxes and VAT.

367. In any event, *i.e.* if treatment afforded to CARGO were to be qualified as less favourable than that reserved to other entities, the Respondent had a legal justification for the treatment in that CARGO expressly accepted to be the guarantor for the transit shipments. CARGO was therefore well aware that its guarantee undertakings could be enforced in case transit shipments were unlawfully removed from customs supervision.

368. Consequently, the Respondent considers that the Claimant's position according to which CARGO was discriminated against cannot be accepted from either a legal or a factual point of view and must therefore be rejected.

*(s) No violation of the full protection and security standard*

369. According to the Claimant, the Respondent violated its obligation to provide full protection and security in accordance with Articles 2(3) and 4(1) of the BIT. The Claimant contends that, although the full protection and security standard has been used predominantly in the context of physical protection, it extends beyond an obligation to protect physical property and includes the obligation to protect the legal security of investments.

370. In the Respondent's opinion, however, the large majority of arbitral awards show that the standard of full protection and security has only been applied to physical harm suffered by investors and/or their investments. Some arbitral tribunals that were asked to apply the full protection and security standard beyond its traditional scope, *i.e.* the protection against physical violence, have explicitly denied the application of the standard in such circumstances.

371. In the absence of any contention that the Claimant, or his investment CARGO, was the victims of violent acts perpetrated by the Respondent, his argumentation regarding a breach of the full protection and security standard fails in the Respondent's view and must be rejected.

*(t) No violation of Article 7(1) of the BIT*

372. The Claimant finally alleges that Article 7(1) of the BIT is a broad provision requiring the contracting parties to treat investments at least as well as required by "obligations under international law existing at present or established hereafter between the Contracting Parties, - - - whether general or specific". In other words, the Claimant contends that Article 7(1) of

the BIT would be the equivalent of the minimum standard of treatment of customary international law.

373. The Respondent argues that this interpretation by the Claimant is nothing but a distortion of the BIT. Far from incorporating within the BIT the minimum standard of treatment (as contended by the Claimant), Article 7(1) is a *sui generis* clause allowing investors of one Contracting Party to benefit from the provisions of the legislation of the other Contracting Party, or of any obligations between the Contracting Parties, if such were found to be more favourable than the provisions of the BIT. Therefore, in order to invoke Article 7(1) of the BIT, the Claimant had to identify provisions of the Czech legal order or international obligations – be they customary or inserted in a treaty – applicable between Germany and the Czech Republic that would allow him a more favourable treatment than that afforded to him in accordance with the BIT. However, the Respondent considers that the Claimant is incapable of demonstrating in what way the general principles he relied upon – due process, transparency, obligations of natural justice, good faith, due diligence and fair dealing, and the protection of economic rights – would allow him a more favourable treatment than that provided for by other standards of the BIT, especially the fair and equitable standard of treatment. Furthermore, again the Claimant's argumentation is only based on general statements which do not show that the Respondent may have breached these general principles.

374. As a result, the Respondent concludes that the Claimant's argumentation regarding Article 7(1) of the BIT must also be rejected.

*(u) Final remarks*

375. The Respondent also considers that, contrary to what the Claimant contends, the *in dubio mitius* principle is not applicable to the facts of the present case. Indeed, the applicability of such principle depends on the existence of doubts about the correct interpretation of a certain set of facts or ambiguity of a legal regulation. In the case of CARGO securing the payment of the taxes on imports of oil in 1994-1995, the Respondent finds no doubts about the facts. There was also no ambiguity of the relevant legal regulations in 1994 and 1995. The submission that there was no ambiguity concerning the interpretation of the relevant legal regulations especially with regard to surety bonds securing payment of excise taxes and VAT is supported, in the Respondent's opinion, by the fact that the customs administration's interpretation of the relevant legal regulations has never been challenged by anyone (in particular, no party to the proceedings) except by the Claimant before this Arbitral Tribunal.

376. The Respondent argues that, despite the fact that CARGO challenged the Czech customs authorities' decisions in many instances and, therefore, became a party to a large number of proceedings before Czech courts, CARGO never made to the Czech courts an assertion that surety bonds did not secure payment of the excise tax and VAT or an assertion that the relevant claims were time-barred or any other of the assertions made in this case. It follows that the relevant legal regulations were not ambiguous. If there had been any doubts about their interpretation, CARGO or the Claimant would certainly have made such an assertion before the Czech courts. They had plenty of occasions to do so.

377. Furthermore, the Respondent considers that there can be no doubt about what was secured by the surety bonds, since the exact amount was stated on these bonds. The amount was calculated on the basis of the excise tax and VAT which were to be paid for the particular

consignment. Therefore, CARGO knew the exact amount it was securing before handing over the surety bond to the drivers.

378. In the Respondent's view, the legality principle was not breached by acts of the Czech customs authorities enforcing the surety bonds against CARGO, since CARGO decided freely and independently to secure payment of excise taxes and VAT by issuing the surety bonds and was not forced to do so by the Czech customs authorities or by any provision of Czech legal regulations.

379. The surety bonds issued by CARGO included its promise to pay the amounts which were calculated on the basis of an assessment of excise taxes and VAT. The Claimant cannot assert that the Czech customs authorities breached the legality principle by enforcing CARGO's promise to pay the amount of excise taxes and VAT.

380. Furthermore, the Respondent argues that enforcement of the surety bonds was in absolute compliance with the legal regulations which were valid and effective during the relevant period of time. In its Section 323, the Customs Act stipulated that securing a customs debt means also securing payment of excise taxes and VAT.

381. The Respondent points out that, in its surety bonds, CARGO specifically undertook to secure payment of the customs debt. In compliance with Section 323 of the Customs Act, this meant that CARGO was securing the payment of excise tax and VAT. Further, the "taxes" were specifically mentioned in the wording of the surety bonds.

382. The Respondent concludes that there can be no breach of the legality principle under these circumstances.

383. The Respondent also relies on the fact that the stamps that were affixed on the TCPs, copy 5, were definitely established as being forgeries in two expert reports of 1996 and 1998 established within a criminal investigation. This is clear evidence that the customs officers whose stamps were copied had no involvement in the Diesel case. Similarly, all drivers transporting oil shipments for CWA *et consortes* have declared as witnesses in the criminal proceedings that they never met any customs officer when their TCP, copy 5, was stamped. This necessarily implies, in the Respondent's opinion, that the person who printed the forged stamp on the TCP, copy 5, was not a customs officer in uniform. While investigations were conducted on all people involved in the Diesel case, customs officers were asked to testify before the competent criminal proceedings authority. None of these customs officers was subsequently prosecuted or *a fortiori* sentenced.

384. In so far as the Claimant contends that CARGO was discriminated against during the year 1995 when the drivers/hauliers using CARGO's services were allegedly forced to support excessive delays at border crossings for customs declaration, the Respondent finds no support for this contention.

## VII. The Arbitral Tribunal's reasoning

### I. General considerations

385. The present arbitration is based on the bilateral Treaty between the Federal Republic of Germany and the Czech and Slovak Federal Republic concerning the encouragement and

reciprocal protection of investments, here called the *BIT*. The question that the Arbitral Tribunal is called upon to answer is whether the Respondent, *i.e.* the Czech Republic, as one of the two successor states of the Czech and Slovak Federal Republic, has violated its obligations under the BIT in regard to the Claimant's investment in the Czech Republic.

386. The alleged violations of the BIT essentially consisted in acts and omissions affecting the company CARGO, formed and operated by the Claimant. In the absence of any objection to the Claimant's capacity to represent the interests of CARGO, the Arbitral Tribunal accepts that any action affecting CARGO in the Czech Republic also affected the Claimant's investment in that state, as protected under the BIT.

387. The Claimant alleges that the Respondent violated the following obligations in the BIT:

- (a) the obligation to accord investments a fair and equitable treatment [Article 2(1)],
- (b) the obligation not to impair investments by arbitrary or discriminatory measures [Articles 2(2), 3(1) and 3 (2)],
- (c) the obligation to give investments full protection and security [Articles 2(3) and 4(1)],
- (d) the obligation not to deprive investors of their investments [Article 4 (2)], and
- (e) the obligation to treat investments at least as favourably as required by international law [Article 7(1)].

388. The Respondent contests that it breached any of these obligations and asks for the dismissal of all the Claimant's claims.

389. A considerable part of the argumentation in this case concerns questions relating to the interpretation and application of Czech law. The Arbitral Tribunal therefore finds it appropriate first to make a few general remarks on the relationship between rights and obligations under domestic law and those founded on the BIT.

390. The BIT is an international treaty and should be interpreted in accordance with the principles of international treaty law, as codified in the Geneva Convention on the Law of Treaties. The Arbitral Tribunal derives its competence exclusively from the BIT and is not competent to decide how Czech law is to be interpreted, this being a matter for the Czech courts. Consequently, the Tribunal cannot review the interpretation of domestic law in Czech court decisions. Nor can the Tribunal express an opinion on the interpretation of Czech law on matters which have not been decided by Czech courts.

391. However, in this arbitration Czech law is one of the factual elements which the Tribunal must take into account when establishing whether the Czech Republic has observed its undertakings in the Czech-German BIT. It is the Tribunal's task to examine whether Czech law, as it was applied to the Claimant and his company CARGO, may have violated the obligations of the Czech Republic in the BIT. In other words, if it should be found that Czech law had such contents, or was applied in such manner, as to violate any of these treaty obligations, the Tribunal is competent to establish that a violation occurred and to draw the legal conclusions following from it. The Tribunal's examination may not only concern specific acts by the Czech authorities but also extend to general questions of whether the

Czech legal system, including the availability of judicial and administrative remedies, was sufficient to provide the Claimant with adequate protection for his investment in the Czech Republic.

392. As a general rule, the Claimant has the burden of proof in respect of the facts which are alleged to violate the BIT. Moreover, it is also incumbent on the Claimant to be specific in regard to his allegations. The obligations in the BIT are defined in general terms, such as fair and equitable treatment, arbitrary or discriminatory measures and full protection and security, and the Claimant should indicate which particular acts or omissions, or which specific domestic laws or regulations, he considers to have violated the Claimant's rights under the BIT. In so far as this has not been sufficiently specified by the Claimant, the Tribunal may find it appropriate, having regard also to the Respondent's right of defence, to limit its examination accordingly.

## 2. Taxation of imports from Slovakia

393. The Claimant's company CARGO was held liable, as guarantor, for payments of excise taxes and VAT on oil products transported in 1994 and 1995 from Slovakia to the Czech Republic. He objects to such liability on the ground that, in his view, goods imported at that time from Slovakia were not subject to excise taxes and value added tax (VAT) in the Czech Republic. He relies in this respect on the definition of the term "customs debt" in the Czech Customs Act. In Section 2 of the Act, "customs debt" was defined as "the obligation of a person to pay the amount of the import duties (customs debt on importation) or export duties (customs debt on exportation)". However, as a result of the customs union between the Czech and Slovak Republics, there were no customs duties on imports into the Czech Republic of goods coming from Slovakia. Consequently, the Claimant considers that no customs debt could arise in the present case which concerned import of oil products from Slovakia. In the Claimant's opinion, this would have the further consequence that there could be no excise tax or VAT on such goods, since in the Excise Taxes Act and the VAT Act the duty to pay taxes arose on the day a customs debt occurred.

394. Moreover, the Claimant argues that the tax obligations were linked to the import of goods and import was understood as the release of goods for procedures specified in the law, in particular the release of goods for free circulation, the release of goods for inward processing and the release of goods for temporary use. The removal of goods from customs supervision, which occurred in the present case, could not, in the Claimant's opinion, be regarded as import and could therefore not give rise to any tax obligations.

395. The Claimant also considers that customs officers were not competent to collect excise taxes and VAT on the oil products, since according to the regulations in force at the relevant time the customs authorities acted as taxation authorities only upon import, and since there was no import in this case, the customs authorities had no competence to decide on taxation.

396. In this regard, the Claimant further refers to two general principles of interpretation. The first principle is the *in dubio mitius* principle which implies in this context that in matters of taxation the interpretation of the law which is most favourable to the taxpayer is to be preferred. The second principle is the legality principle from which it follows that an obligation to pay taxes must be based on clear legal provisions.

397. The Claimant's interpretation of Czech law on these matters is contested by the Respondent which argues that, while there was no liability for customs duties on imports from Slovakia, excise taxes and VAT still had to be paid on goods imported from that country. The Respondent also maintains that there was import in this case and that the customs officers were competent to determine the taxation.

398. The Arbitral Tribunal notes that the Czech court decisions which have been submitted to the Tribunal do not provide support for his views on the interpretation of the Customs Act, the Act on Excise Taxes and the VAT Act. Nor does it appear that the Claimant raised these legal objections in the proceedings before the Czech courts.

399. The Arbitral Tribunal considers that it is not competent to determine how Czech law was to be understood at the relevant time in respect of goods imported from Slovakia. However, the Tribunal notes the divergence of opinion between the Parties and will keep their views in mind, when examining the issues arising under the BIT.

### *3. The surety bonds*

400. According to Section 139(1) of the Customs Act, as in force at the relevant time, "transit" meant "a procedure covering goods transported under customs supervision from one customs office to another customs office". In Section 139(2), "transit operation" was defined as "the movement of goods in transit from the customs office of dispatch to the customs office of destination". The person making the customs declaration, called the "declarant", or the company on behalf of which that declaration was made, was responsible as debtor for the customs debt, and security had to be provided for the fulfilment of the debtor's payment obligation. In respect of the fuel transports from Slovakia now at issue, such security was provided by CARGO in the form of security bonds issued separately for each shipment.

401. However, the Claimant maintains that the surety bonds issued by CARGO only concerned customs duties (which could not be imposed on imports from Slovakia) and did not include liability for taxes, the argument being not only that, in the Claimant's view, such imports were not subject to taxation but also that the Claimant's concrete undertaking in the surety bonds did not extend to taxes.

402. The Respondent takes the opposite view and considers that the surety bonds also covered taxes and that excise taxes and VAT had to be levied on goods imported from Slovakia.

403. The Arbitral Tribunal has been provided with a sample of a surety bond. This bond concerned a specific shipment and was signed by CARGO on 11 November 1994. In the absence of other information, the Tribunal will assume that all the bonds issued by CARGO for transit operations were drafted in the same or a similar way, except as regards the guaranteed amount which was filled in for each shipment. The Tribunal will therefore base its considerations on the wording of the sample which has been submitted to the Tribunal.

404. In the introductory paragraph of the surety bond, CARGO, as guarantor, gives a payment guarantee in a certain amount "as security for customs debts" and undertakes, jointly and severally with the debtor, to fulfil the guaranteed amount of customs debts and to pay the amount that owes or will be owing to the customs authority of dispatch due to dispositions that are prohibited by the Customs Act and whereby, according to Chapter 13 Part One of the Act, a customs debt arises regarding the goods admitted into the transit regime.

405. In the second paragraph of the bond, the guarantor undertakes, within a time-limit of ten days from the notification of the amount of customs duty, tax and fees by the relevant customs authority, forthwith to pay the requested amount, unless the guarantor or any other person concerned furnishes proof to the customs authority of dispatch before the expiration of this time-limit, that negotiations in the transit regime that are prohibited by law did not take place and that a customs debt did not arise.

406. The Arbitral Tribunal first notes that these surety bonds are guarantees issued under Czech private law and that their legal effects should be determined on the basis of that law. It is not the Tribunal's task to make such a determination.

407. However, what is relevant in the present proceedings is that the surety bonds had important economic consequences for CARGO and for the Claimant's investment in the Czech Republic. From this perspective, the Tribunal must examine whether the guarantee claims based on the surety bonds and the measures taken to enforce these claims affected the Claimant's rights under the BIT to protection for his investment.

408. The Arbitral Tribunal considers that the wording of the surety bond is to some extent ambiguous and not fully consistent. The first paragraph of the bond specifies that the guarantee is security for "customs debts" which, if the definition in the Customs Act is applied, could be read as referring only to customs duties. However, in the second paragraph of the bond, the guarantor undertakes to pay not only customs duties but also taxes and fees.

409. The Respondent has also pointed out – and this has not been contested by the Claimant – that in the bond submitted to the Arbitral Tribunal the guaranteed amount corresponded to the amount of taxes (excise tax and VAT) to be levied on the particular shipment of oil products covered by the guarantee. This, in the Tribunal's view, must be seen as a rather strong indication that the bond was intended to provide security for these taxes.

410. It is also difficult to understand why security would be required at all if no question of liability for either customs duties or taxes could arise in respect of goods coming from Slovakia. The Claimant's explanation that the surety bonds were issued only for balance-of-trade and statistical purposes does not appear convincing and is not supported by the evidence in the case.

411. The Arbitral Tribunal therefore, despite the ambiguity in the wording of the surety bonds, finds the conclusion unavoidable that, in so far as the application of the BIT is concerned, the Břeclav-dálnice Customs Office, when accepting the bonds as security, intended them to provide security for taxes and that CARGO, when signing the bonds, was aware that this was the purpose of its undertaking.

412. It must therefore be concluded that CARGO, by signing a large number of bonds of this nature which together represented large sums of money, made a very substantial economic undertaking and exposed itself to considerable economic risks in case the goods would not be properly presented for clearance to the customs office of destination.

#### 4. *The fraudulent acts*

413. It is common ground in this case that the relevant oil products imported from Slovakia were removed from customs control and final clearance as a result of a large scale criminal activity for which several persons have been prosecuted and some have been sentenced to terms of imprisonment. However, some elements are in dispute between the Parties and may be relevant for the consideration of the Claimant's rights and the Czech Republic's obligations under the BIT. The Arbitral Tribunal will therefore give special attention to the questions (i) whether the customs authorities had accepted that customs clearance could take place outside a customs area, (ii) whether certain customs documents had been forged, and (iii) whether one or more customs officers were involved in the fraud.

##### *(a) Customs clearance at CWA's premises*

414. It appears that the drivers of the trucks transporting the oil products from Slovakia to the Czech Republic, after being admitted to the transit regime at the border office of Břeclav-dálnice, did not proceed to an inland customs office for customs clearance. Instead, they went, in accordance with the instructions they had received, to the CWA premises at Lipová or Slušovice where they handed over the relevant documents, not to a customs officer but to the staff of CWA. They were told that CWA would then regulate all customs matters with the Zlín Customs Office. Subsequently, confirmations (slips of the TCP), appearing to come from the Customs Office Olomouc, were sent to the office of despatch at Břeclav-dálnice which concluded that customs clearance had taken place and that the transit procedure had been completed.

415. The Parties disagree on whether the drivers were entitled to deliver the customs documents to CWA instead of the customs office of destination. The Claimant considers that the drivers could do so under the simplified procedure granted to CWA by the České Budějovice Customs Office. This is contested by the Respondent.

416. The Arbitral Tribunal has been provided with a decision of the České Budějovice Customs Office, dated 27 June 1994, and a supplement to that decision, dated 10 January 1995. According to the decision, CWA was granted permission, according to Section 124(1)(b) of the Customs Act, to import diesel oil and gasoline from the Slovak Republic in a simplified procedure. It was specified that import of the goods would be permitted by virtue of a commercial or an administrative document (invoice) which had to contain specific information and which would replace a customs declaration.

417. The Arbitral Tribunal notes, however, that the decision of the Customs Office did not indicate that clearance could be carried out at a place other than a customs office. Further, the decision specified that it was based on Section 124(1)(b) of the Customs Act which authorised a customs office to grant permission for goods to be entered at the declarant's request on the basis of a commercial or administrative document replacing the customs declaration. In view of the wording of the decision and the legal provision concerned, the Tribunal cannot find it established that the decision was intended to allow customs clearance to be carried out outside a customs area.

418. The Claimant has also referred to three documents appearing to have been issued by the Customs Authority at Zlín. According to these documents, dated 7 April, 1 May and – probably – 1 June 1994, the company UNITIP, and the company HOREX Zlín had

been granted permission, in respect of certain categories of diesel oil and gasoline, "to handle the goods before it is let through, provided that the declaring company each Monday for the past week hands in the relevant Single Customs Document and all other administrative and commercial documents containing information for the identification of the goods". These permits were said to be based on Sections 83(1) and 123 of the Customs Act. The latter section allowed a customs office to permit goods to be disposed of prior to their release. However, the Respondent argues that the documents are forged and points out that the customs officer claimed to have signed the documents was not competent to do so and that the signature on the three documents is not his signature.

419. The Arbitral Tribunal considers the circumstances to be such as to create serious doubts about the authenticity of the three permits. However, even if they were genuine documents, the Tribunal finds it doubtful whether they could be read, according to their wording, as authorisations to perform customs clearance of transit goods outside a customs area. The Tribunal therefore cannot accept them as justification for presentation of transit goods and customs documents to CWA personnel without any supervision by customs officers.

420. The Arbitral Tribunal notes, however, that there are situations in which customs proceedings may indeed legally take place outside a customs area. While Section 102(1) of the Customs Act provides that customs proceedings shall be held at a customs office or in customs zones, Section 102(3) states, as an exception, that, at the request and at the expense of the declarant, customs proceedings may also be conducted outside a customs zone. Section 102(4) instructs the Ministry of Finance to lay down in an Ordinance the conditions under which customs proceedings may be so conducted and to set the amount of expenses to be charged for conducting such proceedings. The Ministry of Finance issued instructions in Regulation No. 92/1993 which in Section 16 allows customs proceedings to take place outside a customs area, if this is justified by reasons of economy, especially if it simplifies the transportation of the goods; or if it is otherwise imperative and does not breach the regular activities of the customs authority. A request for proceedings to be held outside the customs area must be made sufficiently in advance, and the customs authority must be given information about the approximate amount of goods and the type of goods. Moreover, it is the customs authority that will conduct the customs proceedings outside the customs area, and the declarant who asked for this procedure will have to pay the costs for the participation of the customs officers.

421. It is clear, however, that this special procedure for customs clearance outside a customs area was not applied in the present case and that, in any event, that procedure would have required the presence of one or more customs officers at the relevant place.

*(b) The use of forged documents*

422. The Arbitral Tribunal has found above (see para. 419) that there are serious doubts about the authenticity of the three permits claimed to have been issued by the Customs Authority at Zlín and allowing goods to be disposed of prior to their release.

423. The Respondent also claims that the part 5 slips of the TCPs confirming the termination of the transit procedure which were returned to the Customs Office Břeclav-dálnice were provided with forged stamps appearing to be those of two customs officers at the Customs Office at Olomouc. This has been questioned by the Claimant.

424. In support of their respective positions on this matter, the Parties have referred to expert opinions. In one expert opinion, dated 20 March 1996, Martina Luňáková, of the Institute of Criminology of the Police of the Czech Republic, reported that the Institute had received 20 pieces of customs documents containing imprints of the stamps of the Customs Office Olomouc 1366.21 and 1373.12 and that a detailed examination of all these imprints of the stamps had revealed that the TCPs in all cases bear the imprints of forged stamps. A similar conclusion was reached in a subsequent expert opinion, dated 22 July 1998, by Miroslav Bflek, of the Section of Criminal Technology and Expertise of the Police at Brno. The accuracy of the findings in these expert opinions has been questioned in a Casework Examination Report of 14 May 2008, issued by Anthony Stockton, Forensic Science Service, Wetherby West Yorkshire, England.

425. The Arbitral Tribunal has no basis for making an assessment of its own as to whether the stamps on the TCP slips were genuine or forged. The Tribunal notes, however, that, in addition to the conclusions reached in the experts reports, the two customs officers who would have been the proper owners of the stamps apparently denied that they had used their stamps in this manner. It must therefore be concluded that there is doubt as to their authenticity.

*(c) Involvement of customs officers*

426. The Claimant maintains that customs officers must have been involved in the fraud, since it would be most unlikely that the customs authorities would otherwise have been unaware of large quantities of oil products, admitted under a transit regime, having disappeared without customs clearance at an inland customs office over a considerable period of time.

427. The Arbitral Tribunal notes that the fraud in the Diesel case has been subject to extensive investigations in the Czech Republic and that several persons have been prosecuted and some of them sentenced to terms of imprisonment. However, the investigation has apparently not provided sufficient evidence of the involvement of any public official. In the judgment of 29 July 2008 in the criminal case against \_\_\_\_\_ the Regional Court of Brno stated as follows:

“The interrogations did not prove involvement of any customs officer in the criminal activity. Even though there is a suspicion that more persons were involved in the criminal activity, perhaps even including any of the customs officers, this fact has no effect on the criminal liability of the defendant  
..”

428. The Arbitral Tribunal is not a criminal court and has neither competence nor any practical means to supplement the criminal investigations conducted in the Czech Republic. The Tribunal notes that no customs officer has been prosecuted and convicted for any offence in connection with the Diesel case and can only conclude that, in these circumstances, it has not been proven that any customs officer was involved in the criminal activities.

*5. Time bar*

429. The Claimant argues that in any case the claims against CARGO were time-barred and should not have been admitted by the Czech courts. The Respondent contests that there was any time bar.

430. It is common ground between the Parties that, at the relevant time, the Customs Act did not contain any provision on a time-limit for claims against guarantors such as CARGO. However, the Claimant argues that it would be inconceivable that no time-limit should be applied and therefore considers it necessary to apply by analogy a time-limit applicable in similar circumstances.

431. The Arbitral Tribunal notes that the existence or not of a time bar for guarantee claims is a matter of Czech law. The issue could have been raised, but was apparently not raised, by CARGO in the court proceedings regarding the guarantee claims against CARGO. The Tribunal cannot determine how Czech law was to be understood at the relevant time and concludes that the Claimant has not shown that the payments orders issued against CARGO violated any domestic legal rule or principle based on a statute of limitations.

## 6. Legal protection

432. The Arbitral Tribunal notes that the Břeclav-dálnice Customs Office rendered a large number of decisions imposing payment obligations on CARGO on the basis of surety bonds issued by CARGO and that CARGO appealed against many of these decisions. In various cases, the proceedings against CARGO had been preceded by proceedings against the drivers who, as declarants, were the primary debtors but who were mostly unable to pay the claimed amounts. As examples, the parties have referred to the following cases:

### (a) *The MORGAN case* (referred to by the Claimant)

On 18 July 1994, a request was presented to the Břeclav-dálnice Customs Office by the company MORGAN spol. s.r.o. for the release of transported goods into the transit regime. This was granted by the Customs Office on condition that the goods should, within a certain time-limit, be presented to the Zlín Customs Office. After it had appeared that no presentation of the goods at Zlín Customs Office had taken place, the Břeclav-dálnice Customs Office, on 28 March 1997, issued a decision ordering MORGAN to cover the customs debt (excise tax and VAT) of CZK 317,826. On 9 June 1997, the Břeclav-dálnice Regional Customs Office quashed the decision because of formal shortcomings and referred the matter back to the Břeclav-dálnice Customs Office for new consideration and decision. In its decision of 7 January 2000, the Břeclav-dálnice Customs Office ordered CARGO to pay the customs debt in the amount of CZK 316,943. The order was confirmed by the Brno Customs Directorate on 19 February 2001. On 14 November 2001, the Regional Court of Brno, upon CARGO's appeal, set aside the decision and referred the case back to the Customs Directorate for further proceedings, the reason being that the Act on the Administration of Taxes which had been applied was not applicable since the proceedings had started before 1 July 1997. It is unclear whether a new administrative decision was taken by the Customs Office or the Customs Directorate.

### (b) *The case* (referred to by the Respondent)

On 4 November 1994, a shipment of diesel oil from Slovakia was presented to the Břeclav-dálnice Customs Office. The declarant was the driver. The shipment was released on the same day into the transit regime under cover of a guarantee by CARGO.

On 1 November 1995, the Břeclav-dálnice Customs Office, with reference to Section 240(3)(d) of the Customs Act, issued a payment order of CZK 342,467 against Jaroslav Šošolik. Payment was to be made within 10 days of delivery of the decision. As no payment was made, the Customs Office, on 7 December 1995, with reference to Section 306(1) of the Customs Act, ordered to pay the outstanding amount within a further term of 20 days from the day of delivery of the decision.

Since payment was not made, the Customs Office, on 28 March 1997, with reference to Section 260 of the Customs Act, issued a payment order in the amount of CZK 341,721 against CARGO as guarantor according to its surety bond. On 9 June 1997, the decision of the Customs Office was quashed by the Břeclav Regional Customs Office which referred the case back to the Břeclav-dálnice Customs Office.

On 7 March 2000, the Břeclav-dálnice Customs Office issued a new payment order against CARGO in the same amount of CZK 341,721, again with reference to Section 260 of the Customs Act. On 27 August 2001, the Brno Customs Directorate quashed the decision of 7 March 2000 and referred the case back for a new hearing and decision, the reason being that the procedural rules that had been applied were not applicable to proceedings which had started before 1 July 1997.

On 4 April 2002, the Břeclav-dálnice Customs Office, again referring to Section 260 of the Customs Act, issued a new payment order in the amount of CZK 341,721 against CARGO. The decision of the Customs Office was again appealed to the Brno Customs Directorate which upheld the decision on 8 August 2002. CARGO's appeal against the decision of the Customs Directorate was rejected by the Regional Court of Brno on 30 April 2004. At that time Cargo had been declared bankrupt and was represented in the proceedings by the administrator of the bankruptcy estate. A cassation appeal was lodged but was rejected by the Supreme Administrative Court on 28 June 2006.

433. The Arbitral Tribunal has been informed that the hundreds of cases regarding CARGO's guarantees may be divided into various categories. There were some decisions which were not appealed by CARGO. Another group consisted of decisions that were set aside for procedural reasons either by a higher administrative body or by a court and then referred back to the customs office for a new decision. A new decision would then normally be taken, and many of these new decisions were also appealed but confirmed by a court. It could also happen that no new decision was taken because CARGO was already in a state of bankruptcy and it would be considered not to make sense to pursue the matter.

434. The Arbitral Tribunal has not been provided with a complete picture of all cases regarding CARGO's payment obligations but notes, on the basis of the available documentation and information, that CARGO had administrative and judicial remedies at its disposal and managed to have a number of decisions set aside for formal reasons. The Tribunal also finds that the judgments in the two cases referred to above (see para. 432) the Czech courts gave extensive reasons for their conclusions on the various arguments invoked by CARGO in its appeals. It has not been alleged that the judgments in other cases were substantially different in content or form.

435. It further appears that in a number of cases CARGO was able to appeal not only to a Regional Court but also against that court's judgment to the Supreme Administrative Court. In some cases, CARGO lodged a constitutional complaint with the Constitutional Court.

## *7. Evaluation under the Czech-German BIT*

436. The Claimant alleges in general that the Respondent's breach of international law consists of "the prosecution of illegal claims", which ultimately "destroyed the Claimant's investment in the Czech Republic". He specifies only to a limited extent how, in his opinion, the Respondent's acts relate to the specific provisions in the BIT which he claims to have been breached. However, on the basis of the indications given by the Claimant, the Arbitral Tribunal will proceed to an examination of whether the events of which he complains could constitute violations of the provisions in the BIT on which he relies.

### *(a) Fair and equitable treatment*

437. The term "fair and equitable treatment" appears frequently in BITs. It cannot be easily defined, but it is generally considered to require at least respect for the international minimum standard of protection which, according to international customary law, any State is obliged to afford to foreign property in its territory.

438. As far as the precise relation between "fair and equitable treatment" and the minimum standard of international law is concerned, there are two main approaches in international case-law regarding investments, especially in awards rendered under the rules of the International Centre for Settlement of Investment Disputes (ICSID):

439. In some awards, "fair and equitable treatment" has been equated with the minimum standard of treatment provided for by general international law. By way of example, the Arbitral Tribunal refers to the following statement by the tribunal in the case of *CMS v. Argentina*:

"In fact, the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international law minimum standard and its evolution under customary law."<sup>2</sup>

440. There were other tribunals which regarded "fair and equitable treatment" as an autonomous standard, more demanding and more protective of the investors' rights than the minimum standard of treatment provided for by general international law. The tribunal in the case of *Azurix v. Argentina* adopted this position:

"The clause, as drafted, permits to interpret fair and equitable treatment and full protection and security as higher standards than required by international law. The purpose of the third sentence is to set a floor, not a ceiling in order to avoid a possible interpretation of these standards below what is required by international law."<sup>3</sup>

441. The Claimant considers that the term "fair and equitable treatment" in the BIT should be interpreted broadly enough to encourage investors to participate in the economy of the host state. He argues that it falls within the legitimate expectations of an investor that a customs administration should exercise reasonably efficient control of movement of goods over national boundaries in order to ensure that investors are not exposed to unnecessary business risks. The Respondent, for its part, argues that the term should be understood to incorporate the customary international law minimum standard of treatment, and not to constitute a new standard binding upon the parties to the BIT.

442. The Arbitral Tribunal notes that the term "fair and equitable treatment" appears in the BIT as a second additional sentence in Article 2(1) whose first sentence provides that each Contracting Party shall in its territory promote as far as possible investments of investors of the other Contracting Party and admit such investments in accordance with its legislation. The Tribunal considers that the two sentences should be read together which means that "fair and equitable treatment" is to be given a sufficiently wide interpretation to be consistent with the promotion of investments which is set out as a primary aim in Article 2(1).

443. In the Arbitral Tribunal's opinion, a treatment, in order to be fair, equitable and consistent with the general aim of Article 2(1) and of the BIT in general, should respect the legitimate expectations of the investor. What the investor may legitimately expect must be evaluated in the light of all circumstances in each given case. The expectations may relate not

<sup>2</sup> *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/8), Award, 12 May 2005, para. 284.

<sup>3</sup> *Azurix Corp. v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award, 14 July 2006, para. 361.

only to the existing contractual or other relations between the investor and the host state, but may also concern the general legal framework in the host state.

444. Thus, when the host state, through its written or oral representations, undertakings or other acts, has created the reasonable expectation on the part of the investor that it will conduct itself in a certain way, the investor legitimately expects that the host state will indeed act consistently with the assurances it has given to the investor. In the words of the tribunal in the case of *International Thunderbird Gaming Corporation v. Mexico*:

“the concept of ‘legitimate expectations’ relates, within the context of the NAFTA framework, to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.”<sup>4</sup>

445. The state’s failure to observe the legitimate expectations of the investor that it has itself induced will amount to a breach of the fair and equitable treatment standard.<sup>5</sup>

446. The standard of fair and equitable treatment also requires that the host state maintain a legal order that is stable and predictable, so as to afford the investor the opportunity to plan and operate its investments in accordance with the state’s legal and business framework.<sup>6</sup> The elements of stability and predictability of the state’s legal order go hand in hand with the need that the state act with reasonable consistency and transparency, as part of an overall aim of enhancing legal certainty.<sup>7</sup> Indeed, having in mind that the purpose of the BIT is to promote and protect foreign investment, these facets of the fair and equitable treatment standard are essential to the maintenance of an environment in which foreign investment is fostered.

447. The standard of fair and equitable treatment also ensures that a state acts in good faith in its dealings with the investor or its investment<sup>8</sup> and that it does not coerce, threaten or harass the investor or its investment.<sup>9</sup> Similarly, if the state conducts itself in an arbitrary or discriminatory way, it will have violated the fair and equitable treatment standard.<sup>10</sup>

448. An important part of fair and equitable treatment is the investor’s access to independent and impartial courts in order to vindicate his rights and protect his investment. If the courts are unable to give effect to the law in an impartial and fair manner, the investor may find himself in a situation of denial of justice which is clearly incompatible with the notion of fair

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<sup>4</sup> *International Thunderbird Gaming Corporation v. United Mexican States*, Award, 26 January 2006, para. 147.

<sup>5</sup> See, for example, *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3), Award, 30 April 2004, para. 98.

<sup>6</sup> See *CMS Gas Transmission Company v. The Argentine Republic* (ICSID Case No. ARB/01/08), Award, 12 May 2005, para. 274; *Occidental Exploration & Production Co. v. The Republic of Ecuador* (LCIA Case No. UN 3467), Award, 1 July 2004, para. 190..

<sup>7</sup> See *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award, 29 May 2003, para. 154; *EnCana Corporation v. Ecuador* (LCIA Case No. UN3481), Award, 3 February 2006, para. 158.

<sup>8</sup> See *Saluka Investments BV v. The Czech Republic*, Partial Award, 17 March 2006, para. 307.

<sup>9</sup> See *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB (AF)/00/2), Award, 29 May 2003, para. 163; *Pope & Talbot, Inc. v. Government of Canada*, Award on the Merits of Phase 2, 10 April 2001, para. 181.

<sup>10</sup> See, for example, *Saluka Investments BV v. The Czech Republic*, Partial Award, 17 March 2006, para. 309.

and equitable treatment. The fair and equitable treatment standard thus protects the investor from manifest maladministration of justice, which may take the form of, *inter alia*, lack of due process, lack of a fair trial, undue delay and obstruction of access to justice, as well as grossly unjust judgments.<sup>11</sup> Accordingly, while a denial of justice normally relates to egregious procedural impropriety, it will also be triggered when the decision of a court or an administrative organ is, as the tribunal in the *Mondev v. USA* case noted, so "clearly discreditable and improper"<sup>12</sup> that it cannot but imply manifest deficiency in the judicial or administrative process.

449. A denial of justice will occur when, in light of the international standards of proper administration of justice, there is a failure of the state's administrative or judicial system in the treatment of the investor and its investment. In the assessment of whether denial of justice has taken place, it is the judicial or administrative system as a whole that is being put to the test.

450. The Arbitral Tribunal is not of the view that for the whole judicial or administrative system to have been tested the investor must have attempted to pursue all available judicial or administrative avenues in the state in order to avail himself of his rights. As in the case of other aspects of the investment protection afforded under the BIT (for example, the obligation not to expropriate without compensation or other aspects of the fair and equitable treatment standard), exhaustion of local remedies is not required for denial of justice to be found. Indeed, as the tribunal in the case of *Mondev v. USA* held, "it is not true that the denial of justice rule and the exhaustion of local remedies rule 'are interlocking and inseparable'".<sup>13</sup>

451. What is required, however, is evidence of failure of the judicial or administrative system as a whole. For example, an isolated instance where a judicial or administrative organ has committed a gross error and an adequate and effective remedy to redress such error existed will not meet the test. Conversely, when a set of decisions or procedures in relation to the same investor (or class of investors) or in relation to the same issue reveals a state of a manifestly defective judicial or administrative process, irrespective of whether all local avenues for redress have been pursued, the test will be met. This is the standard that the Arbitral Tribunal will apply in the present case.

452. The Claimant considers that CARGO did not benefit from fair and equitable treatment, since the guarantees issued by CARGO were enforced without a legal basis, and that the legal remedies at CARGO's disposal were inadequate. He points out that until 1 January 2003 the Czech Republic lacked a Supreme Administrative Court which, in his opinion, meant that there was insufficient judicial protection in administrative matters, including those relating to customs duties and taxes.

453. In the present case, the claims against CARGO were based on the surety bonds issued by CARGO in large numbers and covering high total amounts. The guarantee undertakings made by CARGO were general in character. They were wide and unconditional and only provided for a very limited exception from liability. Their aim was to eliminate for the Czech treasury

<sup>11</sup> See, for example, *Robert Azirian, Kenneth Davitian, & Ellen Baca v. Mexico* (ICSID Case No. ARB (AF)/97/2). Award, 1 November 1999, paras. 102-103.

<sup>12</sup> *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award, 11 October 2002, para. 127.

<sup>13</sup> See *Mondev International, Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award, 11 October 2002, para. 96 (footnotes omitted).

all economic risks connected with the transit regime. In particular, they did not make CARGO's liability dependent on whether any negligence could be attributed to CARGO. Consequently, CARGO could not have a legitimate expectation to escape liability by showing that failure to present goods for customs clearance was not due to CARGO's fault. Even if the absence of customs clearance had been concealed through the use of forged documents, this would not be sufficient to relieve CARGO of its liability as guarantor. The guarantee – with the minor exception set out in the surety bond – covered all situations where a debt to the treasury had not been paid.

454. As the Arbitral Tribunal has found above (see paras. 408-411), the argument that the guarantees only covered customs duties – which could not be imposed on imports from Slovakia – and not claims for excise taxes and VAT does not appear convincing for several reasons. First, it would make the guarantees meaningless, since they would not cover any debt at all. Secondly, the amount specified in each surety bond seems to have been related to the applicable amount of taxes. It also does not appear that this argument was ever raised by CARGO in the domestic court proceedings or that the Czech courts had any doubts about the taxes on imports from Slovakia being subject to taxation.

455. In any case, the Claimant must be considered to have the burden of proof for demonstrating that there was no tax liability, and the Arbitral Tribunal cannot find that he had shown that Czech law should be interpreted in such manner.

456. As regards the facts of the case, it is clear that large quantities of oil products were withdrawn from customs clearance at an inland customs office, and it is unlikely that there was any justification for presenting the goods and delivering the relevant customs documents at CWA's premises to CWA staff members and not to a customs officer. Instead, this seems to have been part of the a large-scale fraudulent scheme which subsequently resulted in prosecutions and criminal convictions.

457. The risk of the occurrence of such events must be considered, at least in principle, to have been covered by CARGO's guarantees. When examining whether the enforcement of claims based on these guarantees could nevertheless be a breach of the Claimant's right to fair and equitable treatment, the Arbitral Tribunal would find it relevant whether the Czech Republic, through its customs officers, was itself involved in the fraud. If there was such involvement by public officials, the state may be considered to have violated its obligation to provide the investor with fair and equitable treatment, at least unless the state, when becoming aware of the misbehaviour of its officials, took forceful action against the guilty persons by bringing them to justice or otherwise. However, as stated above (see para. 428), the Tribunal has found no evidence that there was in fact any such involvement of customs officials in the criminal activities.

458. While the Arbitral Tribunal agrees that it is difficult to understand how the tax fraud in respect of large quantities of imported oil products could remain undetected for a relatively long time, the evidence in this arbitration does not show that this was due to the "dysfunctionality" or negligence of the customs administration, as also alleged by the Claimant. The Tribunal is therefore not called upon to determine whether any such deficiencies could be sufficient to relieve CARGO of liability under the surety bonds.

459. The Claimant's argument that the claims against CARGO were time-barred is based on an interpretation of Czech law according to which a three year time-limit in the Act on the

Tax System or the Act on the Administration of Taxes and Fees should be applicable by analogy to the present case. However, he has not invoked any Czech case-law in support of this interpretation which has been contested by the Respondent.

460. The Arbitral Tribunal considers it impossible to derive from the term "fair and equitable treatment" a requirement regarding the applicable statute of limitations. Consequently, this argument can be left out of account when considering whether the obligation in Article 2(1) last sentence of the BIT has been breached.

461. As regards judicial protection, the Arbitral Tribunal notes that CARGO, after an administrative procedure before the Customs Office and the Customs Directorate, was entitled to appeal to the Regional Court of Brno which CARGO apparently did on various occasions. The few judgments made available to the Arbitral Tribunal show that the Regional Court proceeded to an examination of CARGO's arguments and delivered extensively reasoned judgments. There were also cases where CARGO obtained a further examination by the Supreme Administrative Court and the Constitutional Court.

462. The argument that CARGO should have been invited, or given the opportunity, to participate in the proceedings regarding claims against the drivers as primary debtors would be convincing only if the decisions or judgments resulting from these proceedings were binding on CARGO or precluded CARGO from presenting arguments or adducing evidence in its defence in the subsequent proceedings regarding its own guarantee claims. However, it does not appear that the decisions and judgments regarding the liability of the drivers had any such prejudicial effects for CARGO.

463. The Claimant attaches weight to the fact that the Supreme Administrative Court was only set up on 1 January 2003 and argues that during the preceding years CARGO did not benefit from the legal protection provided by that court. While the setting up of the Supreme Administrative Court may well have significantly strengthened the judicial protection in administrative matters, the Arbitral Tribunal cannot find it established that CARGO, through the absence of such a court before 2003, was denied justice in respect of its appeals against the payment orders of the customs authorities.

464. The Claimant also claims that assets in excess of CZK 45 million were seized by the Czech authorities during the period 1999-2001 pending the ongoing administrative and judicial proceedings and complains that the seized assets were not returned to him after the payment orders had been quashed. The Respondent has replied that the total amount seized was some CZK 43.7 million and that CZK 18.6 million were returned to CARGO, which the Claimant contests. In any case, the Respondent considers that the maintenance of the seizure was legal because the proceedings continued and the courts had not dismissed the state's claims on the merits.

465. The Arbitral Tribunal considers that the upholding of the seizure of assets pending a decision on the merits could not in itself constitute a breach of the BIT. A problem could arise, however, if there were unacceptable delays in the further proceedings. As regards the hundreds of proceedings regarding the guarantee claims against CARGO, the scarce information provided by the Claimant does not allow the Tribunal to conclude that there were unreasonable delays in these proceedings.

466. The Arbitral Tribunal observes that there may have been cases where, after a payment order issued by a customs office was quashed on formal grounds and the case was referred back to the customs office for a new decision, no new decision was in fact taken by the customs office but the seizure of assets as security for the debt was nevertheless maintained. Such a situation might give rise to a question of unfair treatment. It is not clear, for instance, whether the MORGAN case, referred to in para. 432 above, may have been such a case. However, the Claimant has not informed the Tribunal whether, after the judgment of 14 November 2001 had been quashed, a new decision was taken by the customs authority, and whether, if there was no such decision, the seizure of assets in respect of that particular shipment was maintained. Consequently, there is an insufficient basis for concluding that a seizure of assets was maintained despite the fact that the proceedings were terminated without a decision on the merits. Nor has the Tribunal been informed of other cases where this situation arose.

467. The Arbitral Tribunal has not found any other element which would show that CARGO was faced with a situation of denial of justice or was not granted fair and equitable treatment by the Czech authorities or courts.

*(b) Arbitrary or discriminatory measures*

468. The Claimant alleges that he was exposed to arbitrary or discriminatory measures contrary to Articles 2(2), 3(1) and 3(2) of the BIT. He has referred to the failure of the prosecution authorities to investigate the circumstances of the tax fraud, which he considers arbitrary, and argued that the failure to pursue claims against the primarily responsible persons, while instead concentrating on claims against CARGO as guarantor, was discriminatory. He has also alleged that CARGO was exposed to harassment at the border which had negative consequences for its business.

469. The Arbitral Tribunal cannot find it established that the criminal investigation conducted by the prosecution authorities was deficient or incomplete. The Tribunal also points out that CARGO had made very extensive guarantee undertakings and finds that it was within the discretion of the customs authorities whether or not to rely on these guarantees once it appeared that taxes had not been paid on the imports of oil products. Consequently, no arbitrary or discriminatory behaviour can be found in this respect.

470. The Arbitral Tribunal further notes that CARGO was apparently the only haulier who at the relevant time guaranteed the fuel imports which became the subject of fraud. Consequently, since there was no one else in the same position as CARGO, there is no evidence of discriminatory treatment when pursuing the guarantee claims against CARGO.

471. The Claimant also alleges, in a general manner and without giving any details about specific events, that the drivers who had used CARGO as customs agent were exposed to discriminatory treatment at the Břeclav-dálnice customs office. They were allegedly harassed and had to wait for a long time before they were allowed to proceed, which had affected CARGO's business in a negative way. This is contested by the Czech Republic, and there is no evidence showing any occurrences at the border of such gravity as to be regarded as discriminatory treatment of CARGO.

472. Consequently, the Arbitral Tribunal cannot find it established that the Claimant, or his company, suffered arbitrary or discriminatory treatment contrary to the BIT.

(c) *Full protection and security*

473. The Claimant also alleges a breach of the obligation to accord full protection and security to investments according to Articles 2(3) and 4(1) of the BIT.

474. The Arbitral Tribunal notes the two related provisions in the BIT, *i.e.* Article 2(3), which provides that investments and revenue arising therefrom shall enjoy full protection under the BIT, and Article 4(1), which provides that investments by investors of either Contracting Party shall enjoy full protection and security in the territory of the other Contracting Party. It is not entirely clear what the Contracting Parties had in mind when including both these provisions in the BIT, one referring to "full protection" and the other to "full protection and security".

475. The Arbitral Tribunal notes, however, that clauses about "full protection and security" are frequently to be found in BITs and have been the subject of interpretation in several cases.

476. In the case of *Saluka v. The Czech Republic*, the tribunal found that "[t]he 'full protection and security' standard applies essentially when the foreign investment has been affected by civil strife and physical violence" and that the 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".<sup>14</sup> In the case of *Azurix v. Argentina*, the tribunal held in regard to a similar clause that "it is not only a matter of physical security; the stability afforded by a secure environment is as important from an investor's point of view".<sup>15</sup>

477. The Arbitral Tribunal notes that in the present case there is no question of a violation of the physical integrity of the Claimant's investment. In so far as the "full protection and security" clause should be considered to provide further protection, it is difficult to see how such protection would go beyond that of the clause on "fair and equitable treatment" as dealt with above (see paras. 437-467).

478. The Arbitral Tribunal therefore concludes that there has been no infringement of the Claimant's right to "full protection" or to "full protection and security" of his investment.

(d) *Deprivation of property*

479. Article 4(2) of the BIT imposes on a Contracting Party the obligation not to deprive investors of the other Contracting Party of their investments. In other words, it protects against expropriation without full compensation and against other measures equivalent to expropriation or having the same effect as expropriation.

480. The Claimant alleges that the failure to investigate the role of the customs authorities in the tax fraud together with the pursuance of guarantee claims against CARGO are acts having the effect of expropriation. The Arbitral Tribunal cannot find that such omissions or acts could be assimilated to a deprivation of property under Article 4(2) of the BIT. It is true that CARGO went bankrupt as a result of its indebtedness and that a considerable part of its debts

<sup>14</sup> *Saluka Investments BV v. The Czech Republic*, Partial Award, 17 March 2006, paras. 483-484.

<sup>15</sup> *Azurix Corp. v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award, 14 July 2006, para. 408.

were based on the surety bonds. However, bankruptcy is not tantamount to expropriation, and there is no indication that the bankruptcy in this case was unlawful or irregular or that it pursued an expropriatory purpose.

481. Nor can the Arbitral Tribunal identify any other act by the Czech Republic which could be assimilated to expropriation of the Claimant's investment. The Tribunal therefore concludes that there has been no breach of the BIT in this regard.

*(e) Obligations under international law*

482. The Claimant also alleges a breach of Article 7(1) of the BIT which provides that the investor shall be entitled to more favourable treatment than is provided for in the BIT if such treatment is provided for in the law of the investment state or follows from that state's obligations under international law. The Claimant points out that this is a broad provision requiring that, in addition to all obligations under treaties or otherwise, general principles of international law which provide a certain minimum protection to international investments shall apply.

483. The Arbitral Tribunal agrees that Article 7(1) is a broad provision which entitles an investor to benefit not only from more favourable provisions in domestic law and in treaties between the Contracting Parties but also from more favourable treatment resulting from general international law.

484. The Arbitral Tribunal has examined the Claimant's allegation that he was not granted a "fair and equitable treatment" in regard to his investment and found this allegation not be justified (see paras. 453-467). While the standard of "fair and equitable treatment" might be broader than the minimum standard of protection of foreign investments in general international law, the Tribunal considers that the opposite is not true. In other words, once it has been concluded that there has been no breach of the requirement of "fair and equitable treatment", it follows that the minimum standard of protection in general international law has not been breached either.

485. The Arbitral Tribunal thus finds that the Czech Republic has not violated its obligations under Article 7(1) of the BIT.

*8. Conclusion*

486. The Arbitral Tribunal has not found it established that the Czech Republic breached its obligations under the BIT in respect of the Claimant's investment and must therefore reject the Claimant's claims.

*9. Costs*

487. Article 10(2), read in conjunction with Article 9(5), of the BIT provides, *inter alia*, that each Contracting Party shall bear the cost of its representatives in the arbitration proceedings. It is added that the arbitral tribunal may decide on a different allocation of costs. Both Parties in this arbitration have requested to be compensated for their costs.

488. When considering the costs for the Parties' representation, the Arbitral Tribunal notes that the present arbitration has given rise to a number of important and complex legal issues

regarding the Tribunal's jurisdiction as well as the merits of the Claimant's claims. While the Claimant was successful in arguing that the Arbitral Tribunal had jurisdiction to examine his claims on the merits, the Czech Republic was successful in holding that there was no breach of the BIT. The Tribunal further notes that, in the course of the proceedings, a considerable number of procedural requests were addressed to the Tribunal by both Parties, and that each Party was to a varying degree successful or unsuccessful in regard to these requests.

489. Having examined the proceedings as a whole, the Arbitral Tribunal finds it appropriate to order that each Party shall bear its own costs and expenses in the arbitration.

490. As regards the arbitrators' costs, the Arbitral Tribunal notes that, in a Decision of 9 February 2010, the Tribunal decided that the arbitrators should receive fees for the work they had carried out until that time. The Tribunal added that the Decision was without prejudice to the final determination of how the arbitration costs were to be finally borne by the Parties.

491. In a further Decision of 15 November 2010, the Arbitral Tribunal decided that two of the Arbitrators – Professor Creutzig and Professor Gaillard – should receive additional amounts as VAT on the fees awarded to them in the Decision of 9 February 2010.

492. In the present Award, a decision is taken on the arbitrators' fees and expenses relating to the time period after 9 February 2010.

493. Article 10(2), read in conjunction with Article 9(5), of the BIT provides that each Contracting Party shall bear the cost of "its own member" in the arbitral tribunal and that the cost of the chairman and the remaining costs shall be borne in equal parts by the Contracting Parties. In this respect as well, it is provided that the tribunal may decide on another allocation.

494. The Arbitral Tribunal notes that both Parties have, in equal parts, paid advances on the costs of the Tribunal to a bank account administered by the Arbitration Institute of the Stockholm Chamber of Commerce. The amounts awarded to the arbitrators in the Decisions of 9 February and 15 November 2010 have been paid from that account, and the Tribunal finds it appropriate that the same should apply to the fees and expenses awarded to the arbitrators in the present Award.

495. For the same reasons as those indicated in regard to the decision that each Party should bear its own costs in the proceedings, the Arbitral Tribunal also considers that the Parties shall, in equal parts, bear the costs for the arbitrators' fees and expenses.

## **THE AWARD**

The Arbitral Tribunal

(a) dismisses the Claimant's claims regarding breaches of the Treaty of 2 October 1990 between the Federal Republic of Germany and the Czech and Slovak Federative Republic regarding the Promotion and Mutual Protection of Investments, and

(b) decides that each Party shall bear its own costs for the proceedings and half of the arbitrators' fees and expenses.

The arbitrators shall be entitled to the following fees and be compensated for the following expenses:

Hans Danelius: a fee of ninety-one thousand four hundred and forty-five euro (EUR 91,445) and expenses of two thousand one hundred and ninety-eight euro (EUR 2,198),

Jürgen Creutzig: a fee of sixty thousand nine hundred and sixty-five euro (EUR 60,965), VAT of five thousand seven hundred and ninety-one thousand euro and sixty-seven cents (EUR 5,791.67) and expenses of one thousand seven hundred and sixty-one euro (EUR 1,761), and

Emmanuel Gaillard: a fee of sixty thousand nine hundred and sixty-five euro (EUR 60,965), VAT of five thousand nine hundred and seventy-four euro and fifty-seven cents (EUR 5,974.57) and expenses of five thousand five hundred and eleven euro (EUR 5,511)

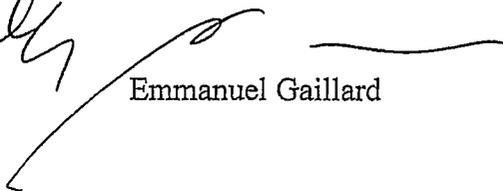
These amounts shall be drawn from the funds provided by the Parties in equal parts to an account (IBAN No. SE2712000000013423606959) at Danske Bank, Stockholm, administered by the Arbitration Institute of the Stockholm Chamber of Commerce.



Hans Danelius



Jürgen Creutzig



Emmanuel Gaillard