

INTERNATIONAL CENTRE FOR  
SETTLEMENT OF INVESTMENT DISPUTES  
(ICSID)

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In the Matter of the Arbitration between  
  
ALEX GENIN, EASTERN CREDIT LIMITED, INC.  
AND A.S. BALTOIL

and

THE REPUBLIC OF ESTONIA

Case No. ARB/99/2

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AWARD

*Date of dispatch to the Parties: June 25, 2001*

*President:* Mr. L. Yves FORTIER, C.C., Q.C.

*Members of the Tribunal:* Professor Meir HETH  
Professor Albert Jan VAN DEN BERG

*Secretary of the Tribunal:* Mr. Alejandro A. Escobar

In Case No. ARB/99/2

*BETWEEN:* Alex Genin,  
Eastern Credit Limited, Inc. and  
A.S. Baltoil

Represented by:

Mr. Kurt Arbuckle

of the law firm *Kurt Arbuckle, P.C.*, as counsel

CLAIMANTS

*And*

The Republic of Estonia

Represented by:

Mr. Martin D. Beirne, Mr. Michael J. Stanley  
and Mr. Christopher Bell

of the law firm *Beirne, Maynard & Parsons, LLP*

and

Mr. Allen B. Green

of the law firm *Howrey & Simon*, as counsel

RESPONDENT

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## THE TRIBUNAL

Composed as above,

After deliberation,

*Makes the following Award:*

### A. INSTITUTION OF PROCEEDINGS

1. By letter dated 11 March 1999, the International Centre for Settlement of Investment Disputes (the “Centre” or “ICSID”) acknowledged receipt of a Request for Arbitration dated 2 February 1999 (the “Request”) from Mr. Alex Genin, a national of the United States of America; Eastern Credit Limited, Inc., a corporation incorporated under the laws of the State of Texas; and A.S. Baltoil, an Estonian company wholly-owned by Eastern Credit (collectively, the “Claimants”).

2. The Request stated that Claimants wished to institute arbitration proceedings against the Republic of Estonia (the “Respondent” or “Estonia”), under the terms of a Bilateral Investment Treaty<sup>1</sup> entered into by the U.S. and Estonia on 19 April 1994 and in effect as of 16 February 1997 (the “BIT”).

3. In their Request, the Claimants declared that an investment dispute had arisen as a result of Respondent’s conduct, comprising violations of numerous provisions of the BIT, in relation to Claimants’ investment in Estonian Innovation Bank, a financial institution incorporated under the laws of Estonia.

4. In the Centre’s letter of 11 March 1999 acknowledging receipt of Claimants’ Request (copy of which was sent to Respondent, enclosing the Request) ICSID requested from Claimants additional information concerning the nature of the dispute alleged by them as well as regarding the

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<sup>1</sup> Treaty Between the Government of the Republic of Estonia and the Government of the United States of America for the Encouragement and Reciprocal Protection of Investment, done at Washington, D.C. on 19 April 1994. (See Part B of this Award for a description of the BIT and its relevant provisions.)

ownership of Estonian Innovation Bank at the time of the dispute. This information was provided to the Centre by Claimants, in letters dated 6 and 14 April 1999.

5. By letter dated 6 May 1999, the Centre requested confirmation from Claimants that the dispute covered by the Request related exclusively to investments owned or controlled by Claimants. Confirmation was provided by Claimants on the same date.

6. On 12 May 1999, the Secretary-General of ICSID transmitted to the parties a Notice of Registration, pursuant to Article 36(3) of the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (the “Convention”) and Rules 6(1)(a) and 7(a) of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings, stating that the Request had been registered in the Centre’s Arbitration Register on 12 May 1999.

7. The Arbitral Tribunal (the “Tribunal”) was duly constituted on 21 September 1999. The Tribunal consists of Mr. L. Yves Fortier, C.C., Q.C. (nominated jointly by the two party-appointed arbitrators) as President, Professor Meir Heth (nominated by Claimants) and Professor Albert Jan van den Berg (nominated by Respondent).

8. In the absence of any agreed request by the parties to vary the rules of procedure laid down in the Convention and the ICSID Rules of Procedure for Arbitration Proceedings, in effect from 26 September 1984 (the “Arbitration Rules”), the Tribunal has followed the direction provided in Article 44 of the Convention, to the effect that the proceedings shall be conducted in accordance with Section 3 of Chapter IV of the Convention and the Arbitration Rules.

## B. THE B.I.T.

### 1) General Description

9. The BIT is a bilateral investment treaty between the U.S. and the Republic of Estonia. It entered into effect on 16 February 1997.

10. The objectives of the BIT, as delineated in its preamble, include economic co-operation, increased flow of capital, a stable framework for investment, development of economic and business ties, respect for internationally-recognised worker rights, and maximum efficiency in the use of economic resources.

## 2) Relevant Provisions of the BIT Invoked by the Parties

11. The following constitutes a brief summary of the provisions of the BIT invoked by the parties in this arbitration.

12. **Article I** sets out the definitions used in the BIT, including “investment”, “national” and “state enterprise”.

13. **Article II** deals with the Parties’ obligations with respect to the treatment of investments.

- **Article II, Paragraph 2 (b)** requires the Parties to ensure that the conduct of governmental authority by a State enterprise is done in a manner that is not inconsistent with the Party’s obligations under the Treaty.
- **Article II, Paragraph 3 (a)** provides for the “fair and equitable” treatment of investments and states that no investment shall be accorded treatment less favourable than that required by international law.
- **Article II, Paragraph 3 (b)** prohibits the Parties from impairing by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of investments.
- **Article II, Paragraph 3 (c)** provides for the respect of obligations entered into with regard to investments.
- **Article II, Paragraph 7** declares that each Party must provide effective means of asserting rights and claims with respect to investments, investment agreements and investment authorisations.
- **Article II, Paragraph 8** requires that all laws, regulations, administrative practices and procedures, as well as adjudicative decisions that pertain to or affect investments, be duly published.

- **Article II, Paragraph 11** prohibits interference with the granting of rights under licenses and requires that nationals and companies of either Party receive the better of national or most favoured nation treatment with respect to certain activities associated with their investment.
14. **Article III** incorporates into the BIT the international law rules and standards relating to expropriation and compensation.
- **Article III, Paragraph 1** requires that an expropriation be done for a public purpose; in a non-discriminatory manner; with payment of prompt, adequate and effective compensation; and that it meet the requirements of due process and the general principles of “fair and equitable” treatment provided for in Article II, Paragraph 3 of the BIT.
  - **Article III, Paragraph 2** requires the availability of prompt and effective judicial or administrative review of claims relating to an expropriation.
15. **Article IV** protects investors from certain government exchange controls limiting current account and capital account transfers.
- **Article IV, Paragraph 1** provides for the free transfer of investments.
16. **Article VI** deals with State-investor dispute resolution and defines the term “investment dispute”.
17. **Article IX** reserves the right of a Party to take measures for the maintenance of public order and the fulfilment of its obligations to international peace and security, including such measures as it considers necessary for the protection of its own essential security interests.
- **Article IX, Paragraph 2** prohibits the imposition of formal requirements that impair substantive rights under the BIT.
18. **Article XII** applies the Treaty to all investments that existed at the time the Treaty became effective.

### C. THE FIRST SESSION OF THE TRIBUNAL

19. By agreement of the parties, the First Session of the Arbitral Tribunal was held on 12 October 1999, in Zurich, Switzerland, in accordance with, and within the period set out in, Rule 13(1) of the Arbitration Rules.

20. At that Session, the parties confirmed that the Tribunal had been properly constituted in accordance with the Convention and the Arbitration Rules.

21. Among the procedural and other matters addressed at the First Session of the Tribunal, it was confirmed that the language of the proceedings would be English and that the place of the proceedings would be Washington, D.C., the seat of the Centre.

22. It was also confirmed that the proceedings would comprise a written procedure followed by an oral procedure.

23. At the First Session of the Tribunal, counsel for Respondent informed the Tribunal of Estonia's position to the effect that the Tribunal lacked jurisdiction to adjudicate the dispute as alleged by Claimants.<sup>2</sup> For their part, Claimants rejected the merits of Estonia's objection to jurisdiction and argued that, in any event, the issue of jurisdiction and the Tribunal's consideration of the issue should be joined to the merits of the dispute.

24. Following counsel's presentations, and after deliberation among the members of the Tribunal, the President informed the parties of the Tribunal's decision to establish a written and oral phase for the hearing of Respondent's objection to jurisdiction as a preliminary matter, and a schedule was fixed, as follows:

- 12 November 1999, for Respondent to file its Memorial in support of its objection to jurisdiction;

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<sup>2</sup> Respondent's intention to raise this preliminary issue had previously been communicated to the Centre in letters dated 6 April, 14 April, 12 May and 5 October 1999.



- 13 December 1999, for Claimants to file their Memorial in response to Respondent's objection to jurisdiction; and
- 8 January 2000 for the oral hearing on jurisdiction, in London, U.K.

#### D. THE HEARING ON JURISDICTION

25. In accordance with the schedule set by the Tribunal at its First Session, an oral hearing took place on 8 January 2000, in London, U.K., on the objection to jurisdiction raised by Respondent.

26. As submitted by counsel for Respondent, and as previously set out in writing in Respondent's 12 November 1999 Memorial on jurisdiction, Estonia advanced two principal grounds in support of its objection to jurisdiction, namely, that the matters alleged by Claimants had been "fully, finally and fairly" litigated before the courts and administrative agencies of Estonia, and that the facts do not evidence an "investment dispute" under the BIT given Claimants' *de minimis* interests in EIB. Both of these arguments were strenuously contested by Claimants.

27. After deliberation, the President of the Tribunal delivered orally, on 8 January 2000, the Tribunal's unanimous decision to the effect that Respondent's objection to jurisdiction was not ripe for decision and would, therefore, be joined to the Tribunal's consideration of the merits of the dispute.

28. As regards the timetable for the arbitration of the merits, after consultation with the parties, the Tribunal established the following schedule prior to the close of the 8 January 2000 hearing:

- 23 March 2000, for the filing of Claimants' Memorial on the merits;
- 16 June 2000, for the filing of Respondent's Memorial ("Counter-Memorial") on the merits;
- 17 July 2000, for the filing of Claimants' Response; and
- 17 August 2000, for the filing of Respondent's Rejoinder.

29. In addition, the Tribunal set the date of 2 October 2000 for the commencement of the oral hearing on the merits, in Washington, D.C.<sup>3</sup>

## E. FACTUAL BACKGROUND TO THE ARBITRATION

### 1) *Dramatis Personae*

#### *Corporate Entities*

30. Estonian Innovation Bank (“**EIB**”) is a financial institution incorporated under the laws of Estonia. Its principal shareholders during the period relevant to the arbitration were A.S. Baltoil, Eastern Credit Limited, Inc. and Eurocapital.

31. A.S. Baltoil (“**Baltoil**”) is an Estonian company wholly-owned by Eastern Credit, which in turn is owned by Mr. Genin.

32. Eastern Credit Limited, Inc. (“**Eastern Credit**”) is a corporation incorporated under the laws of the State of Texas, USA, and owned by Mr. Genin.

33. “**Eurocapital**”, as used in this Award, refers both to Eurocapital Group Limited (“**Eurocapital Ltd.**”) and Eurocapital Group Company (“**Eurocapital Co.**”), an Isle of Man corporation, incorporated in 1988. As stated by Mr. Genin during his testimony in the arbitration,<sup>4</sup> the two are in fact the same company, of which Mr. Genin is the beneficial owner of all of the outstanding (bearer) shares.

34. **Pacific Commercial Credit** is a company affiliated to Eurocapital. It has two shareholders: Eurocapital and Eastern Credit.

35. The Koidu branch of Social Bank (the “**Koidu branch**”) was a branch of Estonian Social Bank Limited (“**Social Bank**”), an insolvent Estonian financial institution.

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<sup>3</sup> Prior to the close of the hearing on jurisdiction, the Tribunal also drew the parties’ attention to several questions that it wished the parties to address in their written submissions on the merits, including as regards various aspects of Estonian law relevant to the arbitration. These issues are summarised, below, where the written procedure is reviewed.

<sup>4</sup> See Part G, below: “THE ORAL PROCEDURE”

*Individuals*

36. **Mr. Alex Genin** is a national of the United States of America. He is EIB's Chairman of the Board, as well as the owner, managing director and sole shareholder of Eastern Credit. As mentioned, Mr. Genin is also the beneficial owner of all of the outstanding (bearer) shares of Eurocapital.

37. **Mr. Michail Dashkovsky** was the President of EIB. He was a shareholder and the President of Baltoil, and the Claimants' principal representative in Estonia.

38. **Mr. Peep Sillandi** was the President of EIB at the time of the signature of the Koidu branch Sales Agreement (discussed below). He was succeeded as President of EIB by Mr. Michail Dashkovsky.

39. **Mr. Vahur Kraft** is the President of the Bank of Estonia and was its Vice-President from 1991–1995, including at the time of the signature of the Koidu branch Sales Agreement. He was previously Deputy Manager of the Credit Department of Social Bank, from 1991 to 1993, and also worked in the international department of Social Bank's main office.

40. **Ms. Pilvia Nirgi** was the Head of the Banking Supervision Department of the Bank of Estonia.

41. **Ms. Eve Sirts** was the head of the Off-site Supervision Sub-department of the Banking Supervision Department of the Bank of Estonia. She was also the Inspector/Share Capital Specialist of the Bank of Estonia, reporting to Ms. Nirgi at all times relevant to the arbitration.

## 2) The Facts Giving Rise to the Dispute

42. It is useful to set out here, by way of background, certain facts of a general nature, largely uncontested, relating to the principal issues in dispute between the parties.<sup>5</sup>

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<sup>5</sup> In the following sections of this Award, the parties' detailed allegations and submissions of fact and law are summarised.

43. On 12 August 1994, at an auction conducted by the Bank of Estonia, the central bank of the Republic of Estonia, EIB agreed to purchase a local branch of Estonian Social Bank Limited, an insolvent financial institution, for 3,000,000 Estonian kroons (“EEK”). The branch in question is known as the “Koidu” branch.

44. On 13 August 1994, a Sales Agreement (the “Koidu branch Sales Agreement”) was signed by the President of EIB, Mr. Peep Sillandi,<sup>6</sup> and by the Vice President of the Bank of Estonia (on behalf of the insolvent Social Bank), Mr. Vahur Kraft.<sup>7</sup>

45. On 16 September 1994, EIB informed the Bank of Estonia, in writing, of discrepancies that it had allegedly uncovered in the Koidu branch balance sheet that had been furnished to potential purchasers of the branch prior to the sale. EIB claimed from the Bank of Estonia, as trustee responsible for Social Bank, the losses allegedly suffered by EIB as a result of these discrepancies.

46. On 2 December 1994, the Bank of Estonia denied any liability for such discrepancies and for whatever losses may have been suffered by EIB as a result.

47. On 9 January 1995, EIB sued Social Bank before the City Court of Tallin (“City Court”), in Estonia, seeking to recover its losses allegedly caused by misrepresentations in the Koidu branch balance sheet.

48. On 3 May 1995, the City Court entered an order, pursuant to an agreement between the parties, establishing EIB’s damages in the amount of 20,977,117 EEK, representing approximately 2,893,991 EEK for *non-existent* assets included on the Koidu branch balance sheet, and 18,083,126 EEK for *non-performing* notes. Certain payments were made by Social Bank to EIB, leaving a total of 19,491,947 EEK owing.

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<sup>6</sup> Mr. Sillandi was succeeded as President of EIB by Mr. Michael Dashkovsky. In that capacity, Mr. Dashkovsky represented EIB during the period relevant to the arbitration.

<sup>7</sup> Mr. Kraft was later named President of the Bank of Estonia, a position he occupied throughout much of the period relevant to the arbitration.

49. In March 1996, the Bank of Estonia and EIB discussed the possibility of EIB amortising its losses related to the Koidu branch over five years. As explained more fully below, although Claimants allege that a binding agreement was reached, Respondent contends that no such agreement was ever concluded. In any event, in October 1996, the Bank of Estonia required EIB to write off its Koidu-related losses.

50. On 12 April 1996, EIB and the Bank of Estonia concluded an agreement—which Respondent claims was merely “tentative”—under the terms of which EIB was to assign all of its claims against Social Bank to the Bank of Estonia, in exchange for the latter’s assignment to EIB of various obligations owed to it by third-party banks. As discussed below, that agreement was never finalised.

51. In August 1996, EIB assigned its outstanding claims relating to the Koidu branch losses, in the amount of 19,491,947 EEK (US \$1,639,344), to Eastern Credit.<sup>8</sup> Eastern Credit then proceeded to file a lawsuit in the State of Texas, U.S.A., seeking, unsuccessfully, to recover those losses from the Bank of Estonia.<sup>9</sup>

52. In early 1997, the Bank of Estonia conducted its annual audit of EIB. In the course of their inspections, the Bank of Estonia’s inspectors requested EIB to provide various information concerning certain of its shareholders, including two of the Claimants.

53. On 18 March 1997, the Bank of Estonia issued “Prescription”<sup>10</sup> no. 19–2–406 (the “March 1997 Prescription”), requiring EIB, Eastern Credit, Baltoil and Eurocapital Ltd. to apply for qualified holding permits, formally entitling those entities to hold stock in EIB in accordance with Estonian law.

54. Although EIB claims that it complied with the March 1997 Prescription by submitting the required applications, on 24 March 1997 it

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<sup>8</sup> A “restated assignment” was entered into in May 1997, to correct certain omissions. Claimants’ Memorial, para. 134.

<sup>9</sup> In June 1998, the US Court declared that it did not have jurisdiction over the Koidu branch dispute and dismissed the case, without prejudice.

<sup>10</sup> A “prescription” is a form of regulatory order, also referred to in the parties’ submissions as a “precept”.

nonetheless challenged the validity of the Prescription in the Administrative Court of Tallin (“Administrative Court”).<sup>11</sup>

55. On 21 May 1997, the Bank of Estonia sent a letter to EIB requesting further detailed information about its shareholders and their affiliates, and enclosing a list (which the Tribunal shall refer to as the “May 1997 Regulations/Guidelines”) stipulating the information to be provided.

56. On 19 June 1997, Estonian counsel for EIB met with representatives of the Bank of Estonia to discuss the matter of the March 1997 Prescription and the 21 May 1997 request for information. As discussed below, Claimants allege that, at that meeting, the Bank of Estonia admitted that its conduct was motivated by a desire to glean information of use to it in its defence to the Texas lawsuit.

57. On 9 September 1997, while the proceedings challenging the 18 March 1997 Prescription were pending, the Council of the Bank of Estonia voted a resolution revoking EIB’s banking license, effective immediately.

58. On 11 September 1997, EIB instituted proceedings before the Administrative Court, challenging the license revocation as regards both the Bank of Estonia’s authority to revoke the license and the correctness of its decision to do so in this case.

59. While the license revocation proceedings were pending, a minority shareholder of EIB (unrelated to the parties to the arbitration) petitioned the court on 18 November 1998, in separate proceedings, to order the liquidation of EIB, on the grounds that EIB’s license had been revoked on 9 September 1997. The petition was granted.

60. On 12 January 1999, an application by EIB to stay the liquidation pending the outcome of the license revocation proceedings was rejected, which decision was subsequently upheld on appeal.

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<sup>11</sup> Those proceedings were suspended on 23 March 1998, by which time they had been superseded by events: EIB’s license had been revoked by the Bank of Estonia and separate proceedings challenging that revocation had been launched by EIB—see below.

61. On 6 October 1999, EIB's challenge to the revocation of its license was dismissed, on the grounds, *inter alia*, that the bank was, by then, already in liquidation.

### 3) Relevant Provisions of Estonian Law

62. The principal provisions of domestic law referred to by the parties and relevant for the purposes of the Tribunal's determination are found in two Estonian statutes, namely, the *Law of the Central Bank of the Republic of Estonia*, passed on 18 May 1993 and in force as of 18 June 1993, as amended on 5 April 1994 (the "Bank of Estonia Act")<sup>12</sup> and the *Law on Credit Institutions*, passed on 15 December 1994 and in force as of 20 January 1995 (the "Credit Institutions Act")<sup>13</sup>. Those provisions read as follows:

#### Bank of Estonia Act

##### Part I. General Regulations

##### Article 2. Responsibilities of *Eesti Pank*<sup>14</sup>

(. . .)

(4) *Eesti Pank* carries out the monetary and banking policy and directs the credit policy of the Republic of Estonia.

(5) *Eesti Pank* carries out control over all credit institutions within the Republic of Estonia. *Eesti Pank* supervises their activities as regards to their correspondence to the laws, obligatory norms and regulations as well as takes measures to ensure the strict following of the laws, norms and regulations.

(...)

##### Part IV. Control Over Credit Institutions

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<sup>12</sup> Claimants' Exhibit 8 (English version).

<sup>13</sup> Claimants' Exhibit 9 (England version).

<sup>14</sup> "*Eesti Pank*" refers to the Bank of Estonia.

### Article 17. Basic Generalities of Banking Supervision

- (1) *Eesti Pank* provides control over all credit institutions located in the Republic of Estonia through the Banking Inspection and its own departments.
- (...)
- (5) *Eesti Pank* has the right to request from all credit institutions data, documents, reports and agreements as well as to require appropriate explanations of these data.<sup>15</sup>

### Article 18. Issuing and Cancelling Licences

- (1) *Eesti Pank* issues to credit institutions licences and cancels them in case the credit institution do not follow established laws and regulations, or violate the law or any demands imposed upon them by *Eesti Pank*.
- (2) Conditions for issuing and cancelling licences for credit institutions are established by *Eesti Pank*.
- (...)

### Credit Institutions Act

### Article 19. Withdrawal of the Licence

*Eesti Pank* may withdraw the licence

(...)

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<sup>15</sup> Claimants have alleged that certain words are missing from Article 17(5) of the English version of the Bank of Estonia Act that has been filed as an exhibit in these proceedings. According to Claimants, the correct translation of art. 17(5) is: “*Eesti Pank* has the right to request from all credit institutions data, documents, reports and agreements **relating to their operations** as well as to require appropriate explanations of these data.” While the matter was the object of testimony and submissions during the hearing, the controversy, such as it is, need not be resolved. Even if Claimants’ contention is accepted, that is, even if art. 17(5) of the Bank of Estonia Act is read so as to include the qualifying words “relating to their operations”, this would have no impact on the Tribunal’s assessment of the Bank of Estonia’s conduct or its determination of the merits of Claimants’ claims in this arbitration.



- (5) if wrong or misleading data, information, advertisements or reports are submitted or published deliberately;

#### **Article 28. Qualifying Holding**

A qualifying holding within the meaning of this law is a holding of capital representing 10% or more of the undertaking's share capital or of the voting rights, or which makes it possible to exercise significant influence over the management of the undertaking, either on the basis of a contract or in some other way.

#### **Article 29. Increasing and Disposing of Qualifying Holding**

- (1) A credit institution or individual who is willing to acquire, directly or indirectly, a qualifying holding of a credit institution, or to increase such a holding to exceed 20%, 30% or 50% of the credit institution's share capital or number of votes, must apply for authorization from *Eesti Pank*. The application shall be submitted in writing and must contain information on the size of the intended holding.
- (2) The obligation to obtain authorization set out in Clause 1 of the present Article applies also to cases when:
  - 1) the acquisition or increase of a qualifying holding results from the activities of third parties;
  - 2) the credit institution might, as a result of a transaction, become a subsidiary of some other person.
- (3) *Eesti Pank* will refuse authorization to acquire or increase a qualifying holding in a credit institution;
  - 1) to a person who lacks an immaculate business reputation;
  - 2) if it may restrict free competition.
- (4) *Eesti Pank* will make a notification of its decision concerning the authorization mentioned in Clause 1 of the

present Article no later than one month after the receipt of the application.

- (5) Should *Eesti Pank* refuse the authorization mentioned in Clause 1 of the present Article, the transaction of acquiring or increasing the qualifying holding will be forbidden.
- (6) A credit institution and a person wishing to dispose of a qualifying holding in a credit institution is required to first inform *Eesti Pank*.

#### Article 59. The Basis and Limits of Supervision

- (1) The activities of credit institutions are subject to supervision by *Eesti Pank*. The objective of such supervision is to guarantee that the establishing and activities of all the credit institutions conform with the existing laws and other legal acts issued on their basis.
- (...)
- (6) The Banking Supervision Department will carry out continuous inspection of a credit institution's activities and its condition on the basis of regular reports submitted by the latter. If necessary, the Banking Supervision Department is entitled to :
  - 1) demand that a credit institution submit supplementary information, in order to specify information in the reports;
  - 2) demand information from persons who are shareholders of the credit institution, as well as from legal persons in which the credit institution is a shareholder;
  - 3) carry out on-site inspection of a credit institution's clients, relating to issues concerning the relations between the client and the credit institution.
- (7) The principles and procedures of the consolidated supervision of a credit institution and parties connected to it, shall be established by *Eesti Pank*.

(...)

#### **Article 60. On-Site Inspection of Credit Institutions**

- (1) The Banking Supervision Department is entitled by this law and its own Statutes to carry out on-site inspection of credit institutions.
- (2) When being inspected on site, it is the obligation of the credit institution to allow the employees of the Banking Supervision Department and other persons authorised by *Eesti Pank* in accordance with this law:
  - 1) to enter all the rooms of the credit institution provided all security regulations established by the credit institution are observed;
  - 2) to use a separate room for performing their duties. The credit institution shall appoint a competent representative whose responsibility is to provide the inspector will (*sic*) all the necessary documents and with explanations related to these documents.

(...)

#### **Article 69. Methods of Winding Up a Credit Institution**

- (1) A credit institution's activities may be wound up:

(...)

- 2) on the initiative of *Eesti Pank* or other persons listed in the law and on the basis of a court order (hereinafter compulsory liquidation);

(...)

### **F. THE WRITTEN PROCEDURE**

#### **1) Claimants' Memorial**

63. As ordered by the Tribunal, Claimants duly filed their Memorial, with supporting documentation, on 24 March 2000.

64. In their Memorial, Claimants allege what they refer to as “eight transgressions” of the BIT committed by Respondent, arising in particular as a result of the conduct of the Bank of Estonia and its representatives. These are summarised, below.<sup>16</sup>

65. The central theme that emerges from Claimants’ written submissions is that Respondent’s actions were allegedly motivated by a desire to destroy EIB, by revoking the bank’s operating license, as a means of evading its liability arising from the Bank of Estonia’s role in the Koidu branch affair and by an intent to retaliate for the launching of the Texas lawsuit.

*Claim 1: The Bank of Estonia is Responsible for EIB’s Losses Relating to the Purchase of the Koidu Branch*

66. Claimants allege that, in the summer of 1994, Mr. Kraft, then Vice President of the Bank of Estonia, wrote to Estonia’s financial institutions regarding the auction of various branches of the insolvent Social Bank, among them, the Koidu branch. Enclosed with that letter, *inter alia*, was a copy of the Koidu branch’s balance sheet.

67. Claimants declare that EIB agreed to purchase, and did purchase, the Koidu branch in reliance on Mr. Kraft’s representations, including, in particular, the balance sheet provided by him. The agreed purchase price for the Koidu branch was 3,000,000 EEK (in addition to the assumption of the branch’s liabilities), which, in accordance with the Koidu branch Sales Agreement, EIB paid to the Bank of Estonia, apparently in partial payment of amounts owed to the Bank of Estonia by Social Bank.

68. It is Claimants’ contention that the balance sheet of the Koidu branch submitted to EIB in advance of its purchase of the Koidu branch contained serious misrepresentations, and that, moreover, the Bank of Estonia was aware of these misrepresentations. Indeed, Claimants allege that, as Deputy Manager of the credit department of Social Bank from 1991 to 1993, Mr. Kraft had been directly involved in the evaluation of the particular loans that were misstated in the Koidu branch balance sheet.

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<sup>16</sup> At the outset of their Memorial, Claimants also reiterate their argument in support of the Tribunal’s jurisdiction in these proceedings, as originally submitted in their Memorial on Jurisdiction, discussed above.

69. Claimants submit that the Bank of Estonia refused to remedy the situation caused by its complicity in the misrepresentations of the assets of the Koidu branch and to compensate EIB for losses resulting from those misrepresentations. Those losses, Claimants state, total 19,491,947 EEK,<sup>17</sup> in addition to the 3,000,000 EEK paid to purchase the Koidu branch.

70. Claimants submit that, by its conduct, the Bank of Estonia violated Article II, Paragraph 3 (a) of the BIT. Specifically, it is submitted that the Bank of Estonia failed to give EIB's (and hence the Claimants') investment in the Koidu branch fair and equitable treatment, that it failed to provide full protection for the investment and that such treatment falls below the standards required by international law.

71. Claimants also allege that the requirement that EIB's payment for the Koidu branch be made directly to the Bank of Estonia, rather than to Social Bank, should be regarded as an expropriation for a non-public purpose, done in a discriminatory manner and without payment of prompt, adequate and effective compensation, thus violating Article III, Paragraph 1 of the BIT.

*Claim 2: The Bank of Estonia Entered Into, and then Breached, a Settlement Agreement*

72. Claimants contend that the Bank of Estonia acknowledged its partial responsibility for EIB's losses resulting from the purchase of the Koidu branch. Specifically, Claimants allege that, on 12 April 1996, EIB and the Bank of Estonia entered into an agreement under the terms of which EIB was to assign all of its claims against Social Bank to the Bank of Estonia, in exchange for the latter's assignment to EIB of various obligations owed to it by third-party banks (the "Koidu Settlement Agreement").<sup>18</sup> According to Claimants, it remained only for the Bank of Estonia to arrange with those banks for the extension of certain of the obligations in question (essentially, for the Bank of Estonia to extend the terms of various loans) before the Koidu Settlement Agreement could be finalised and signed.

73. Claimants state that, on 14 June 1996, Mr. Michail Dashkovsky, President of EIB, inquired of Mr. Kraft as to when the Koidu Settlement

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<sup>17</sup> See para. 48 of this Award.

<sup>18</sup> Claimants' Exhibit 29.

Agreement would be ready for signing. According to Claimants, Mr. Dashkovsky was assured that only “technical” matters remained outstanding and that the required contract would be completed and signed shortly.

74. Claimants allege that, on 17 July 1996, the matter still unresolved, Mr. Dashkovsky sent a letter to the chief of the Bank Inspectorate of the Bank of Estonia. In reply, EIB received, on 5 August 1996, a letter signed by Mr. Andres Sutt, secondary head of the Bank Inspectorate, enclosing what was purportedly a draft text of the agreement concerning the assignment of claims.<sup>19</sup> Claimants stress that this so-called “draft” contained terms that bore little resemblance to those agreed on 12 April 1996 and were far less generous as regards the consideration for EIB’s claims against Social Bank.

75. On 5 August 1996, Mr. Genin, on behalf of EIB, responded by letter, rejecting the changes to the Koidu Settlement Agreement and notifying the Bank of Estonia that he considered it to be in breach of that Agreement.<sup>20</sup> Claimants contend that, in so doing, EIB rejected only the 5 August 1996 text proffered by the Bank of Estonia, and not the April 1996 Settlement Agreement itself.

76. Claimants submit that the conduct of the Bank of Estonia as regards the Koidu Settlement Agreement constitutes a violation of Article II, Paragraphs 3 (a) and (c) of the BIT, which provide, respectively, for the fair and equitable treatment of investments and for the respect of obligations entered into with regard to investments.

*Claim 3: The Bank of Estonia Attempted to Cause EIB’s Capital to Fall Below Minimum Capitalisation Requirements*

77. Claimants allege that, by letter dated 21 March 1996, the Bank of Estonia agreed to allow EIB “to amortise the damages resulting from the purchase of the branch of Estonian Social Bank over a maximum of five years (...)” (the “Write-Off Agreement”).<sup>21</sup> This, they claim, was expressly intended to enable EIB to maintain its capitalisation above the legally

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<sup>19</sup> Claimants’ Exhibit 31.

<sup>20</sup> Claimants’ Exhibit 32.

<sup>21</sup> Claimants’ Exhibit 37.

required minimum, and to avoid the under-capitalisation that would have resulted had EIB been required to write off its approximately 19,000,000 EEK Koidu branch-related losses all at once. Claimants argue that the Bank of Estonia's letter also demonstrated its view that EIB was sufficiently healthy and well-managed to absorb those losses by the end of the five-year period.

78. Claimants allege that, on 10 October 1996, the Bank of Estonia reneged on the Write-Off Agreement, instead requiring EIB to charge its Koidu branch-related losses as costs and noting, moreover, that this would cause EIB's equity to fall below minimum required levels.<sup>22</sup>

79. As mentioned above,<sup>23</sup> in August 1996, Eastern Credit had taken an assignment of EIB's claims (restated in May 1997) in order to pursue those claims in a United States court. The consideration owed to EIB for the assignment was to have comprised the first 15,000,000 EEK recovered in the litigation; alternatively, it was hoped that a settlement could be reached with the Bank of Estonia. In either case, Claimants allege, there was no need for Eastern Credit actually to transfer funds to EIB to pay for the assignment. In December 1996, however, after receiving the Bank of Estonia's 10 October 1996 letter reneging on the Write-Off Agreement, Claimants state that Eastern Credit made full payment to EIB for the assignment of claims, in the amount of 19,491,947 EEK (US \$1,639,344).

80. Claimants contend that the Bank of Estonia intentionally breached the Write-Off Agreement in order to engineer a shortfall in EIB's capital levels that would justify the revocation of the bank's license. Claimants declare that the resulting payment by Eastern Credit was made with the express aim of ensuring that EIB would be able to write off the Koidu branch losses without falling below the minimum capital requirements imposed by Estonian law and constituted an additional "investment" for which Respondent is liable.

81. Claimants submit that the Bank of Estonia's actions violate Article II, Paragraphs 3 (a) and (c) of the BIT, as well as Article III, Paragraph 1. In addition, Claimants allege breaches of Article II, Paragraph 3 (b), prohibiting arbitrary or discriminatory measures, and Article IX, Paragraph 2, prohib-

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<sup>22</sup> Claimants' Exhibit 38.

<sup>23</sup> See para. 51 of this Award.

iting the imposition of formal requirements that impair substantive rights under the BIT.

*Claim 4: The Bank of Estonia's 18 March 1997 Prescription Was Illegal*

82. As noted earlier, on 18 March 1997, the Bank of Estonia issued Prescription No. 19–2–406, requiring EIB and certain of its shareholders (Eastern Credit, Baltoil and Eurocapital Ltd.) to apply for “qualified holding permits” entitling them, under Estonian law, to hold stock in EIB in excess of certain specified percentages (so-called “*qualified* holdings”) of EIB’s share capital.

83. Claimants allege that Eastern Credit’s shares in EIB were already legally held pursuant to a foreign investment license granted by the Bank of Estonia on 7 October 1992, permitting Eastern Credit to acquire a 33% interest in EIB.<sup>24</sup> Claimants also state that, on 30 June 1995, an entity known as Eurocapital Co. had been granted a qualified holding permit for an interest in excess of 50% of EIB, and the Bank of Estonia was well aware that Eurocapital Ltd. and Eurocapital Co. were in fact one and the same company. Claimants further allege that Baltoil’s 5% shareholding in EIB did not, on its own, even constitute a “qualified” holding requiring a permit.

84. While contesting the validity of the March 1997 Prescription, Claimants state that EIB and the shareholders in question nonetheless complied with its terms, by submitting the requested applications on 18 April 1997.

85. Claimants submit that the issuance of the Bank of Estonia’s 18 March 1997 Prescription violates Article II, Paragraphs 3 (a) and (b) and Article IX, Paragraph 2 of the BIT, as well as Article II, Paragraph 11, relating to interference with the granting of rights, licenses, permits.

*Claim 5: The Use of Unpublished and Legally Baseless Regulations—  
The 1997 Regulations/Guidelines*

86. Claimants allege that the Bank of Estonia’s purpose in requesting detailed information concerning EIB’s shareholders—and, in particular, the

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<sup>24</sup> Claimants’ Exhibit 42.



use of the 1997 Regulations/Guidelines—was unrelated to any legitimate supervisory activity. The information requests, say Claimants, fell “like rain out of a clear blue sky”, unrelated to any supposed concern regarding qualified holdings. Those requests, say Claimants, served merely as a pretext, first, to gain information to assist the Bank of Estonia in its defence to the United States litigation launched by Eastern Credit and, ultimately, to revoke EIB’s license.

87. Claimants contend that the Bank of Estonia had no legal right to much of the information requested—for example, balance sheets of EIB’s shareholders and information concerning the shareholders of the shareholders of EIB—and that EIB did not possess and could not possibly have provided such information in any event. Indeed, Claimants declare that EIB in fact provided all of the information requested by the Bank of Estonia of which EIB had knowledge.

88. Claimants submit that the Bank of Estonia’s use, in particular, of “unpublished, secret and legally baseless regulations” (i.e., the 1997 Regulations/Guidelines enclosed with its 21 May 1997 request for information) to glean information to which it had no legal right constitutes a violation of Article II, Paragraph 8 of the BIT, requiring that all laws, regulations, administrative practices, etc., affecting investments be duly published.

*Claim 6: The Bank of Estonia Revoked EIB’s License on a Pretext*

89. Claimants assert that the reasons stated by the Bank of Estonia for the revocation of EIB’s license are mere pretexts. In Claimants’ words:

Of course, all of these prescriptions and demands for information would have meant nothing had they stopped at this point. However, on September 9, 1997, the Bank of Estonia used the supposed requests for information and the supposed requirement for applications to acquire qualifying holdings as its reasons for revoking the license of [EIB].<sup>25</sup>

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<sup>25</sup> Claimants’ Memorial, para. 166.

90. Claimants contend that the Bank of Estonia's conduct, and in particular its revocation of EIB's license, was designed to enable the Bank of Estonia to avoid its liability to EIB for its involvement in the Koidu branch affair. Claimants also contend that they were denied due process in the matter of the license revocation.

91. Claimants submit that the Bank of Estonia's revocation of EIB's license without due process, without prior notice of any kind and for reasons which were totally pretextual, comprises a violation of Article II, Paragraph 3 (a) and (b), Article II, Paragraph 11, Article III, Paragraph 1, Article IX, Paragraph 2 of the BIT, as well as Article IV, Paragraph 1, providing for the free transfer of investments.

*Claim 7: Respondent is Responsible for the Forced Liquidation of EIB and the Dismissal of its Challenge to the License Revocation*

92. As indicated above, on 11 September 1997, EIB challenged the revocation of its license in proceedings before the Administrative Court. While that challenge was pending, the Administrative Court, in separate proceedings, granted a petition by a minority shareholder of EIB to order the bank's liquidation, on the grounds that the bank's license had been revoked.

93. On 12 January 1999, the City Court refused to stay the liquidation of EIB pending the outcome of the litigation over the revocation of its license (which decision was upheld by the District Court on appeal) and, on 6 October 1999, EIB's license revocation challenge was dismissed by the Administrative Court, on the grounds that the bank was in liquidation.<sup>26</sup>

94. Claimants submit that the Estonian courts, by refusing to allow the liquidation of EIB to be stayed pending the outcome of litigation regarding the revocation of its license, and then dismissing the license revocation proceedings on the grounds that a liquidation was pending, have committed a travesty of justice for which the Republic of Estonia is liable under Articles II, Paragraphs 3 (a) and (b), Article III, Paragraph 1 and Article IV, Paragraph 1 of the BIT, in addition to Article II, Paragraph 7, requiring that investors be provided with effective domestic means of asserting investment claims.

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<sup>26</sup> Claimants' Exhibits 78 and 79.

*Claim 8: The Republic of Estonia is Responsible For Harassment*

95. Claimants allege that, on 15 January 1999, Alex Genin received a letter from the Estonian police stating that a criminal investigation was pending against Eastern Credit. They further claim that Eastern Credit was subsequently accused of various false charges, but that the Estonian authorities never pursued a criminal case against the company, their purpose being to intimidate rather than prosecute.

96. Claimants also allege that, on 18 September 1997, Mr. Dashkovsky, the President of EIB and Claimant's principal representative in Estonia, was confronted by the Manager of Control of the Department of Immigration and Citizenship of the Republic of Estonia and threatened with deportation and the refusal to extend his residency permit; the officer in question also allegedly questioned Mr. Dashkovsky about Mr. Genin.

97. Claimants submit that the Republic of Estonia, by threatening criminal charges against one or more of the Claimants, among other forms of harassment, has violated Articles II, Paragraphs 3 (a) and (b) of the BIT.

*Damages*

98. Claimants claim damages in the amount of US \$1,639,344 representing their alleged losses resulting from misrepresentations associated with the purchase of the Koidu branch of Social Bank (based on the amount paid by Eastern Credit to purchase EIB's claims against Social Bank in December 1996<sup>27</sup>) plus 10% interest as of the date of payment.

99. Claimants also request damages relating to the loss of their original 3,000,000 EEK investment in EIB, which they submit should be calculated on the basis of the current fair market value of EIB *had its license not been revoked*. Claimants' valuation of their losses in this regard, as stated in their Memorial, is based on the expert valuation provided by Mr. Bryan V. Murray of B. V. Murray Company (discussed below), who calculated EIB's potential worth, currently, to be between US \$50 and US 70 million.<sup>28</sup>

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<sup>27</sup> See paras. 48–51 of this Award.

<sup>28</sup> Claimants' Exhibit 88.

## 2) Respondent's Counter-Memorial

100. As ordered by the Tribunal, Respondent duly filed its Counter-Memorial, with supporting documentation, on 19 June 2000.

101. In an “overview” of its case, at the outset of its Counter-Memorial, Respondent summarises the series of events leading to the revocation of EIB's license. It states that, in the course of its 1997 audit of EIB, the Bank of Estonia requested, and was denied, information concerning the identity of the bank's largest shareholders and regarding what appeared to be irregular transactions with related parties. Respondent declares that EIB's refusal, in addition to violating Estonian law, “only invited further scrutiny”.<sup>29</sup> Closer examination revealed, it claims, serious violations of Estonia's banking laws and regulations by EIB, as well as a “pattern of reporting false and misleading information to regulatory authorities”. In Respondent's words:

[EIB] did nothing to ameliorate the situation and, consequently, its license was revoked by the Bank of Estonia. Although numerous legal challenges were brought in Estonia, Claimants are again seeking a review of the Bank of Estonia's actions in this arbitration.<sup>30</sup>

102. Respondent further states: “At the heart of the matter were the banking regulators' legitimate concerns over the nature and identity of [EIB's] owners.”<sup>31</sup>

103. In sum, Respondent's basic tenet is that the Bank of Estonia's concerns, and EIB's alleged refusal to provide the information requested of it and required by Estonian law, justifiably led to the decision to revoke the bank's license.

### *The Factual Background as Described by Respondent*

104. In a lengthy review of the facts, Respondent alleges that, during the 1997 audit of EIB, Ms. Eve Sirts, banking examiner of the Bank of Estonia,

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<sup>29</sup> Counter-Memorial, p. 1.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

asked for information concerning the identity of the bank's largest shareholders and for explanations about irregular transactions with seemingly related parties. Respondent states that Ms. Sirts was denied any information. Respondent also alleges that, upon closer examination, serious violations of Estonian banking law were discovered, as well as a pattern of false and misleading reporting.

105. Respondent contends that EIB did nothing to improve the situation and that this led to its license revocation. Respondent reiterates that this action was justified in view of the banking regulators' legitimate concerns over the nature and identity of EIB's owners.

*Eurocapital Group Limited*

106. Respondent submits that Eurocapital Ltd. is an Isle of Man corporation, incorporated in 1988, that owned in excess of 70% of EIB. Respondent alleges that Eurocapital is not a claimant in this arbitration and, in any event, could not avail itself of the BIT because of its nationality.

107. Respondent alleges that the shareholders of Eurocapital and its state of incorporation were never disclosed to the Estonian banking authorities and that this was one of the central concerns that led to the revocation of EIB's license.

*Estonian Banking Reform*

108. Respondent claims that the Bank of Estonia is responsible for the banking reform that has taken place in Estonia over the last decade. It is directly responsible for regulating the banking industry, including the establishment and enforcement of regulations regarding minimum share capital requirements.

109. Respondent asserts that Mr. Vahur Kraft presided as Governor of the Bank of Estonia for a five-year term starting in April 1995 and was the Vice-Governor from 1991–1995. During the period relevant to this arbitration, Ms. Pilvia Nirgi was the Head of the Banking Supervision Department, and Ms. Eve Sirts was the Inspector/Share Capital Specialist, reporting to Ms. Nirgi.

110. Respondent claims that, in December 1994, the Estonian Parliament passed the *Credit Institutions Act*, which contained important financial reforms. Respondent also states that both the *Credit Institutions Act* and the *Bank of Estonia Act* grant certain powers to the Bank of Estonia which enable it to carry out its mandate, including the right to obtain information relating to a financial institution, its operations and its shareholders.

*Claimants' Initial Investment in EIB*

111. Respondent alleges that, in 1992, Eastern Credit applied for a foreign investment license in order to become a shareholder of EIB. Respondent claims that, as part of its application, Mr. Genin submitted a balance sheet for Eastern Credit which reflected that it had over \$34,400,000 in assets; after reviewing the application, the Council of the Bank of Estonia decided to grant the license to Eastern Credit.

112. Respondent contends, however, that the license was obtained by presenting false financial information. It alleges that a majority of Eastern Credit's assets, \$34,041,987, was reported as "investments in subsidiaries", while Eastern Credit's tax returns for 1991, 1992 and 1993 did *not* identify any such investments and expressly stated that Eastern Credit did not control any foreign corporations.

113. Moreover, Respondent alleges that Eastern Credit's initial investment in EIB was actually paid for by Eurocapital. Similarly, according to Respondent, when Baltoil purchased EIB shares in 1993, it did so with funds wired from the same Eurocapital account.

114. Respondent states that Baltoil never sought permission for its shareholding in EIB and made no disclosure about its relationship to Eastern Credit or Eurocapital. As a result, Baltoil is not a party to any "investment agreement" with the Estonian Government, such as to render its claim arbitrable.

115. Respondent also contends that Baltoil's shareholding should not be considered part of Eastern Credit's 1992 application for the following reasons :

- Eastern Credit never mentioned Baltoil in its request for a foreign investment license;

- Eastern Credit requested permission for an interest up to 33%, which it acquired in its own name;
- Baltoil's 20% interest was acquired in 1993, more than a year after Eastern Credit applied for its shareholding; and
- Eastern Credit and Baltoil had a combined shareholding of 51%, far in excess of what Eastern Credit sought permission to hold.

116. Respondent also submits that no claim by Baltoil should be permitted since the BIT does not apply to domestic corporations who invest in their home state.

117. Respondent alleges that, by 1994, Eurocapital had acquired a majority ownership of EIB through its surrogates Eastern Credit and Baltoil, although it had never applied for a foreign license or entered into any agreement with the Estonian regulators.

*The Auction of the Koidu Branch*

118. Respondent claims that notice of the auction of the Koidu branch was sent to all Estonian financial institutions on 11 August 1994. Respondent also alleges that the assets of the said branch were available for inspection and that arrangements were made for potential bidders actually to visit the branch and review the assets on-site.

119. Respondent further contends that all documents concerning the value of the assets purchased were prepared and presented by Social Bank personnel, not by the Bank of Estonia. In this regard, Respondent asserts that neither Mr. Kraft nor any other Bank of Estonia official prepared the documents representing the value of the branches sold, nor did they make representations concerning the assets during the auction.

120. Respondent claims that Mr. Kraft had no specific knowledge of the Koidu branch assets sold at the auction and that, although Mr. Kraft had worked, years earlier, in the international department of Social Bank's main office, he had no dealings with the Koidu branch operations.

121. Respondent alleges that Mr. Peep Sillandi, President of EIB, was present at the auction, and that he bid for, and ultimately purchased, the

Koidu branch of Social Bank on behalf of EIB. Respondent contends that Mr. Sillandi was invited to inspect the assets on-site at the Koidu branch subsequent to the auction, and that EIB personnel in fact visited the Koidu branch and undertook their own due diligence with regard to the assets purchased, to their satisfaction, before the transaction was completed.

122. Respondent asserts that the purchase price of 3,000,000 EEK was paid to the Bank of Estonia, rather than to Social Bank, in partial satisfaction of Social Bank's debt to the Bank of Estonia.

123. Respondent alleges that, one month after the auction, Alex Genin and EIB's President, Mr. Sillandi, wrote to the Bank of Estonia, alleging that approximately 7,200,000 EEK worth of loans outstanding on the Koidu branch books were in default and non-performing. Respondent also submits that, on 2 December 1994, the Supervision Department of the Bank of Estonia reviewed EIB's claim and determined that it was unfounded, since EIB had conducted its own due diligence before agreeing to the transfer of assets.

124. Respondent contends that, after the claim was denied by the Bank of Estonia, EIB brought a lawsuit against Social Bank in the City Court, that EIB and Social Bank settled the lawsuit in 1995 and that an agreement was reached by virtue of which EIB returned some of the Koidu branch assets to Social Bank in return for certain monetary payments (totalling approximately 20 million EEK). Respondent points out that no representatives of the Bank of Estonia or the Estonian Government were parties to the agreement.

*Eurocapital Group Company's Qualified Shareholding in EIB*

125. Respondent contends that Claimants should not be entitled to an award relating to Eurocapital's investment in EIB, since Eurocapital is not covered by the BIT.

126. Respondent alleges that, on 21 April 1995, a letter was sent to Mr. Kraft at the Bank of Estonia, on the letterhead of Eurocapital Group Ltd., in regard to a possible \$1,000,000 investment in EIB. The letter was purportedly signed by Gregory F. Zak, Eurocapital Ltd.'s Vice President of Finance. Respondent alleges that Mr. Zak did not author the 21 April 1995 letter from Eurocapital Group Ltd.; that the signature is not his; that he never authorised anyone to prepare the letter on his behalf; that the signature



was placed on the letter by Ms. Delores Severson, Mr. Genin's secretary; that Mr. Zak and Eurocapital Ltd. never made a \$1,000,000 investment in EIB; and that Mr. Zak was never even aware of an entity known as Eurocapital Co.<sup>32</sup>

127. Respondent submits that subsequently, on 1 June 1995, EIB submitted an application for a qualified shareholding of "Eurocapital Group Company (a finance company located in England)" and that the permit was granted by the Bank of Estonia on 30 June 1995.

128. Respondent contends that Eurocapital Ltd. was hiding behind other companies in order to acquire and maintain, secretly, a controlling interest in EIB, first through Eastern Credit and Baltoil (a combined 51% interest in 1993 and 1994) and then through Eurocapital Co.

129. Respondent contends that, regardless of whether there was one or more "Eurocapitals", Eastern Credit's purported investment in EIB in fact was owned by Eurocapital, for the following reasons :

- EIB voted to sell shares to Eurocapital;
- Eurocapital applied for a qualified shareholding;
- Eurocapital funds were used to purchase Eastern Credit's shares;
- Eurocapital ledgers do not reflect a loan to Eastern Credit;
- the EIB share ledger names Eurocapital as the shareholder;
- Eastern Credit's tax return does not reflect a controlling interest in EIB;
- Eastern Credit's tax return does not reflect a loan from Eurocapital;
- there is no evidence that Eastern Credit deposited funds with Eurocapital to purchase the shares;
- Eurocapital claimed the investment as its own in the Texas litigation; and
- Eurocapital presented a claim to the EIB liquidation commission based on its investment in EIB.

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<sup>32</sup> Counter-Memorial, pp. 9–10.

*EIB Struggled to Meet Minimum Capitalisation Requirements*

130. Respondent contends that EIB struggled to satisfy the capital requirements for lending institutions in Estonia. Respondent states that, in June 1995, EIB was warned that its insolvency indicator was below the minimum of 8% and that its risk concentration was too high. Respondent alleges that EIB was able to maintain its marginal status only by artificially inflating its balance sheet.<sup>33</sup>

131. Respondent asserts that, under the new banking law implemented in 1995 by means of the *Credit Institutions Act*:

- the qualified shareholding requirement was introduced as part of the *Credit Institutions Act*;
- the Bank of Estonia was given the responsibility of scrutinising banks' balance sheets to make sure the many capital and liquidity requirements were properly met; and
- the Bank of Estonia was given broad powers to inspect commercial banks in order to fulfil its mandate.

132. Respondent alleges that EIB, given its precarious financial situation in early 1996, sought assistance from the Bank of Estonia. Respondent also states that, on 12 April 1996, the Bank of Estonia entered into a *tentative* agreement with EIB<sup>34</sup> in which the Bank of Estonia would transfer 5,000,000 EEK worth of debentures to EIB in exchange for EIB's claim against the insolvent Social Bank; the Bank of Estonia further agreed to try to reach an agreement with a third party—Commercial Bank of Industry and Building ("Commercial Bank")—that would possibly result in the assignment to EIB of an additional 10,000,000 EEK notes.

133. Respondent contends that this tentative agreement was not an admission that the Bank of Estonia was responsible for representations concerning the Koidu branch, but was, rather, an action motivated by its desire to assist a financial institution in difficulty.

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<sup>33</sup> Counter-Memorial, p. 13.

<sup>34</sup> The "Koidu Settlement Agreement".

134. Respondent states that the Bank of Estonia gave no guarantees as regards the third-party agreements and, in the end, was unable to conclude the 10,000,000 EEK agreement with Commercial Bank. Respondent states that the Bank of Estonia offered instead to assign to EIB 5,000,000 EEK worth of bills with Estonian Land Bank (“Land Bank”) and pay EIB up to 5,000,000 EEK in recovered loans. Respondent contends that this offer had much more value than the claims against Commercial Bank that were the subject of the original, tentative agreement.

135. Respondent asserts that, on 5 August 1996, Mr. Genin responded to this offer by stating that he considered the tentative agreement of 12 April 1996 to be “null and void”.

*Requests for Information Followed by the Texas Lawsuit*

136. Respondent claims that, on 20 September 1996, due to reforms in banking legislation as well as a general concern about the ability of Estonian banks to meet their share capital requirements, the Bank of Estonia sent a letter to all credit institutions requesting information concerning their shareholders, shareholders of shareholders, subsidiaries and affiliated corporations of the shareholders.

137. Respondent states that, on 9 October 1996, EIB identified its largest shareholder as “Eurocapital Group”, a Texas company and, shortly thereafter, EIB reported that its largest shareholder was “Eurocapital Group, Ltd., a UK company”.

138. Respondent denies that its 20 September 1996 letter and subsequent requests for information were sent in an effort to harass EIB or retaliate for the United States lawsuit filed against the Bank of Estonia. Respondent notes that similar requests had been sent at the beginning of 1996, well before the Texas lawsuit was filed, and that even the 20 September 1996 request was sent before the Bank of Estonia received notice of the lawsuit.

*The “20,000,000 EEK Juggle”*

139. Respondent alleges that, by October 1996, Social Bank had gone out of business and filed for bankruptcy, and that EIB had filed a bankruptcy claim in the Estonian courts against Social Bank for the amount of the unpaid settlement agreement (approximately 19,000,000 EEK).

140. Respondent submits that :

- following the filing of EIB's bankruptcy claim and because recovery of the full amount from Social Bank was unlikely, the Bank of Estonia directed EIB to reclassify its claim as a "doubtful account" on its balance sheet, by the end of October 1996, in accordance with sound accounting practices;
- no response was received from EIB by the deadline;
- on 4 November, the Supervision Department of the Bank of Estonia followed up on this matter;
- in response to this inquiry, EIB informed the Bank of Estonia that the claim had been sold to Eastern Credit for 20,000,000 EEK on 25 October 1996;
- Eastern Credit did not pay anything on the closing of the transaction; rather, it promised to pay in four instalments over more than two years.<sup>35</sup>

141. Respondent contends that the agreement between EIB and Eastern Credit is inconsistent with an earlier agreement, dated 26 August 1996, in which EIB had purportedly *already* assigned all of its rights and claims regarding the Koidu branch to Eastern Credit, in exchange for the first 15,000,000 EEK recovered by Eastern Credit.<sup>36</sup>

142. Respondent submits that the 25 October 1996 agreement between EIB and Eastern Credit was simply a manoeuvre concocted to inflate EIB's balance sheet, by reporting a 20,000,000 EEK asset when, in reality, such an asset did not exist.

143. Respondent alleges that the Bank of Estonia, having discerned the nature of the transaction, instructed EIB to classify it as a loan, not a receivable, so as to reflect the true value of the asset. Respondent alleges that EIB refused to do so, claiming that it would classify the transaction as a sale from the moment of the transaction regardless of when it might actually receive payment. Respondent also states that Eastern Credit made its first "payment"

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<sup>35</sup> Counter-Memorial, p. 17; Respondent's Exhibit 29.

<sup>36</sup> Counter-Memorial, p. 17; Respondent's Exhibit 27.

to EIB with worthless shares of stock in a defunct company called Landmark International (“Landmark”).

144. Respondent also alleges that EIB entered into a similar series of questionable transactions relating to stock in a defunct yacht manufacturer, Tollycraft Corporation (“Tollycraft”). Respondent claims that the Tollycraft stock was purchased by EIB for a price much higher than their worth and was then sold to Eurocapital, a few months later, for only half of the purchase price.<sup>37</sup>

*Two Eurocapitals, Pacific Commercial Credit, More Questions*

145. Respondent contends that the Bank of Estonia’s requests for information were prompted in part by inconsistent references to Eurocapital Group and an undisclosed relationship to a company, Pacific Commercial Credit, that had received hundreds of thousands of dollars from EIB. Respondent points out that the Bank of Estonia subsequently learned that Pacific Commercial Credit had two shareholders, Eurocapital Group Limited and Eastern Credit, and that the “Eastern Credit” in question appeared to be an Isle of Man corporation and not a Texas corporation, suggesting that there may as well have been two corporations named “Eastern Credit”.<sup>38</sup>

146. Respondent claims that, following a January 1997 request for additional information, EIB identified its largest shareholder as “EuroCapital Group Ltd.”<sup>39</sup>

*The 1997 Audit of EIB*

147. Respondent states that, from 4 February 1997 through 7 March 1997, the Bank of Estonia conducted its annual audit of EIB. Ms. Sirts was assigned the specific responsibility of verifying the share capital of EIB. Respondent claims that, despite numerous requests, EIB refused to clarify the confusion surrounding “Eurocapital”.

148. Respondent further asserts that, during the audit, several other unusual and irregular facts were discovered, including:

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<sup>37</sup> Counter-Memorial, p. 19; Respondent’s Exhibit 106.

<sup>38</sup> Counter-Memorial, p. 20; Respondent’s Exhibit 82.

<sup>39</sup> Counter-Memorial, p. 21; Respondent’s Exhibit 58.

- EIB had given a proxy to invest its funds to Alex Genin, Gregory Zak and Harri Faiman;
- EIB funds were invested in Landmark and Tollycraft stock acquired from a related entity, Eastern Credit, at inflated prices;
- not all of the stock transactions were reflected on the books of EIB;
- interest-free loans (approximately US \$600,000 to US \$800,000) had been made to Pacific Commercial Credit Limited without proper documentation; and
- questions had arisen about a Russian company called SAIS.

149. Respondent asserts that Ms. Sirts' requests for information in regard to these matters, both oral and in writing, were denied or ignored by EIB.

150. Respondent also submits that the formal inspection report issued following the audit raised additional questions concerning EIB's shareholders, their affiliates and suspect transactions.

*The March 1997 Precept (Prescription)*

151. Respondent asserts that the Estonian *Credit Institutions Act* requires a party or related parties seeking to acquire a 10%, 30% or 50% shareholding (or to increase an existing shareholding to such levels) to obtain permission from the Bank of Estonia, in the form of a qualified holding permit.

152. Accordingly, Respondent claims that the Bank of Estonia issued, on 18 March 1997, Prescription No. 19–2–406 requiring EIB and certain shareholders to apply for a qualified holding permit, because (1) no qualified shareholding had ever been sought or issued in the name of "Eurocapital Group Limited" and (2) the combined shareholding of Eastern Credit and Baltoil, which claimed to be related, put them above the 10% threshold.<sup>40</sup>

153. Respondent alleges that, immediately following issuance of the March 1997 Prescription, EIB's lawyers wrote to the Bank of Estonia, claiming that Eurocapital Group Limited "has never acquired nor enlarged a

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<sup>40</sup> Counter-Memorial, p. 23.

holding in the share capital of EIB”. Further, in legal pleadings filed that same day, EIB challenged the Prescription and claimed that it was “unfamiliar with Eurocapital Group Limited”.<sup>41</sup>

154. Respondent contends that Claimants attempted to create the illusion that they were trying to comply with the Bank of Estonia’s request. In this regard, Respondent states that, on 24 March 1997, Mr. Dashkovsky filed with the Estonian court copy of a letter from EIB addressed to “Eurocapital Group Company, Eastern Credit and AS Baltoil” with no names of individuals or addresses. Respondent also claims that, on 27 March 1997, Mr. Dashkovsky wrote to Ms. Nirgi at the Bank of Estonia and told her that he had asked for the shareholders’ help in obtaining the requested information.

155. Respondent asserts the following :

- Mr. Dashkovsky was the sole shareholder and president of Baltoil, as well as the European representative of Eurocapital and Eastern Credit;
- Mr. Genin was the managing director and sole shareholder of Eastern Credit;
- the letters in question were, in effect, letters written by Mr. Dashkovsky to himself.

156. Respondent claims that it was a ruse and fiction to suggest that Mr. Dashkovsky, as president of EIB, and Mr. Genin, as chairman of EIB’s board, were unable to provide the information requested.

157. Respondent states that, on 18 April 1997, the Estonian law office of Kaasik & Co. applied for qualified holdings for Eurocapital Ltd., Eastern Credit and Baltoil. Respondent submits that the Bank of Estonia responded by requesting additional information concerning the applicants, necessary to evaluate their suitability to be qualified shareholders. Respondent submits that, in this regard, the Bank of Estonia provided “*internal guidelines*” (i.e., the “March 1997 Regulations/Guidelines”) delineating the exact information sought, but that EIB refused to supply this information.

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<sup>41</sup> Counter-Memorial, p. 23; Respondent’s Exhibit 70.

*The License Revocation*

158. Respondent contends that EIB's pattern of refusing to answer the Bank of Estonia's questions; barely meeting, for a number of years, the minimum capital requirements and, on numerous occasions, falling below the statutory minimum; and conducting a series of questionable transactions, fully warranted increased regulatory scrutiny and justified the eventual revocation of EIB's license.

159. Respondent submits that, during the February 1997 audit, inspectors discovered once again that EIB's share capital was below the minimum required level, and an appropriate instruction was issued to EIB. Respondent also claims that, on 27 June 1997, another precept was issued to EIB requiring it to comply with the minimum capital requirements by 21 July 1997.<sup>42</sup>

160. Respondent alleges that, on 16 July 1997, Eurocapital converted subordinated debt of EIB into stock in the bank, without prior permission of the Bank of Estonia. Respondent further contends that the Bank of Estonia repeatedly asked to see information concerning this debt instrument, but that EIB refused to comply.

161. Respondent claims that, on 30 July 1997, representatives of the Bank of Estonia again visited EIB to follow up on these issues, at which time the inspectors learned the following:

- that Landmark shares had been acquired from Eastern Credit for \$3.75 a share and then sold to Eurocapital a few months later for \$2.50 a share;
- that Tollycraft shares had been acquired directly from Tollycraft, many for only \$1.50 a share;
- that EIB was planning to have its shares listed on the NASDAQ market in the United States.

162. Respondent submits that EIB's purported plans to go public in the US were speculative, at best, as no business plan was shown to the inspectors

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<sup>42</sup> Counter-Memorial, p. 26; Respondent's Exhibit 84.



and no supporting documentation was ever provided. On the contrary, Respondent points out that EIB's business plan for 1997, furnished to its auditors earlier that year, made absolutely no reference to this purported plan.<sup>43</sup>

163. Respondent states that, during the week of 7 August 1997, based on the information gleaned during the July inspection as well as EIB's and its shareholders' continued refusal to submit data in support of their application for qualified shareholdings, the Bank of Estonia conducted a *special inspection* of EIB; the inspectors continued to ask questions about particular transactions and relationships, but still received no answers. Respondent declares that the report issued following the special inspection mentions several problems, the most notable of which related to the bank's capital adequacy rate. Respondent alleges that, rather than a 38.5% rate, as reported by EIB, the true rate was only 10.91%.<sup>44</sup>

164. Respondent alleges that the recommendation to revoke EIB's license was made by Ms. Sirts following the August 1997 special inspection, and was based on EIB's repeated presentation of false and misleading information, its refusal to provide information requested in accordance with the law, and its failure to meet the minimum capital requirements for a banking institution.

165. Respondent claims that the recommendation was transmitted to the Council of the Bank of Estonia, which voted on 9 September 1997 to revoke EIB's license as of 10 September 1997,<sup>45</sup> and that a formal notice was sent to EIB containing the following instructions :

- (1) to call a meeting of shareholders in order to decide on reorganisation or dissolution;
- (2) not to prefer one client over another;
- (3) to make no transactions concerning the bank's share capital until all claims are settled; and
- (4) to forward a notice of annulment to all foreign correspondent banks.

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<sup>43</sup> Counter-Memorial, p. 27; Respondent's Exhibit 60.

<sup>44</sup> Counter-Memorial, p. 28; Respondent's Exhibit 90.

<sup>45</sup> Counter-Memorial, p. 28.

166. Respondent alleges that EIB ignored all of these instructions. Specifically:

- (1) no decisions on the future of EIB were taken until a minority shareholder petitioned the bank into involuntary liquidation in 1999;
- (2) EIB continued to make preferential transfers to Eastern Credit and Eurocapital: it paid the rent for Eastern Credit's office in Texas, and paid \$21,000 every two months to Eurocapital as "management fees";
- (3) EIB's management made a share capital-related transaction in 1997 by, in essence, transferring \$2,900,000 to Eurocapital (as "collateral" for its investment as a shareholder);
- (4) EIB did not notify correspondent bank ABN AMRO that its license was revoked, and the Bank of Estonia was therefore required to do so itself.

167. Finally, Respondent claims that EIB launched a challenge to the license revocation in the Estonian courts one day following notice of the revocation. Respondent contends that the Estonian judicial system was accessible to the Claimants, that there are no allegations, much less evidence, that the system was anything other than impartial, and that Claimants have no grounds for a "denial of justice" claim.

#### *Respondent's Defences*

168. After describing the factual background to the dispute, Respondent sets out its defences to the claims alleged by Claimants.

#### *The pre-BIT claims are untimely*

169. Respondent first submits that most, if not all, of Claimants' claims are not "investment disputes" within the meaning of the BIT and that several are, moreover, time-barred. In this regard, Respondent notes that the first three of Claimants' eight claims arose prior to 16 February 1997, the date on which the BIT came into effect, and are therefore not actionable.

170. Respondent then addresses the merits of each of the so-called “eight transgressions” alleged by Claimants in their Memorial.

*Claimants’ Claim 1: The Koidu Branch*

171. Respondent submits, first, that there is no “investment agreement” or “investment authorisation” between Claimants and the Republic of Estonia, as those terms are used in the BIT. For this reason, there is no arbitrable “investment dispute” under the BIT in this case.

172. In this regard, Respondent contends as follows:

- neither Mr. Genin, Baltoil or Eastern Credit ever obtained the legally required permission for a shareholding in EIB that, when combined, exceeded 10%;
- in the absence of such authorisation to invest in EIB, there was no “investment agreement” under the BIT;
- for the same reasons, “investment authorisation” for Claimants’ holdings in EIB was also lacking;
- Baltoil never applied for a qualified holding permit for its interest in EIB, as required by law;
- Eastern Credit’s 1992 foreign investment license was obtained on false pretences (i.e., that the company had US\$34,000,000 in assets) and was, in any event, superseded by the enactment in 1995 of the *Credit Institutions Act*, which required Eastern Credit to obtain a *new* authorisation;
- Eastern Credit’s purchase of EIB’s claims relating to the sale of Koidu branch does not represent an “investment” under the BIT. Moreover, the rights and remedies purchased from EIB did not include the right to ICSID arbitration, and Claimants do not allege misconduct by Respondent with respect to the alleged investment represented by the assignment. Further, Eastern Credit never paid for the assignment of EIB’s claims: the alleged December 1996 transfer of funds for this purpose was illusory.

173. Respondent submits that there was no misrepresentation made by the Bank of Estonia in the sale of the Koidu branch. Indeed, Respondent alleges

that all representations concerning the Koidu branch assets were made by Social Bank personnel. Respondent also contends that Mr. Kraft had no specific knowledge of the Koidu branch assets sold at the auction and that he did not make any representations whatsoever concerning those assets.

174. Respondent submits that, after the auction, Claimants had the opportunity to inspect the Koidu branch assets and to review them on-site, at the branch, prior to going forward with the transaction. Respondent contends that Claimants availed themselves of this opportunity, which demonstrates that they did not, in fact, rely on whatever prior representations concerning the assets may have been made.

175. Respondent states that the 3,000,000 EEK payment for the Koidu branch was made to the Bank of Estonia (and not Social Bank) in order to satisfy Social Bank's obligations to the Bank of Estonia. Respondent submits that this is clearly *not* a case of expropriation, and that, even were it to be considered an expropriation, it would be an expropriation of Social Bank's—not EIB's—assets.

176. Respondent submits, lastly, that, even if Eastern Credit legally acquired EIB's claims relating to the sale of the Koidu branch, those claims were already time-barred in 1996, since the statute of limitations for a fraud claim, under Estonian law, is one year.

*Claimants' Claim 2: The "Tentative" Koidu Settlement Agreement*

177. Respondent contends that the 12 April 1996 agreement between EIB and the Bank of Estonia was only a "tentative" settlement agreement, "little more than a conditional memorandum of understanding" and not enforceable under Estonian law.

178. Respondent alleges that, because the Bank of Estonia was unable to obtain certain third-party approvals necessary to give effect to the tentative agreement, it proposed another form of agreement to EIB. Respondent contends that, when Mr. Genin refused this second offer, on 5 August 1996, the tentative agreement of 12 April 1996 became "null and void".<sup>46</sup> In any

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<sup>46</sup> Counter-Memorial, p. 37; Respondent's Exhibits 24 and 26.

event, Respondent alleges that Claimants suffered no damage as a consequence of these events.

*Claimants' Claim 3: EIB's Reduction In Capital*

179. Respondent submits that the claim based on EIB's reduced capital does not involve an arbitrable "investment agreement" between Claimants and the Republic of Estonia.

180. Respondent declares that, more than two years after the Koidu branch acquisition, its banking regulators determined that EIB's approximately 20,000,000 EEK claim against Social Bank should be reclassified on its books as a "doubtful account". Respondent alleges that, in order to avoid this reclassification, EIB sold the claim to Eastern Credit.

181. Respondent contends that there was no agreement between EIB and the Bank of Estonia regarding amortisation of EIB's Koidu branch-related losses over five years (the so-called "Write-Off Agreement"). Respondent claims that EIB's ability to amortise those losses was, in any event, unrelated to the Bank of Estonia's instructions to reclassify the asset in question, which simply constituted prudent banking oversight.

*Claimants' Claims 4 & 5: The Qualified Holding Prescription*

182. Respondent alleges that, in the course of routine semi-annual inquiries, inspectors of the Bank of Estonia discovered many discrepancies in EIB's books and records. Respondent alleges that EIB either refused to provide information regarding these discrepancies or provided inadequate information.

183. Respondent claims that, among the questions raised by EIB's records, it was discovered that Eurocapital Co. (the company that had applied for and received a qualified holding permit in 1995) was not listed as a shareholder, but that there were two companies listed as Eurocapital Ltd. EIB, Respondent claims, stated that the companies were one and the same, but refused to provide any documentation in this regard to the inspectors.

184. Estonia also claims that its inspectors uncovered evidence of questionable transactions, including:

- Pacific Commercial Credit, a subsidiary or affiliate of Eurocapital, was receiving “deposits” from EIB;
- EIB was involved in the purchase and sale of shares of two corporations, Tollycraft and Landmark, that were misleadingly and inaccurately reported; and
- Claimants themselves, through these transactions, had diverted millions of dollars from EIB to their own accounts.

185. As indicated above, Respondent alleges that Eastern Credit, Baltoil and Eurocapital Ltd., were not authorised to be shareholders of EIB, none of them ever having applied for qualified holding. However, Respondent acknowledges that “Eurocapital Group Co.” did apply for, and was granted, a qualified holding permit in 1995.

186. Respondent contends that the above-mentioned discrepancies and Claimants’ confusing, if not deceptive, use of what appeared to be multiple shell companies, justified the Bank of Estonia’s requests for information. Respondent also submits that the information requested by the Bank of Estonia from EIB was directly related to Bank of Estonia’s oversight responsibility and had nothing to do with the US litigation.

187. Respondent states that the Bank of Estonia’s power to obtain information relating to a financial institution, its operations and its shareholders derives from the *Credit Institutions Act* and the *Bank of Estonia Act*, and that its requests, as indeed all of its conduct in this case, were in full conformity with its statutory rights and responsibilities.

188. Finally, Respondent submits that Claimants have failed to demonstrate any damages arising from these “transgressions” and that, in any event, its claims are barred by the one-month statute of limitations relating to administrative acts under Estonian law.

*Claimants’ Claims 6 & 7: The License Revocation*

189. Respondent submits that EIB’s license was revoked because EIB committed serious violations of the Estonian banking code. In particular :

- EIB repeatedly refused to provide information or reported false and misleading information to regulatory authorities;

- EIB's principal shareholders did not have qualified holding permits;
- EIB had difficulties in meeting its minimum capitalisation requirements;
- EIB, its shareholders and their affiliates were responsible for a series of questionable transactions; and
- EIB artificially inflated its balance sheet.

190. Respondent submits that, for the above-mentioned reasons, EIB's license revocation was justified. Respondent also contends that this revocation cannot be considered an expropriation.

191. Respondent declares that there was no denial of justice in the Estonian courts, and that much of what Claimants now complain of was due to their own dilatory tactics in the various Estonian proceedings.

192. Finally, Respondent submits that Claimants' claims are time-barred.

*Claimants' Claim 8: Harassment*

193. Respondent claims that the criminal investigation of Mr. Genin for possible tax evasion and Mr. Dashkovsky's troubles with the Immigration Board had nothing to do with the matter of EIB's conduct.

194. Respondent submits that, in any case, this claim is not an "investment dispute" under the BIT and therefore does not give rise to an arbitrable claim, and further submits that Claimants have failed to demonstrate any damages relating to the alleged harassment.

*Damages and Counterclaim*

195. As a preliminary matter, Respondent submits that Eastern Credit's purchase of EIB's claims relating to the sale of the Koidu branch does not involve an investment agreement with the Republic of Estonia and, therefore, is not an arbitrable "investment dispute" under the BIT.

196. Respondent also contends that the transfer of EIB's claims relating to the sale of the Koidu branch to Eastern Credit was entered into for the

purpose of artificially inflating EIB's balance sheet and that there is no evidence that any money was ever paid to EIB. Indeed, Respondent alleges that Eastern Credit, employing feigned transactions, used over-valued stock to divert in excess of US\$500,000 from the coffers of EIB to the Claimants.<sup>47</sup>

197. Similarly, Respondent alleges that Claimants diverted in excess of US\$1,000,000 in transactions involving the purchase and sale by EIB of shares in Tollycraft Corporation.<sup>48</sup>

198. Respondent submits that Claimants' request for the future value of EIB, following a merger and/or a public offering, is purely speculative, and that such damages may not be recovered under Estonian law. Respondent also points out that such a claim is based on ownership of 100% of EIB, while Claimants (to the exclusion of "Eurocapital") only owned 9.2% of EIB at the time that the license was revoked.<sup>49</sup> Thus, Respondent contends that, even assuming that any damages resulting from that violation could be established, Claimants would only be entitled to 9.2% of those damages.

199. Respondent also alleges that Mr. Genin and Mr. Dashkovsky took approximately US\$ 2,900,000 out of EIB after the license was revoked, and that this constitutes a preferential transfer in violation of Estonian law.

200. Respondent submits Claimants are not entitled to recover any sums from Respondent, but should, rather, be required to return the proceeds of their various illicit transactions.

201. By way of counterclaim, Estonia requests damages in excess of US\$3,400,000 for money illegally diverted from EIB by the Claimants, plus the costs of the arbitration.

### 3) Claimants' Response

202. As ordered by the Tribunal, Claimants filed their Reply Memorial ("Reply"), with supporting documentation, on 18 July 2000.

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<sup>47</sup> Counter-Memorial, p. 52.

<sup>48</sup> Counter-Memorial, p. 53.

<sup>49</sup> Counter-Memorial, p. 54, referring to Claimants' Exhibit 12.



203. In their Reply, Claimants address a series of preliminary points.

204. First, Claimants allege that Eastern Credit owns Baltoil, and that there is overwhelming documentation contained in public records in Estonia in that regard. Claimants also state that it is not possible for them to prove who the shareholders of Eurocapital Ltd. were at the time that the transactions at issue in this arbitration occurred, because the shares of Eurocapital Ltd. are, and always have been, issued to bearer.

205. Claimants reiterate their contention that the Bank of Estonia revoked EIB's license in order to avoid its responsibility for misrepresentations in connection with the sale of the Koidu branch, and that the Bank of Estonia created so-called "regulations" (the 1997 Regulations/Guidelines) in order to discover information from EIB's shareholders that it hoped to use in the United States litigation.

206. Claimants point out that the only trouble that EIB had in maintaining its legal capital requirements resulted from the losses it suffered in the purchase of the Koidu branch, for which the Bank of Estonia is responsible. Indeed, it was the Bank of Estonia's breach of the April 1996 Koidu Settlement Agreement that imperilled the bank's capitalisation. Further, the third party agreement that the Bank of Estonia claims was a condition of the Settlement Agreement was, in essence, irrelevant.

207. Claimants contend that all transactions concerning Landmark International, Tollycraft and Pacific Commercial Credit are legitimate. Moreover, Claimants submit that the Bank of Estonia revoked EIB's license on the sole ground of the alleged failure to apply for qualified holdings. For this reason, it is Claimants' contention that Respondent's arguments regarding these transactions have nothing to do with the present arbitration.

208. Claimants assert that all of the relief sought by them is grounded in breaches of the BIT that occurred after the date on which the BIT entered into force. Claimants point out that the Treaty specifically applies to investments that were already in effect at the time the Treaty went into force.

209. Claimants reiterate their position that the assignment of claims to Eastern Credit by EIB was not limited to claims against Social Bank, but

rather covered any claims arising out of the sale of Koidu branch, including claims against the Bank of Estonia.

210. Claimants contend that the assignment of EIB's claims to Eastern Credit was validly paid for with the transfer of Landmark and Tollycraft shares.

211. Claimants submit that the one-year statute of limitations raised by Respondent only applies to a cause of action to cancel a contract on the basis of misrepresentation, and *not* to a cause of action for compensation. Claimants allege that the cause of action for compensation, which comprises the sort of claims made in this arbitration, has a ten-year statute of limitations under Estonian law.

212. Finally, as regards the amount of damages claimed, Claimants submit that Respondent has not offered any evidence as an alternative to Mr. Murray's valuation of the fair market value of EIB.

#### 4) Respondent's Rejoinder

213. As ordered by the Tribunal, Respondent filed its Rejoinder Memorial ("Rejoinder"), with supporting documentation, on 18 August 2000.

214. In its Rejoinder, Respondent reiterates that EIB lost its license because it failed to follow the law governing the operation of a commercial bank in Estonia.

215. Respondent states that, under international law, it is the party alleging a violation of international law giving rise to international responsibility that has the burden of proving the allegation. Respondent submits that Claimants have failed to meet this burden.

216. Respondent reiterates that the Tribunal does not have jurisdiction over the claims that relate to acts that occurred before the entry into effect of the BIT, citing, as examples, Claimants' claims 1 to 3.

217. Respondent also contends that the Bank of Estonia at all times acted in conformity with the relevant banking laws and regulations.

218. Respondent then reviews its position with respect to each of the issues addressed in its Counter-Memorial.

*Claimants' Claim 1: The Koidu Branch*

219. Respondent contends that Claimants' claim regarding compensation for misrepresentations in the sale of Koidu branch is not related to an "investment" for which there may be an "investment dispute" under the BIT; that the investment in question is a domestic claim by EIB; and that Eastern Credit should not be able to convert an acquired domestic claim into an international dispute. Respondent also contends that this "investment" is pre-BIT and is therefore not subject to arbitration.

220. Respondent further submits that there is no proof that the Bank of Estonia made any misrepresentations in the sale of Koidu branch.

*Claimants' Claim 2: The April 1996 Settlement Agreement*

221. Respondent reiterates its contention to the effect that the April 1996 Koidu Settlement Agreement between EIB and the Bank of Estonia was merely a memorandum of understanding, or tentative agreement, and that no final agreement was ever entered into. Respondent also points out that this attempt to reach an agreement was ultimately rejected by Alex Genin, who declared all prior agreements, including the tentative agreement, "null and void".

222. Respondent submits that the allegations relating to this claim are pre-BIT and, for this reason, the Tribunal does not have jurisdiction over the matter.

*Claimants' Claim 3: EIB's Reduction in Capital*

223. Respondent reiterates its contention that there was no agreement between EIB and the Bank of Estonia to amortise EIB's losses relating to the sale of the Koidu branch over a five-year period. Respondent explains that such an accounting mechanism is recognised in Estonia and is available to all, but that EIB apparently chose not to avail itself of this mechanism.

224. Respondent also submits that the allegations relating to this claim are pre-BIT and are therefore not subject to arbitration.

*Claimants' Claims 4 & 5: The Qualified Holding Prescription*

225. Respondent submits that the requests for information by the Bank of Estonia from EIB were reasonable and in accordance with published Estonian law.

226. Respondent also submits that, under Estonian law, the claims relating to the March 1997 Prescription or the September 1999 license revocation are barred by the Estonian statute of limitations.

*Claimants' Claim 6: The License Revocation*

227. Respondent reiterates its position that the Bank of Estonia was justified in revoking EIB's license and that it did so in accordance with the laws of Estonia.

228. Respondent also reiterates its submission that the litigation before Estonian courts and the statute of limitations for challenging administrative acts gives rise to an absolute, jurisdictional bar to arbitration on this issue.

*Claimants' Claim 7: The Actions of the Estonian Courts*

229. First, Respondent points out that it was a minority shareholder of EIB, over whom Respondent exercised no control, who initiated mandatory liquidation of EIB. For this reason, Respondent contends that this act cannot be attributed to the Republic of Estonia.

230. Respondent further submits that the Bank of Estonia revoked EIB's license in accordance with Estonian law and that this was neither the result of, nor did it give rise to, any denial of justice in the Estonian administrative or judicial process.

231. Respondent also reiterates that Claimants' prior resort to litigation in Estonia divests the Tribunal of jurisdiction.

*Claimants' Claim 8: Harassment*

232. Respondent reiterates its position that the claim of "harassment" is not an "investment dispute" and that the acts described in the claim have no relation to this case.

*Damages*

233. Respondent asserts that the valuation report prepared by Mr. Murray is flawed; that it is Claimants' burden to construct a credible model of damages; and that they have failed to do so in this case. Respondent also reiterates its contention that Claimants have suffered no damages from the actions of the Bank of Estonia.

234. In any event, Respondent reiterates that the appropriate measure of damages in this case is the quantum actually lost by the Claimants and not the value of a 100% interest in EIB.

235. Moreover, Respondent reiterates that Claimants illicitly diverted nearly US\$3,000,000 to Eurocapital following the revocation of EIB's license, and that the proceeds from these transactions must be returned.

#### G. THE ORAL PROCEDURE

236. In accordance with the Tribunal's directions, each party filed with the Tribunal, prior to the commencement of the oral hearing, written statements by its witnesses.

237. As scheduled, the hearing commenced on Monday, 2 October 2000, in Washington, D.C. Eleven witnesses were heard and counsel for the parties presented extensive oral arguments.

238. The hearing ended on Friday, 6 October 2000.

##### 1) Claimants' Evidence

239. On behalf of Claimants, the following two expert and four fact witnesses appeared and gave evidence during the oral hearing:

- Mr. Brian V. Murray and Mr. Janos Eros, both of whom were involved in the preparation of the expert valuation prepared for Claimants, gave evidence jointly, as agreed by counsel and the Tribunal. They testified as to the nature of their mandate (to value EIB, not its operating license *per se*), the conduct of their mandate and the conclusions reached by them. They testified that, in their

opinion, the most realistic valuation could be attained only on the basis of a “going concern” analysis and by means of a “price to book value” assessment. Their “going forward” approach involved estimating a value for EIB *had it been able to achieve its business plan objectives, one of which included a possible merger with Eeva Bank and eventual listing on U.S. stock markets*. The witnesses stressed that they had no mandate to conduct an audit of EIB or to test the financial or other information provided to them by Messrs. Genin and Daskovsky, which formed the basis of their analysis.

- Mr. Alex Genin testified, over almost two full days, regarding virtually all aspects of Claimants’ claims as well as the issues raised in Respondent’s submissions. This included the origin and nature of the Claimants’ respective shareholdings in EIB, the ownership and inter-relationship of the various companies in which Mr. Genin is involved, and the actions of EIB and its shareholders, on one hand, and of the Bank of Estonia, on the other, comprising the factual background to the arbitration. Of particular interest was Mr. Genin’s disclosure, for the first time in these proceedings, that *he is the beneficial owner of the “bearer” shares of Eurocapital*. Mr. Genin also gave evidence regarding the transactions at issue in the arbitration, involving himself, his companies, EIB and third parties, including as regards the purchase and sale of Landmark and Tolleycraft stock. He also testified as to the history of his relationship with the Bank of Estonia and, in particular, Mr. Kraft; this included evidence concerning his companies’ various requests for investment authorisation, as well as the alleged Koidu Settlement Agreement and Write-Off Agreement between the central bank and EIB.
- Mr. Michail Dashkovsky gave evidence regarding his ten-year relationship with Mr. Genin, working on projects in Russia and Estonia, and his eventual appointment as president of EIB. Along with Mr. Genin, Mr. Dashkovsky was a key participant in almost all of the events on which Claimants’ claims are based, including EIB’s purchase of the Koidu branch and the subsequent negotiations, with Mr. Kraft of the Bank of Estonia, regarding the losses allegedly suffered by EIB as a result of that purchase. Mr. Dashkovsky also testified regarding the ownership of the various companies at issue in the arbitration. In addition, he gave evidence regarding the relationship between EIB and the Bank of Estonia, the latter’s

audits, inspections and requests for information, EIB's responses to those requests and, generally, regarding events leading up to the revocation of EIB's license. Finally, Mr. Dashkovsky testified regarding the alleged harassment suffered by him at the hands of the Estonian authorities.

- Mr. Viktor Kaasik, Claimants' and EIB's Estonian counsel, gave evidence regarding certain aspects of the Estonian statutes at issue in the arbitration (the *Credit Institutions Act* and the *Bank of Estonia Act*), as well as regarding the proceedings launched by EIB to challenge the 9 September 1997 revocation of its license. Mr. Kaasik testified that, in his opinion, much of the information requested of EIB and its shareholders by the Bank of Estonia prior to the revocation of EIB's license was illegal, and the revocation itself constituted a breach of Estonian law.
- Mr. Janus Mody, a lawyer working with Mr. Kaasik's law firm, testified regarding EIB's responses to the Bank of Estonia's various information requests, including the May 1997 filing of applications for qualified holdings and the EIB's request regarding the legal basis of the March 1997 Regulations/Guidelines. He also gave evidence regarding certain provisions of the *Bank of Estonia Act* and the *Credit Institutions Act* and, in particular, their English translations. Of particular relevance was Mr. Mody's testimony regarding a meeting with representatives of the Bank of Estonia, prior to the revocation of EIB's license, at which he claims to have shown those present a document containing information responsive to the Bank of Estonia's various requests, in response to which he was told that the sole purpose of those requests was to garner information that would be of use to Bank of Estonia in its defence to the Texas litigation initiated by Eastern Credit.

## 2) Respondent's Evidence

240. The following two expert and three fact witnesses appeared and gave evidence on behalf of Respondent:

- Mr. Paul Varul testified regarding his expert opinion concerning the *Bank of Estonia Act* and the *Credit Institutions Act*. He gave evidence regarding the origin and the nature of these statutes and their applicability to the questions at issue in this arbitration. His

testimony covered the specific provisions of the Estonian legislation that, in his opinion, empower the Bank of Estonia to request such information as it considers necessary in the exercise of its regulatory and supervisory functions; this includes the legislative provisions empowering the Bank of Estonia to revoke an institution's license, provisions which, in Mr. Varul's opinion, were respected in this instance.

- Mr. Vahur Kraft, President of the Bank of Estonia, gave evidence principally in respect of the sale of the Koidu branch of Social Bank and the subsequent events relating to alleged discrepancies in the branch's balance sheet. Mr. Kraft also testified regarding the nature and content of the so-called Koidu Settlement Agreement, which he described as tentative, and, generally, regarding the action of the Bank of Estonia leading up to and surrounding the revocation of EIB's license. In particular, Mr. Kraft described the decision-making process immediately preceding the Bank of Estonia's revocation of EIB's license on 9 September 1997, and explained the reasons for the Bank of Estonia's decision.
- Ms. Eve Sirts, the head of the Off-site Supervision Sub-department of the Banking Supervision Department of the Bank of Estonia, provided evidence concerning details of the Bank of Estonia's various requests for information, which culminated in its decision to revoke EIB's license. Ms. Sirts testified regarding the conduct of the Bank of Estonia's inspections and audits of EIB, as well as regarding the reasons for those inspections and their results. In particular, she gave evidence with respect to the various "concerns" regarding EIB alleged in Respondent's written submissions, such as the identity of Eurocapital, alleged self-dealing among EIB and its shareholders and EIB's alleged misstatement of assets on its books. Ms. Sirts also described the nature of the March 1997 Regulations/Guidelines, including their use by the Bank of Estonia in this and other instances.
- Mr. Aare Tark, Estonian counsel to the Bank of Estonia, gave evidence and answered questions from the Tribunal.<sup>50</sup> He testified as to various procedural issues associated with the Estonian legal proceedings launched by Claimants, and expressed his opinion

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<sup>50</sup> While a witness statement by Mr. Tark had been filed by Respondent, neither Claimants nor Respondent expressed a desire to examine him at the hearing.



that the long delays in the conduct of those proceedings was the fault of EIB. He also gave evidence regarding the Bank of Estonia's authority to issue Prescriptions (Precepts) and described the nature of such Prescriptions and the obligations arising therefrom.

- Mr. Joseph Anastasi, a representative of Deloitte & Touche gave evidence seeking to rebut the expert report and testimony of Claimants' witness, Brian V. Murray. Although Mr. Anastasi did not participate in the Deloitte & Touche report in this regard, which was filed with Respondent's written submissions, his testimony was permitted by agreement of the parties and with the consent of the Tribunal. Accordingly, Mr. Anastasi testified in particular as regards the assumptions underlying Mr. Murray's report and the methodology employed by him, which, in his opinion, rendered Mr. Murray's conclusions inaccurate.

## H. POST-HEARING SUBMISSIONS

### 1) Claimants' Post-Hearing Memorial

241. As ordered by the Tribunal, Claimants duly filed their Post-Hearing Memorial, with supporting documentation, on 19 December 2000.

242. In their Post-Hearing Memorial, Claimants summarize what they refer to as "*the core issue*" in this case as follows:

(. . .) Estonia violated the [BIT] when its state enterprise, the Bank of Estonia, revoked [EIB's] license at a time when the bank was a solvent and growing institution, the depositors and creditors of the bank were in no danger, and the [Claimants'] investment in the bank posed no potential harm to the Estonian banking system.<sup>51</sup>

243. "Boil[ing] this case down to its essence", Claimants' declare:

(. . .) [w]hat makes the Bank of Estonia's actions so unjust, so unfair, and so totally without due process is the complete

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<sup>51</sup> Claimants' Post-Hearing Memorial, p. 1.

lack of any legitimate reason to take the extreme measures of destroying [EIB].<sup>52</sup>

244. Claimants' post-hearing submissions focus on "the nature of the conduct of the Bank of Estonia as reflected in its actions and the allegations it has attempted to make in this proceeding."<sup>53</sup>

245. Claimants emphasise that the motivations of the Bank of Estonia are at the heart of the matter, and are relevant in determining whether or not its actions were fair, just and in accordance with the requirement of due process.

246. Claimants declare that the case that the Bank of Estonia attempted to make when it revoked EIB's license and that it is now defending in this arbitration is but an "*illusion*", that is, "an attempt (...) to persuade the decision-maker that some circumstance is true without meeting [the] burden of proof on that issue."<sup>54</sup>

*"Proof vs. Illusion"*

247. Claimants submit that they have met their burden of proof on the evidence that they have adduced.

248. They state that, on 9 September 1997, EIB's license was revoked, for four stated reasons:

- (1) the address of Eurocapital Group on EIB's stock register was Houston, Texas, while on the list of stockholders it was the Isle of Man;
- (2) the Bank of Estonia refused to recognise that Eurocapital Co. and Eurocapital Ltd. are the same entity;
- (3) the EIB failed to provide information on the shareholders of Eurocapital Group;
- (4) EIB's shareholders did not provide information sufficient to determine their application for qualified holdings.

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<sup>52</sup> *Ibid.*, p. 2.

<sup>53</sup> *Id.*

<sup>54</sup> *Ibid.*, p. 3.

249. In response, Claimants state the following :

- (1) Eurocapital Group has both an Isle of Man address and a Houston, Texas, address;
- (2) the Bank of Estonia knew, on 9 September 1997, that Eurocapital Group Company and Eurocapital Group Ltd. are the same company;
- (3) the Bank of Estonia knew that the shareholder of Baltoil was Eastern Credit, that Eastern Credit was owned by Mr. Genin and had been informed in April 1996, that Mr. Genin was also Eurocapital Group's owner and sole shareholder;<sup>55</sup>
- (4) the necessary investment licenses and authorisations had already been granted to Claimants.

250. Claimants contend that, in order for "misinformation" to be a ground for license revocation, the allegedly wrong or misleading data in question must have been communicated deliberately, which is not the case with EIB.<sup>56</sup>

251. Claimants allege that, on 10 February 1997, the Bank of Estonia requested information about EIB's shareholders that it had already twice requested in 1996, at the time EIB and the Bank of Estonia were involved in the United States litigation over the Koidu branch. Claimants contend that Estonian law did not allow the Bank of Estonia to request this information.

252. Claimants reiterate that, when the Bank of Estonia sent EIB a set of regulations in support of its request for information in regard to Claimants' applications for qualified holding (the March 1997 Regulations/Guidelines), EIB responded with its own request regarding the legal basis for the regulations. Claimants state that the Bank of Estonia never responded to this request. Claimants contend that the Bank of Estonia's decision to revoke EIB's license, while ignoring EIB's legitimate request, was unfair, unjust and contrary to due process.

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<sup>55</sup> Claimants' Post-Hearing Memorial, pp. 8–9; Claimants' Exhibit 16 to Respondent's Exhibit 3.

<sup>56</sup> Claimants' Post-Hearing Memorial, pp. 9–10; Claimants' Exhibit 9, Article 195.

253. Claimants submit that the Bank of Estonia's decision to revoke EIB's license is flawed in three respects :

- (1) the stated reasons were false;
- (2) even in the event that the reasons were true, those reasons are purely formalistic, with no substantive basis;
- (3) even in the event that the reasons were true and based on substantive issues, revocation was a disproportionate remedy in the circumstances.

254. Claimants also allege that, as a result, the Bank of Estonia's revocation of EIB's license is unjust, unfair and devoid of due process.

*The Bilateral Investment Treaty*

255. Claimants submit that the Bank of Estonia has violated the BIT:

- by revoking EIB's license;
- by failing to abide by the April 1996 Koidu Settlement Agreement; and
- by failing to abide by the March 1996 Write-Off Agreement.

256. In this regard, Claimants refer to the following provisions of the BIT:

- Article 2, Paragraph 2 (b), requiring Estonia to ensure that the conduct of governmental authority by the Bank of Estonia was not inconsistent with its obligations under the Treaty;
- Article 2, Paragraph 3 (a), requiring Estonia to accord "fair and equitable" treatment to Claimants' investment;
- Article 2, Paragraph 3 (b), prohibiting Estonia from impairing by arbitrary means Claimants' activity related to that investment;
- Article 2, Paragraph 3 (c), requiring that Estonia abide by its agreements entered into in connection with Claimants' investment;
- Article 2, Paragraph 7, requiring Estonia to provide effective means for the Claimants to assert claims and enforce their rights regarding their investment;

- Article 3, requiring an expropriation to meet the requirements of due process (paragraph 1) and requiring the availability of a prompt review of the expropriation (paragraph 2);
- Article 7, Paragraph 1, rendering the Treaty applicable to investments that existed at the time the Treaty became effective.

257. Claimants contend that the BIT applies retroactively to all investment disputes that arise from a failure by the State to abide by the Treaty, even if the controversy initially arose before the Treaty went into effect.

*“The Defenses That Never End”*

258. Claimants contend that most of the Bank of Estonia’s stated justifications for its actions were not mentioned at the time of EIB’s license revocation. Claimants contend that these justifications have been constructed for the purpose of this arbitration.

*“Inconsistent Reasoning”*

259. Claimants allege the following:

- Eastern Credit has held an authorised qualified holding in EIB since the early 1990s;
- Baltoil is the subsidiary of Eastern Credit; and
- Eurocapital Group Ltd. has held an authorised holding since 1995.

260. Claimants contend that the Bank of Estonia concocted, in 1997, a technical argument that the above-mentioned entities had neither applied nor received permission for qualified holdings in EIB.

261. Moreover, Claimants allege that Estonian law requires the Bank of Estonia to notify an applicant for a qualified holding of its decision in regard to that application within one month. Claimants submit that this was not done for the above-mentioned entities when they re-applied for qualified holdings, in 1997. Claimants state that the Bank of Estonia instead responded, on exactly the 30th day after receipt of the applications, by sending the March 1997 Regulations/Guidelines.

262. Claimants assert that, while Respondent claims that the March 1997 Regulations/Guidelines were established in 1995, the information supposedly required by that instrument was never requested of Eurocapital when it applied for a qualified holding, in 1995, approximately six months after the *Credit Institutions Act* went into effect. Claimants contend that the March 1997 Regulations/Guidelines were fabricated specifically so that the Bank of Estonia could use them to get information from EIB for use in the United States litigation.

*“When is an Eye Really an Ear”*

263. Claimants assert that the fact that Mr. Genin has incorporated numerous companies for specific purposes (such as the need to have a corporate entity in different countries) merely reflects the scale of Mr. Genin’s business activities, *not* that he is engaged in any improper activity.

264. Claimants emphasise that it is Estonia that bears the burden of proving that the existence of those corporations is related to activity that affected EIB in an improper way. Claimants submit that Estonia has failed to provide any evidence that these companies were involved in any wrongdoing.

265. Regarding the Landmark and Tollycraft stock transactions, Claimants contend that, overall, EIB lost no money in these transactions.<sup>57</sup> Claimants also submit that the Respondent has not proved any wrongdoing merely by showing that this stock was purchased by the bank and ultimately sold to its shareholders. Claimants allege that the reason for transferring the stock into EIB in the first place was to cover losses caused by the Bank of Estonia’s reneging on the March 1996 Write-Off Agreement.

266. Claimants submit that Respondent bears the burden of proving that Claimants have acted improperly in a manner that related to the revocation of EIB’s license. Claimants declare that Estonia has provided no evidence of such wrongdoing or of any relationship between the conduct in question and the revocation of EIB’s license.

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<sup>57</sup> Claimants’ Post-Hearing Memorial, p. 30–31; Claimants’ Exhibit 98–100.

*“Alex Genin’s Testimony Concerning Eurocapital”*

267. Claimants acknowledge that Mr. Genin declared at the hearing that he considers himself to be the beneficial owner of Eurocapital Ltd., after having previously maintained, throughout the case, that he was not the owner of the company.

268. Claimants contend that the fact that this declaration was not made previously does not have any bearing on the merits of the case, because Estonia already knew, in essence, that Mr. Genin was the owner of Eurocapital Group—in early 1996, EIB stated this fact in its report to the Bank of Estonia.<sup>58</sup> Further, there is nothing in the record that would in any way indicate that Estonia believed the shareholder of Eurocapital to be anyone *other* than Mr. Genin, or that the Bank of Estonia believed there was anything improper in Mr. Genin’s ownership.

269. In addition, Claimants suggest that Mr. Genin’s ownership of Eurocapital is actually favourable to his claims in the arbitration:

- since the BIT defines an investment as being “direct or indirect”, an investment in the name of Eurocapital Ltd. is arbitrable;
- the ownership issue in no way changes the fact that Eastern Credit had entered into an agreement with Eurocapital Ltd. to borrow funds for the purchase of EIB stock in its own name.

270. Claimants state that the Bank of Estonia was not concerned about Eurocapital Ltd. until the US litigation began, and that all the matters that the Bank of Estonia complained about in September 1997, when it revoked EIB’s license, had been evident at least since 1995.

271. Claimants concede that Mr. Genin’s failure to reveal the fact that he considered himself the beneficial owner of Eurocapital Ltd. could be considered to have affected this case. They declare that, as a result, it would be appropriate for the Tribunal to adjust the amount of costs to be awarded in the arbitration, to reflect the extra work and expenses to which Mr. Genin’s conduct in this regard has contributed.

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<sup>58</sup> Claimants’ Post-Hearing Memorial, p. 32; Claimants’ Exhibit 16 to Respondent’s Exhibit 3.

272. However, Claimants submit that, even had Mr. Genin stated at the outset that he was the beneficial owner of Eurocapital Ltd., it is clear that Respondent would have investigated the matter in any event, given that the shares are issued to “bearer” and are currently held as collateral by another individual. Claimants contend that, while the issues that would have been raised might have been different, the issue of Eurocapital’s ownership would not have been eliminated altogether.

*“A Matter of Perspective”*

273. In regard to Mr. Hobbs, the promoter of the Tollycraft stock who was apparently found to have engaged in securities fraud, Claimants state that there is no indication that Mr. Genin was in any way related to those matters.

274. Claimants contend that, whether or not Mr. Hobbs is a criminal, there is no proof of any wrongdoing by Mr. Genin.

*“Get Out Your Straightedge”*

275. Claimants submit that, throughout the arbitration, whenever Estonia is unable to reply to the documentary evidence, it qualifies that evidence as forged. For example, the Bank of Estonia denies receiving the 26 May 1997 letter produced by Claimants, in which Mr. Mody, Estonian counsel to EIB, requests the legal justification for the March 1997 Regulations/Guideline, even though internal Bank of Estonia documents indicate that personnel from EIB reminded the Bank of Estonia of this letter well before the EIB’s license was revoked in September 1997. Similarly, Estonia suggests that Claimants’ Exhibit 80, a letter predating the license revocation by a year, in which various “rumours” regarding the Bank of Estonia’s intentions vis-à-vis EIB are recorded—intentions that were actually manifested over the course of the ensuing year—is a forgery.<sup>59</sup>

276. Finally, Claimants reiterate their submissions to the effect that the Bank of Estonia revoked EIB’s license on totally fabricated grounds and without any prior notice, that Respondent caused negative publicity for EIB and its investors, and that it harassed those investors and Mr. Dashkovsky.<sup>60</sup>

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<sup>59</sup> Claimants’ Post-Hearing Memorial, p. 44.

<sup>60</sup> Claimants’ Post-Hearing Memorial, p. 45.



*“Damages”*

277. Claimants explain the valuation of EIB conducted by B.V. Murray & Company, by stating the following :

- Claimants own a total of 84.145 % of EIB (assuming that Euro-capital is a direct investment of Genin);
- the value of EIB, as valued by B.V. Murray & Company in September 1997, when EIB’s license was revoked, ranges between US\$20 million to US\$21 million;
- at the time, there was good chance that EIB would merge with a financial institution known as EVEA Bank;
- the total equity in a merged EIB/EVEA entity would have been 151.6 million EEK; EIB’s share would have been 82.3 million EEK (54%), while EVEA Bank’s share would have been 69.3 million EEK (46%);
- Claimants would have owned 84.145% of 54% of the merged bank, i.e. approximately 46%;

278. B.V. Murray & Company’s three alternate valuations, based on projections of the value of the merged entity as of the end of 1999, are as follows:

- \$29 million to \$36 million, based on *Estonian* market conditions at the time;
- \$67 million to \$112 million, as a bank publicly traded on the less volatile, more liquid *US* markets.
- \$100 million to \$125 million, as an “internet stock” traded on *US* markets.

279. As a matter of law, Claimants argue that the amount that should be awarded is the market value of the investment at the time that the injury occurred,<sup>61</sup> including future profits.

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<sup>61</sup> Claimants cite the *AAPL v. Sri Lanka* case.

280. Claimants state that the calculation of damages should also include the 5% interest in EIB held by a company called OCS, which was bought back by Eurocapital, out of fairness towards OCS, when EIB's license was revoked by the Bank of Estonia.<sup>62</sup>

## 2) Respondent's Post-Hearing Memorial

281. As ordered by the Tribunal, Respondent duly filed its Post-Hearing Memorial, with supporting documentation, on 19 December 2000.

282. In its Post-Hearing Memorial, Respondent states that Claimants' entire case lacks credibility; that their assertions are unsubstantiated, as nearly all their "proof" derives from the self-serving declarations and unreliable oral testimony of Mr. Genin and Mr. Dashkovsky; and that no credible, contemporaneous evidence—documentary or otherwise—has been offered to support their claims of misrepresentation, breach of contract, denial of justice or harassment.

283. Respondent claims that Mr. Genin's evasiveness at the hearing illustrates that he was attempting to circumvent Estonian banking regulations and deceive Estonian banking officials.

284. Respondent submits that, based on what has been revealed about EIB in this proceeding, it is abundantly clear that it was not unfair, inequitable or arbitrary for the Estonian regulators to act to protect depositors and creditors by revoking EIB's license.

### *"Jurisdiction is Absent"*

285. Respondent alleges that Mr. Genin controlled EIB—both directly and indirectly—through his subordinates and other corporations over which he had unlimited authority. Three such corporations, Eurocapital Ltd., Eastern Credit and Baltoil, held over an 85% interest in EIB when the license was revoked.

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<sup>62</sup> Claimants' Post-Hearing Memorial, pp. 45–49. Claimants refer to their Exhibit 103.

286. Respondent also submits that the testimonial and documentary evidence proves that Mr. Genin dominated and controlled EIB and its majority shareholders. Specifically :

- Mr. Genin was Chairman of the Board of EIB;
- Mr. Genin and his surrogates, Mr. Dashkovsky, Ms. Dee Severson, Mr. James Sutherland, and Mr. Joselito Sangel, engaged in numerous, non-arms length transactions with EIB;
- Mr. Genin had unlimited investment authority for EIB;
- in exercising his authority, Mr. Genin reportedly transferred assets (*e.g.*, the Tollycraft and Landmark stock he had obtained both personally and in the names of Eastern Credit and Eurocapital) to EIB without requiring or producing any written documentation;
- one of the few written documents regarding the transfers of shares was unilaterally disregarded by Mr. Genin: Mr. Genin entered into a “put” agreement with EIB which he ignored once he felt that the bank had benefited enough from the instrument (although EIB had the right under the agreement to sell its remaining 500,000 shares of Tollycraft stock to Eurocapital for \$4.50 per share, Mr. Genin decided that Eurocapital should only pay \$1.75 per share);
- Although the Texas litigation is not “litigation in the host State”, which would divest the Tribunal of jurisdiction, it provides further evidence of how Claimants dominated EIB and ignored the traditional boundaries between a company and its shareholder—in that instance, by means of a self-serving “assignment” of EIB’s rights to Eastern Credit;
- Messrs. Genin and Dashkovsky used EIB to pay for their Houston office space;
- EIB paid substantial “management fees” to Eurocapital, although there is no evidence that there was any type of management agreement between the two companies;
- Mr. Dashkovsky was the “formal decision maker” who first authorised EIB’s decision to pursue litigation in the Estonian courts over the Koidu bank dispute;

- Mr. Genin admitted he was the owner and sole shareholder of Eastern Credit throughout the relevant period;
- Mr. Genin beneficially owned Eurocapital at all relevant times, and held a “full” power of attorney to act on Eurocapital’s behalf;
- Mr. Genin made decisions to appoint and replace Eurocapital’s directors, including his secretary and his wife, and also dictated how Eurocapital’s ledgers were handled;<sup>63</sup>
- Respondent also submits that there is no evidence that anyone *other* than Mr. Genin (through his companies and Mr. Dashkovsky) controlled EIB.

287. Respondent submits that the parties to the arbitration are, in effect, *the same as those in the Estonian court proceedings* and that, for this reason alone, the Tribunal does not have jurisdiction in this case.

288. Respondent contends that, under Article VI (3) of the BIT, ICSID has no jurisdiction if the “national or company” submitted the dispute for resolution to the courts or administrative tribunals of Estonia. Respondent also alleges that it would be contrary to the BIT to allow an entity (EIB) to sue in one forum while its parent company or shareholders sue, derivatively elsewhere, for the same alleged wrong.

289. Respondent also submits that Baltoil is not owned by Eastern Credit, as claimed by Claimants, and therefore Baltoil cannot be a proper claimant in this arbitration under Article VI (8) of the BIT.

*“Genin’s Story is not Credible”*

290. Respondent contends that Mr. Genin’s testimony is discredited for the following reasons, and should therefore be rejected by the Tribunal :

- he lacks credibility;
- he repeatedly gave inconsistent statements on key issues in this case;

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<sup>63</sup> Respondent’s Post-Hearing Memorial, pp. 3–4.

- he deliberately misrepresented facts when it was to his legal and financial advantage to do so; and
- he engaged in questionable financial activities.

291. Respondent contends that there are many inconsistencies in Mr. Genin's testimony, *e.g.* the refusal or inability to explain the origin and nature of Eurocapital, while finally admitting, during his cross-examination, that he is its legal owner.<sup>64</sup>

292. Respondent alleges that Claimants' entire relationship with the Bank of Estonia was predicated upon false and misleading information :

- Eastern Credit misrepresented its financial condition when it originally submitted financial statements to the Bank of Estonia in 1992, listing \$34 million in assets which it did not, in reality, own.

293. Eurocapital's application for a qualified shareholding in EIB, in 1995, was likewise predicated upon false information submitted by Genin and Dashkovsky to the Bank of Estonia:

- Eurocapital misrepresented itself as "Eurocapital Group Company" when, in fact, there is no evidence that such a company ever existed;<sup>65</sup>
- Ms. Severson, Mr. Genin's secretary, forged the signature of Eurocapital Ltd.'s CFO, Mr. Gregory Zak, on the application.<sup>66</sup>

294. Respondent contends that this evidence is but part of a larger pattern of conduct in which Mr. Genin and his associates fabricated documents and evidence to support their ends, for example:

- Mr. Genin admitted that he used fictitious names on commercial contracts;
- Mr. Genin knowingly participated in false "confirmations" of non-existent transactions; and

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<sup>64</sup> Respondent's Post-Hearing Memorial, pp. 7–9.

<sup>65</sup> Respondent's Post-Hearing Memorial, p. 11; Respondent's Exhibit 146.

<sup>66</sup> Respondent's Post-Hearing Memorial, p. 10; Respondent's Exhibit 109.

- Mr. Genin manufactured evidence of US \$41 million damages as made-up expenses for another Genin entity (Sovtex).<sup>67</sup>

295. Respondent submits that, given Claimants' pattern of conduct, no weight should be given to allegations that are not substantiated by credible, independent evidence.

296. Respondent contends that the testimony at the hearing on the merits showed the extent to which Mr. Genin, aided and abetted by Mr. Dashkovsky, regularly engaged in self-dealing between and among his companies to further his own personal interests. For example:

- Mr. Genin prepared and signed documents as both borrower and lender;
- the funds of many of Eurocapital's clients were regularly commingled with Eurocapital's own money;
- Mr. Genin used his companies to buy his house (Pacific Commercial Credit) and his car (Eastern Credit);
- EIB agreed to settle its lawsuit with Social Bank in exchange for the latter's promise to pay over 20 million EEK, although EIB "never contemplated that those payments would be met by Social Bank";
- Mr. Genin used worthless stock in a defunct corporation, Tollycraft, through a series of feigned transactions, to inflate artificially EIB's balance sheet;
- similarly, Mr. Genin acquired shares of Landmark for less than \$0.15 per share from Peter Hobbs, which he immediately conveyed to EIB at a much higher price;
- EIB executed a "put" with Eurocapital, but sold shares to Eurocapital below the strike price when Mr. Genin decided the bank had benefited "enough";
- EIB made a \$2.9 million "deposit" of its money with Eurocapital to secure Eurocapital's claim against EIB.<sup>68</sup>

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<sup>67</sup> Respondent's Post-Hearing Memorial, p. 11.

<sup>68</sup> Respondent's Post-Hearing Memorial, p. 12.

*“Dashkovsky’s Story is not Credible”*

297. Respondent contends that Mr. Dashkovsky lacks credibility for the following reasons :

- he (along with Mr. Genin) executed most of the documents involving related-party transactions;
- he conceded on cross-examination that he effectively “sent to himself” a letter from EIB to Eastern Credit, Baltoil and Eurocapital requesting information from those companies;
- although he knew the answers to the questions posed by the Bank of Estonia, he never provided the bank’s regulators with the information requested during their inspections.

*“The Revocation of EIB’s License was Justified”*

298. Respondent claims that the decision to revoke EIB’s license was not made overnight, but was based on events that had occurred over the better part of a year. The bank’s license was revoked for several reasons, as disclosed in the minutes of the meeting of the Council of the Bank of Estonia and in the formal “denunciation” (revocation notice) of the license. Those reasons included:

- the submission of incorrect or misleading information about shareholders;
- Eurocapital Ltd. had not been granted permission for a qualified shareholding;
- EIB had refused to provide information concerning its shareholders and concerning parties and companies related to those shareholders;
- the instructions contained in the 10 February 1997 and 13 February 1997 letters had not been fulfilled; and
- the documents necessary to consider the granting of an authorisation for a qualified shareholding had not been submitted.<sup>69</sup>

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<sup>69</sup> Respondent’s Post-Hearing Memorial, p. 17.

299. Respondent also submits that Claimants, even when purportedly “responding” to the Bank of Estonia’s requests for information, never actually provided the information requested.

300. Respondent reiterates that Estonian banking law permits the Bank of Estonia to request information from financial institutions, and specifically provides for the revocation of an institution’s license in the event that such information is not transmitted. Respondent also asserts that Estonian banking officials had legitimate questions about the identity EIB’s shareholders.

301. For these reasons, Respondent contends that the Bank of Estonia’s requests for information in order to determine EIB’s shareholders’ identity, as well as its decision to revoke EIB’s license to operate as a depository institution, were not unfair, arbitrary or inequitable.

302. Respondent reiterates that, following the license revocation, EIB was given the opportunity to challenge the action in the Estonian courts, that it availed itself of its due process rights and was heard, repeatedly, in a series of legal challenges. Respondent also states that there is no evidence of any irregularity or fraud in the Estonian legal system; no reasons have been offered by Claimants as to why the Tribunal should effectively “disavow the Estonian legal system at the international level.”

*“The Koidu Branch Claims Have no Merit”*

303. Respondent contends that the Koidu branch claims fail for several reasons:

- Claimants offer no evidence that Mr. Kraft had knowledge of the condition or value of the Koidu branch assets that EIB purchased;
- Mr. Kraft had not worked for Social Bank for years, and was never in a position at Social Bank that would have given him knowledge of the Koidu assets;
- EIB’s purchase of the Koidu branch assets is not an “investment” under the BIT.

304. Regarding the 12 April 1996 “tentative agreement”, Respondent reiterates that Claimants have not adduced any evidence that the Bank of



Estonia acted improperly, nor did they submit proof that the Bank of Estonia breached a binding agreement by failing to obtain the third-party consent necessary for agreement to be finalised. Respondent also contends that EIB never intended to perform its obligations under the Settlement Agreement.

305. Respondent contends that the Koidu branch claims should fail because no damages have been demonstrated. It submits that Claimants have offered no credible evidence regarding how the fair market value of their EIB shareholding—which Respondent alleges comprises no more than approximately 8%—was diminished by any alleged wrongdoing relating specifically to the Koidu branch affair.

306. Finally, Respondent reiterates that all of the claims relating to the Koidu branch concern events that occurred in 1994–1996, thus pre-dating the BIT.

*“Claimants Have Suffered No Damages”*

307. Respondent contends that Claimants have suffered no damages in the present case, for the following reasons :

- Claimants presented no evidence of the fair market value of their *pro rata* portion of EIB as of the date of the revocation of its license;
- Mr. Murray’s opinion is not credible and does not prove the fair market value of Claimants’ interest. No independent investigation of the information upon which he based his opinion was ever made; the valuation was based on totally unrealistic growth projections;<sup>70</sup>
- Mr. Murray failed to account for the relatively small percentage of EIB shares actually owned by Claimants (approximately 8%) and the value that might be assigned such a small portion even in an eventual merger with EVEA Bank;
- EIB was not insolvent at the time of the license revocation. Mr. Genin and Mr. Dashkovsky transferred approximately \$2.9 million of EIB’s funds to Genin-controlled trading accounts of

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<sup>70</sup> Respondent’s Post-Hearing Memorial, p. 27.

Eurocapital Ltd. and gave up \$2.75 per share on Tollycraft shares when EIB intentionally waived its right to force Eurocapital Ltd. to purchase the shares at \$4.50 each under a pre-existing “put” option agreement;

- Claimants failed to mitigate any damages that they may have suffered. For example, the license revocation did not prevent EIB from reorganising as a lending (as opposed to a depository) institution.

308. Respondent also contends that Claimants should not be entitled to claim damages on the basis of Eurocapital’s interest in EIB, since Eurocapital is not a party to the arbitration. Likewise, Respondent contends that, since there has been no evidence that Baltoil was owned by Eastern Credit at the time of the alleged wrongful actions, its interest should not be accounted for.

309. Finally, Respondent states that the Tribunal should award Estonia the \$2.9 million transferred out of EIB by Mr. Genin and Mr. Dashkovsky, so that it may continue the liquidation process. As long as these funds are held by Eurocapital, Respondent states that it will be impossible to wind down the bank and distribute its funds to any remaining creditors and shareholders.

*“Mr. Genin’s Conduct Compels an Award of Costs & Fees”*

310. Respondent claims that Mr. Genin’s conduct throughout this case, and his extraordinary efforts to obfuscate the truth, demonstrate his severe lack of credibility. By way of example, Respondent cites the issue of Mr. Genin’s ownership of Eurocapital.

311. Respondent submits that an award requiring Claimants to reimburse it the costs and fees incurred defending itself in this proceeding is a proper means for the Tribunal to sanction Mr. Genin’s conduct.

## I. ISSUES AND ANALYSIS

312. Given the exceedingly lengthy and detailed submissions made by the parties, and the extensive documentation filed by them as evidence, the Tribunal has summarized, above, in greater detail than might otherwise have been the case, the parties’ respective positions. At the end of the day, however, and as the foregoing recital makes clear, the issues to be determined are relatively few.

313. The claims—the so-called “eight transgressions” of the BIT—alleged by Claimants, and addressed at length in the parties’ respective written submissions, can properly and logically be grouped into three categories:

- (1) Claims relating to EIB’s purchase of the Koidu branch and its losses arising therefrom (“Transgressions” 1 and 2);
- (2) Claims relating to the revocation of EIB’s license (“Transgressions” 3 to 7);
- (3) Claims concerning the alleged harassment of Messrs. Genin and Dashkovsky (“Transgression” 8).

314. By way of counterclaim, Respondent asks the Tribunal to order the restitution of \$2.9 million allegedly transferred out of EIB by Messrs. Genin and Dashkovsky and currently held by Eurocapital, failing which Respondent claims it will be impossible to finalize the liquidation of EIB.

315. Accordingly, the substantive issues to be determined may be simply and comprehensively stated as follows:<sup>71</sup>

- (1) Did Respondent, in the person of its agency, the Bank of Estonia, violate the BIT or Estonian law in relation to the sale of the Koidu branch to EIB or in regard to the handling of losses relating to EIB’s purchase of the branch (and if so, what damages are owed as a result)?
- (2) Did Respondent, in the person of its agency, the Bank of Estonia, violate the BIT or Estonian law by revoking EIB’s license (and if so, what damages are owed as a result)?
- (3) Did Respondent, in the person of its police or other agencies, violate the BIT or Estonian law by “harassing” Messrs. Genin and/or Dashkovsky (and if so, what damages are owed as a result)?
- (4) Is Respondent’s counterclaim justified (and if so, what damages are owed as a result)?

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<sup>71</sup> The issue of the costs of the arbitration, and their allocation as between the parties, is dealt with in the following section of this Award.

316. From the foregoing, and consistent with its obligations under the Convention and the BIT, it is evident that the mandate of the Tribunal is to determine whether the conduct of Respondent or its agencies, as alleged in this case, constitutes a breach of the BIT. More specifically, the fundamental question is whether the conduct of the Bank of Estonia as regards the sale of the Koidu branch and the revocation of EIB's license, and of the Estonian police as regards their treatment of Messrs. Genin and Dashkovsky, was such as to rise to the level of violations of the international law standards of "fair and equal treatment" and "non-discriminatory and non-arbitrary treatment" of investment, as those standards are reflected in Articles II(3)(a) and (b) of the BIT.

317. For the reasons explained more fully below, this multi-part question must be answered in the negative.

318. Prior to addressing the four issues identified above, however, it is necessary to consider the objection to the Tribunal's jurisdiction in this case, as formulated by Respondent.

### 1) Jurisdictional Issues

319. The Tribunal wishes to express the following observations regarding the matter of jurisdiction. The amount of \$1.6 million paid by Eastern Credit for the claims it bought from EIB could only with difficulty be considered an "investment" within the meaning of Articles I and VI of the BIT, for many of the reasons set out by Estonia in its Counter-Memorial.<sup>72</sup> Moreover, the payment was not made in cash, as required by Article 27(2) of the *Law on Credit Institutions*, and could not, therefore, qualify as additional capital. As a result, if the entirety of Claimants' case revolved around EIB's purchase of the Koidu branch and the losses allegedly suffered by Claimants as a result, it is possible that jurisdiction would not be present. This is not, however, the case. Rather, "the heart of the matter" to be determined by the Tribunal, to borrow Respondent's words,<sup>73</sup> is the legitimacy of the Bank of Estonia's concerns regarding EIB and its reaction to those concerns, that is, its revocation of EIB's license. Claimants, too, recognize that "the core issue" in the arbitration is the revocation of EIB's license.<sup>74</sup> The Tribunal agrees. As

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<sup>72</sup> Counter-Memorial, pp. 31–33.

<sup>73</sup> Counter-Memorial, p. 1; see also para. 102 of this Award.

<sup>74</sup> Claimants' Post-Hearing Memorial, p. 1; see Part H of this Award.

such, the question of jurisdiction relates essentially to Claimants' ownership interest in EIB (as opposed to EIB's ownership interest in the Koidu branch) and whether that interest constitutes an investment under the BIT such as to afford jurisdiction to the Tribunal.

320. The Tribunal has no hesitation in stating that Respondent's objection to the jurisdiction of the Tribunal over claims relating to Claimants' ownership of EIB and the loss of that investment do not withstand scrutiny and should thus be dismissed.

321. Estonia claims that the Claimants were not entitled to submit their dispute with the Government of Estonia for settlement by binding arbitration provided for in the BIT, for two reasons. First, Respondent submits that Claimants' claims do not relate to "investments" as that term is understood in the BIT. Second, Estonia argues that those claims were previously litigated in Estonia and the U.S.; both the BIT and the Convention include provisions relating to choice of forum, and by choosing to litigate their disputes with Estonia in the Estonian courts, argues Estonia, Claimants have exhausted their right to choose another forum to relitigate those same disputes.

322. In his declaration in support of Estonia's contentions, Prof. Andreas F. Lowenfeld expresses his opinion that Claimants, Eurocapital Group and EIB "(. . .) are affiliated with one another, and that they are or were all controlled or managed by Mr. Alex Genin and/or his associate Mr. Michael Dashkovsky."<sup>75</sup> Prof. Lowenfeld goes on to state:

If I am correct that all of the corporate entities are affiliated with one another and are or have been under common control, it follows, in my view, that any resort to local administrative or judicial remedies by any member of the group is attributable to all members of the group and to the group itself . . . It would be wholly inconsistent with the principle [of "election of remedies"] . . . and in particular with the objective of avoiding inconsistent decisions, for one member of the group to try a domestic court, for another member of

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<sup>75</sup> Declaration of Prof. Andreas F. Lowenfeld dated 10 November 1999, Exhibit B to Respondent's Memorial in support of its objection to jurisdiction, p. 11. Prof. Lowenfeld also testified, on behalf of Respondent, at the 8 January 2000 hearing on jurisdiction.

the group to try an administrative proceeding, and for still another member of the group (or its controlling shareholders) to submit the dispute to arbitration pursuant to the BIT and the ICSID Convention.<sup>76</sup>

323. In order to assess the validity of Prof. Lowenfeld's conclusion that Claimants have forfeited their right to have their claims arbitrated under ICSID's auspices, it is appropriate to consider, one by one, the conditions laid down in the Convention and the BIT for ICSID to have jurisdiction in this case. Those conditions are:

- (1) A legal dispute arising directly out of an investment;
- (2) between a Contracting State or an agency of a Contracting State; and
- (3) a national of another Contracting State;
- (4) consent to submit the dispute to ICSID; and, as a condition attached to Respondent's consent given in the BIT,
- (5) that the Claimants have not submitted the dispute for resolution to the courts or administrative tribunals of Estonia or in accordance with any applicable, previously agreed dispute-settlement procedure.

324. The term "investment" as defined in Article I(a)(ii) of the BIT clearly embraces the investment of Claimants in EIB. The transaction at issue in the present case, namely the Claimants' ownership interest in EIB, is an investment in "shares of stock or other interests in a company" that was "owned or controlled, directly or indirectly" by Claimants. The investment of Claimants in EIB is also embraced by the meaning of the term "investment" under the Convention.

325. An "investment dispute" is defined in Article VI(I) of the BIT as a "dispute arising out of or relating to: (a) an investment agreement . . . (b) an investment authorization . . . or (c) an alleged breach of any right conferred

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<sup>76</sup> *Id.*

or created by this Treaty with respect to an investment”. The revocation of EIB’s license is, without doubt, covered by this definition.

326. It is also significant to note that Article XII of the BIT provides for the application of the BIT to all investments made prior to, and existing at the time of, the entry into effect of the Treaty, on 16 February 1997.

327. The Bank of Estonia is an agency of a Contracting State. The Estonian central bank is a “state agency”, as defined by the BIT, which stipulates in Article II 2(b) that “Each Party shall ensure that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party’s obligations under this Treaty wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses . . .”. The Republic of Estonia is therefore the appropriate Respondent to a complaint relating to the conduct of the Bank of Estonia.

328. The Claimants are nationals of another Contracting State. Mr. Genin is an American citizen and Eastern Credit is a U.S. corporation wholly-owned by him. Baltoil is an Estonian corporation wholly-owned by Eastern Credit and therefore entitled to be considered a national of the United States by virtue of Article 25(2)(a) of the Convention and Article VI(8) of the BIT.

329. Estonia’s consent to resolution of disputes by submission to ICSID arbitration is provided in Article VI(3) of the BIT. Claimants provided evidence of their consent to submit this dispute to ICSID arbitration in their Request and in their Exhibit B.

330. The first four conditions having been satisfied, the fundamental issue as regards the matter of the Tribunal’s jurisdiction in this case relates to whether the Claimants have submitted the dispute for resolution to the courts or administrative tribunals of Estonia or in accordance with any applicable, previously agreed dispute-settlement procedure. Two questions arise in this regard. First, to what extent were the issues litigated in Estonia and the United States identical to those raised by the Claimants in this arbitration? And second, is it proper to consider EIB and the Claimants as a “group” and to view EIB’s legal acts in Estonia as an “election of remedy” for the group as a whole?

331. As to the first of these questions, the Tribunal is of the view that the lawsuits in Estonia relating to the purchase by EIB of the Koidu branch of Social Bank and to the revocation of EIB's license are not identical to Claimants' cause of action in the "investment dispute" that they seek to arbitrate in the present proceedings. The actions instituted by EIB in Estonia regarding the losses suffered by EIB due to the alleged misconduct of the Bank of Estonia in connection with the auction of the Koidu branch and regarding the revocation of the Bank's license certainly affected the interests of the Claimants, but this in itself did not make them parties to these proceedings.

332. The distinction between the causes of action brought by EIB, in Estonia, and by the Claimants, here, is perhaps best illustrated by the circumstances of EIB's recourse to the courts in the matter of its license revocation. The effort by EIB to have the Bank of Estonia's decision overturned, and its license restored, was in effect undertaken on behalf of all the Bank's shareholders (including minority shareholders), as well as on behalf of its depositors, borrowers and employees, all of whom were damaged by the cessation of EIB's activities. It is quite obvious that this matter had to be litigated in Estonia; there was no other jurisdiction competent to deal with the restoration of the *status quo*. The "investment dispute" submitted to ICSID arbitration, on the other hand, relates to the losses allegedly suffered by the Claimants alone, arising from what they claim were breaches of the BIT. Although certain aspects of the facts that gave rise to this dispute were also at issue in the Estonian litigation, the "investment dispute" itself was not, and the Claimants should not therefore be barred from using the ICSID arbitration mechanism.

333. Estonia also submits that since Article VI(8) of the BIT qualifies EIB as a U.S. "national or company", its resort to the courts and administrative tribunals of Estonia should preclude the "parents" from submission of their dispute to an ICSID arbitration. However, as mentioned above, EIB had no choice but to contest the revocation of its license in Estonia, in the interest of all its shareholders, whereas the Claimants submitted to ICSID arbitration an "investment dispute", as defined by the BIT, seeking compensation for what they claim was a violation of their rights under the BIT.

334. For similar reasons, the litigation instituted by one of the Claimants, Eastern Credit, in the United States, should also not be an obstacle to ICSID arbitration. The U.S. litigation did not relate to the major issue at stake



here—the revocation of EIB’s license—and should not be considered resort to an alternative forum under Article VI (2)(a) of the BIT such as to preclude submission of the present “investment dispute” to arbitration.

335. As regards the question of jurisdiction over the last of Claimants’ claims, arising from the alleged harassment of Messrs. Genin and Dashkovsky, the Tribunal declines to address the matter other than to state that the question need not be resolved given the lack of any support for the claim itself. Moreover, the claim, if not entirely abandoned by Claimants, has been relegated to secondary—if not tertiary—status in Claimants’ submissions at the hearing and subsequently.

## **2) The Koidu Branch Purchase and its Aftermath**

336. The facts relating to the Koidu branch transaction, and the parties’ submissions in this regard, are dealt with in some detail above, in Parts E, F and H of this Award. Many of the facts pertinent to this Award are indeed uncontested as between the parties. For present purposes, it is sufficient to highlight those events of particular relevance, which include the relevant facts as found by the Tribunal.

337. On 12 August 1994, EIB purchased the Koidu branch of Social Bank, in an auction organized by the Bank of Estonia. The Sales Agreement was signed, on behalf of Social Bank, by Mr. Vahur Kraft then Vice-President of the Bank of Estonia. The purchase price of 3 million EEK was paid to the Bank of Estonia, according to the instructions of Mr. Kraft. On 16 September 1994, EIB informed the Bank of Estonia that the assets of the branch fell short of the amounts stated in the balance sheet provided to it in advance of the auction, creating a loss of approximately 7.25 million EEK. EIB blamed Kraft, *inter alia*, for the discrepancies and claimed that he should have been aware of them, having formerly been an officer of Social Bank.

338. The Inspection Department of the Bank of Estonia, designated by the parties in the Sales Agreement of 13 August 1994 as a final arbiter in the event of a dispute “with regard to the description of the Object”, determined that EIB’s claim against Social Bank was unfounded.

339. EIB sued Social Bank for recovery of its losses, but on or about 28 April 1995 the parties reached an out-of-court settlement entitling EIB to transfer to Social Bank some 21 million EEK of the Koidu branch assets and

receive payments totalling approximately 17 million EEK in instalments stretching over close to three years. These payments were secured by loans totalling some 47 million EEK from the loan portfolio of Social Bank, that were apparently worthless. Only about 1 million EEK were paid on account of this settlement since Social Bank was declared bankrupt soon after signing the settlement.

340. EIB applied to the Bank of Estonia, asking for compensation for its losses. The Bank of Estonia agreed to cover a substantial part of EIB's claim against ESB Finanskontor Ltd. (the successor to Social Bank), by assigning to EIB its rights in loans granted to other Estonian banks in the total amount of 15 million EEK. A tentative agreement to this effect was signed on 12 April 1996. On 5 August 1996, the Bank of Estonia sent EIB the draft of an agreement that altered some of the terms of the tentative agreement.

341. Claimants contend that the 12 April 1996 tentative agreement was binding and that the changes made in the new agreement diminished the value of the package that had been promised in the tentative agreement. For this reason, EIB refused to sign the second agreement and assigned to Eastern Credit its interest in the settlement with Social Bank. The Claimants also consider the purchase by Eastern Credit of EIB's claims, resulting from the Koidu branch purchase, to be a separate investment of more than \$1.6 million in Estonia. Eastern Credit went on to sue the Bank of Estonia and Mr. Kraft in Texas.<sup>77</sup>

342. Another offshoot of the Koidu branch affair relates to the accounting treatment of the losses arising from the purchase of the branch in EIB's balance sheet. In a letter dated 4 March 1996 to EIB, Mr. Sutt from the Bank of Estonia's Bank Inspectorate suggested that the loss would be amortized over a period of no more than five years. Six months later, the Bank of Estonia demanded an immediate write-off of the said loss, resulting in a capital deficiency for EIB.<sup>78</sup>

343. In sum, Claimants claim that the Bank of Estonia violated Article II(3)(a) of the BIT, which provides for the fair and equitable treatment of investments, by the following acts or omissions:

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<sup>77</sup> The assignment was substituted later by a sales agreement selling EIB's claims arising from the acquisition of the Koidu branch to Eastern Credit for 20 million EEK.

<sup>78</sup> Claimants' Exhibit 38.

- (1) Its refusal to compensate EIB for the losses resulting from the misrepresentations of the Koidu branch assets in which the Bank of Estonia participated;
- (2) the Bank of Estonia's breach of the tentative agreement to settle the Koidu branch controversy with EIB;
- (3) the Bank of Estonia's reversal of its previous agreement to allow a gradual amortization of the losses caused to EIB, which necessitated the \$1.6 million sale to Eastern Credit of EIB's claims arising from its acquisition of the Koidu branch.

344. These claims are rejected, for the following reasons.

345. First, there is no legal basis for the demand that the Bank of Estonia compensate EIB for its losses arising from the Koidu branch purchase. The claim that Mr. Kraft participated in the misrepresentation of the branch assets is simply not substantiated. His previous association with Social Bank, in a head-office function, does not support the contention that he was aware of the condition of the credit portfolio of the branch at the time of the auction. On the other hand, the officers of EIB who conducted the negotiations regarding the purchase of the branch clearly acted unprofessionally and, indeed, carelessly. A credit portfolio cannot be checked on the spot in a few hours; the buyers should have known that Social Bank was on the verge of bankruptcy and should thus have taken extra precautions, such as insisting on warranties relating to the quality of the assets. The responsibility for the result of EIB's conduct, including its omissions, is EIB's alone.<sup>79</sup>

346. Second, although the Claimants contend that the April 1996 agreement with the Bank of Estonia was intended to be final, despite the heading "Tentative Agreement", this Tribunal is not persuaded that the proposed change in the package of assets offered to EIB in August 1996 justified its rejection by EIB without further negotiation. Simply put, the claim that the Bank of Estonia breached a binding agreement was not proven to our satisfaction.

347. Third, no convincing explanation was provided to the Tribunal regarding why the Bank of Estonia was willing to allow a gradual writing

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<sup>79</sup> It should be noted, however, that one would expect a central bank handling an auction of the assets of a failing institution to be more attentive to the potential risks to the buyers.

down of the Koidu branch's bad assets; neither were we adequately informed why this decision was apparently reversed.<sup>80</sup> In any event, whatever was the reason for the Bank of Estonia's apparent change of mind, it cannot be considered a breach of agreement. Both the decision to allow gradual amortization and its reversal were regulatory rulings, and the demand to write down the losses at once was not, in the circumstances, unreasonable according to accepted accounting practices.

### 3) The Revocation of EIB's License

348. We turn now to the crux of the case to be determined—what Claimants refer to as “the core issue” and Respondent calls “the heart of the matter”: the revocation of EIB's license. In doing so, the Tribunal considers it imperative to recall the particular context in which the dispute arose, namely, that of a re-nascent independent state, coming rapidly to grips with the reality of modern financial, commercial and banking practices and the emergence of state institutions responsible for overseeing and regulating areas of activity perhaps previously unknown. This is the context in which Claimants knowingly chose to invest in an Estonian financial institution, EIB.

349. As described above,<sup>81</sup> the Claimants consider the repeated demands by the Bank of Estonia to apply for approval of their holdings in EIB, and the demands for information grounded on what they claim were legally baseless regulations, as distinct transgressions of their rights under various provisions of the BIT. However, it seems to the Tribunal that these claims are in fact part and parcel of the principal issue at stake, namely, the legitimacy of the Bank of Estonia's revocation of EIB's license. They will therefore be treated as such.

350. According to Article 42 (1) of the Convention “the Tribunal shall decide a dispute in accordance with such rules as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.” In the present case, in the absence of any agreement by the parties to the contrary, it is the law of the Republic of Estonia that applies. Moreover, neither party

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<sup>80</sup> The Claimants contend that it was an act of retaliation following the lodging of the lawsuit in Texas.

<sup>81</sup> See Parts F and G of this Award.

has argued otherwise or contended that particular rules of international law (other than as set out in the BIT and the Convention) apply, and there is no basis on which to conclude that the application of rules of international law would effect a result any different than that reached on the basis of Estonian law.

351. The essence of the explanation given by Respondent for the Bank of Estonia's demands to submit fresh applications for "qualified holdings" in EIB by Eurocapital Eastern Credit and Baltoil is as follows:

It became apparent from EIB's limited and evasive disclosures that Eastern Credit claimed to be the shareholder of Baltoil and that, together, they owned more than 10% of EIB. Under the law, a party wishing to acquire a 10% interest in a bank must first make an application for a qualified holding. Eastern Credit and Baltoil, however, had never applied for their qualified holding.

Similarly, "Eurocapital Group Limited" had never applied for a qualified holding. Although a company called "Eurocapital Group Company" did apply in 1995, it appeared to inspectors that the investment was held in the name of Eurocapital Group Limited and there was great confusion over the identity of that entity. It was unknown whether "Company" and "Limited" were the same entities (sic); which "Limited" was the investor (Hong Kong or Isle of Man); who was behind Eurocapital; and how Eurocapital was related to EIB and other shareholders. The only facts that were known with any degree of certainty were that "Limited" had not applied for a qualified shareholding and . . . was not authorized to be a shareholder.<sup>82</sup>

352. This is exceptionally formalistic reasoning. On its own, the explanation could not have justified, in the opinion of the Tribunal, the revocation of EIB's license, as eventually occurred. However, the facts amply demonstrate that, although its reasoning may have been superficial, the decisions reached by the Bank of Estonia and the actions taken by it as a result were not unsound. A few examples of Claimants' lack of prudent cooperation in

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<sup>82</sup> Counter-Memorial, pp. 39–40.

providing information required by the Bank of Estonia, by virtue of its powers according to Article 17 (5) of the *Bank of Estonia Act*, suffice to make the point.<sup>83</sup> Eurocapital used alternate addresses in the U.S., U.K. and Hong Kong, and the enquiries of the Bank of Estonia with the regulatory authorities of the Isle of Man and Hong Kong yielded ambiguous results. EIB refused to supply to the Bank of Estonia clear, reliable data concerning shareholders of their shareholders, *inter alia*, shareholders of Eurocapital. Tellingly, as discussed above, it was not until Mr. Genin testified at the hearing in these proceedings, and only after substantial questioning, that the Bank of Estonia, and indeed the Tribunal, learned for a fact that all of the companies in question, including Eurocapital, were owned, at all relevant times, by Mr. Genin himself, either directly or indirectly.<sup>84</sup>

353. In the opinion of the Tribunal, there is no doubt but that the Bank of Estonia's demands for information on EIB's shareholders and their shareholders were validly based on Article 59 (6) of the *Credit Institutions Act*,<sup>85</sup> and constituted entirely legitimate and fully proper exercises of the central bank's regulatory and supervisory responsibilities. The information sought was needed to assess whether EIB granted credit to, or was otherwise engaged in transactions with, related parties. The unreasonable reluctance of EIB to divulge this information gave rise to genuine suspicion that transactions with related parties had taken place. Indeed, in the inspection carried out by the Bank of Estonia from 4 February 1997 to 7 March 1997, the inspectors took particular exception to the deposit of \$650,000 with Pacific Commercial

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<sup>83</sup> Article 17(5) provides (see Part E. 3) of this Award):

*Eesti Pank* has the right to request from all credit institutions data, documents, reports and agreements as well as to require appropriate explanations of these data.

<sup>84</sup> See Transcript, pp. 426–429, and especially p. 429, lines 15–21.

<sup>85</sup> Article 59(6) provides (see Part E. 3) of this Award):

The Banking Supervision Department will carry out continuous inspection of a credit institution's activities and its condition on the basis of regular reports submitted by the latter. If necessary, the Banking Supervision Department is entitled to:

- 1) demand that a credit institution submit supplementary information, in order to specify information in the reports;
- 2) demand information from persons who are shareholders of the credit institution, as well as from legal persons in which the credit institution is a shareholder;
- 3) carry out on-site inspection of a credit institution's clients, relating to issues concerning the relations between the client and the credit institution.

Credit Ltd., a company located in Hong Kong at the same address as Eurocapital Group (HK). In the Inspection Report, the following comments appeared in the section on EIB's share capital:

During the inspection of EIB the Banking Supervision Department requested information in respect of shareholders, related parties as well as subordinate companies and subsidiaries. No such information was provided. By this action, Article 60 Section 2 clause 2 of the Credit Institutions Act and Article 17 Section 5 of the Bank of Estonia Act were violated.<sup>86</sup>

354. In its letter dated 21 May 1997, the Bank of Estonia demanded that the applicants for qualified holdings in EIB submit to the central bank certain documents and information that were specified in the attached Procedure for the acquisition, increase and disposal of a qualifying holding in a credit institution appended to the letter. These were the so-called "Regulations/Guidelines". EIB, through its lawyers, contested this demand by purporting to require the Bank of Estonia to "notify by whom and under which legal basis the specified order has been established".<sup>87</sup>

355. We consider that the Bank of Estonia was fully authorized by Article 17(5) of the *Bank of Estonia Act* to make such a demand. We find, further, that the Bank of Estonia was fully empowered to utilize and to communicate to commercial banks, such as EIB, the sort of "guidelines" appended to its demand. However, we consider that it was somewhat irregular to send such a demand to EIB more than 30 days after submission of the various applications for qualified holdings, on 18 April 1997, when Article 29(4) of the *Credit Institutions Act* stipulates that the Bank of Estonia must notify its decision on an application for the acquisition of a qualifying holding not later than one month after receiving such application. In any event, fortunately or unfortunately as the case may be, the 21 May 1997 demand cannot be regarded as a breach of the relevant statutes or the BIT such as to have caused Claimants any damages or to afford them any recourse.

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<sup>86</sup> See EIB Inspection Report, Respondent's Exhibit 80.

<sup>87</sup> Respondent's Exhibit 79.

356. In its report dated 27 June 1997, the Banking Supervision Department of the Bank of Estonia reported to the Governor of the Bank of Estonia on EIB's transactions in the shares of Landmark and Tollycraft. The prudence of these investments was, without a doubt, highly questionable. The amount invested was excessive in relation to EIB's capital, the prices of the shares fluctuated widely and Mr. Genin was associated with the promoters of both. The report concludes that booking the Tollycraft shares according to their market price would reduce EIB's capital below the minimum required. Although the Tollycraft transaction was covered by a put option provided by Eurocapital Ltd., which, as alleged by Claimants, protected EIB, the Landmark shares purchased on 31 October 1996 for \$3.75 per share were sold four months later to Eurocapital Ltd. at \$2.50 a share, for a loss of \$500,000.

357. It is quite obvious that the Banking Supervision Department had good reason to be critical of various aspects of EIB's business and operations. It was perfectly justified to request the information which it sought. The question the Tribunal must answer, however, is whether the central bank afforded Claimants due process in the procedure leading to the revocation of EIB's license. Not without some hesitation, we conclude that the actions of the Bank of Estonia did not amount to a denial of justice.

358. The principal reasons why the Tribunal is concerned with the process which led to the revocation of EIB's license are the following. No notice was ever transmitted to EIB to warn that its license was in danger of revocation unless certain corrective measures were taken, and no opportunity was provided to EIB to make representations in that regard. When the Council of the Bank of Estonia was convened on 9 September 1997 to discuss the revocation of EIB's license, no representative of EIB was invited to respond to the submission made by P. Nirgi, head of Banking Supervision, and A. Schmidt, head of the Legal Department, as to why revocation of EIB's license was necessary or appropriate in the circumstances.

359. The document presented to the Council by Nirgi and Schmidt accused EIB of violating numerous Articles of the Bank of Estonia Act and of the *Credit Institutions Act*. The main contention related to the discrepancy between the name of the major shareholder in the share register of EIB (Eurocapital Group Ltd.) and in the list of shareholders as at the same date presented to the Banking Supervision Department in the course of an inspection (Eurocapital Group Company). As a ground for revocation, this conten-



tion is, as mentioned above, exceedingly formalistic since the amount of EIB's shares held by the two entities on 31 July 1997 was identical and one could have presumed that the two "Eurocapitals" were, in fact, one and the same. But since the authorization to acquire a qualifying holding in EIB was granted in 1995 to Eurocapital Group Company and the share register of EIB recorded Eurocapital Group Limited as the major shareholder, it is arguable that the Bank of Estonia was justified in concluding that the latter shareholder had not received a permit to acquire a qualified holding. It should also be recalled that in its action before the Tallin Administrative Court of 24 March 1997, EIB, through its lawyers, had claimed that Eurocapital Ltd., the major shareholder of record had never acquired or increased a qualifying interest in EIB.

360. The effect of the Bank of Estonia's refusal to recognize Eurocapital Ltd.'s shareholding as a legally-held qualified holding was that the company's holdings in excess of 10% less 1 share were deduced from EIB's capital and resulted in a large capital deficiency. This result, and the ramifications which flowed therefrom, are, in the end, soundly based on Article 29(1) of the *Credit Institutions Act*.<sup>88</sup>

361. Can the revocation of EIB's license be justified on grounds that, at first blush, appear extremely technical? It is the opinion of this Tribunal that the decision taken by the Bank of Estonia must be considered in its proper context—a context comprised of serious and entirely reasonable misgivings regarding EIB's management, its operations, its investments and, ultimately, its soundness as a financial institution.

362. The unlimited authority given to Mr. Genin to invest money on behalf of EIB made the identity of Eurocapital's shareholders a matter of genuine and pressing regulatory concern. Contrary to Claimants' repeated assertions, both in their written submissions and during the hearing, the reluctance of Mr. Genin to divulge the beneficial ownership of Eurocapital,

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<sup>88</sup> Article 29(1) provides (see Part E. 3) of this Award):

A credit institution or individual who is willing to acquire, directly or indirectly, a qualified holding of a credit institution, or to increase such a holding to exceed 20%, 30% or 50% of the credit institution's share capital or number of votes, must apply for authorization from *Eesti Pank*. The application shall be submitted in writing and must contain information on the size of the intended holding.

which would have enabled the Bank of Estonia's Banking Supervision department to understand the relationship of the various entities associated with him, was the cause of legitimate concern and cannot be considered to have been a mere excuse, or pretext, to revoke EIB's license. Mr. Genin's failure to disclose the true ownership of the companies in question was one of the very reasons for the Bank of Estonia's suspicions regarding EIB—even if the central bank was unable, at the time, to identify precisely the cause of its unease or to confirm its suspicions regarding self-dealing among EIB's shareholders and affiliated entities.

363. In sum, the Tribunal finds that the Bank of Estonia acted within its statutory discretion when it took the steps that it did, for the reasons that it did, to revoke EIB's license. Its ultimate decision cannot be said to have been arbitrary or discriminatory against the foreign investors in the sense in which those words are used in the BIT.<sup>89</sup> The decision, as it turns out, was further justified by subsequent revelations and appears even more understandable with hindsight.

364. The Tribunal considers, however, that certain procedures followed by the Estonian authorities in the present instance, while they do conform to Estonian law and do not amount to a denial of due process, can be characterized as being contrary to generally accepted banking and regulatory practice. They include the following:

- (1) No formal notice was given to EIB that its license would be revoked unless it complied with the Bank of Estonia's demands within a reasonable time;
- (2) no representative of EIB was invited to the session of the Bank of Estonia's Council that dealt with the revocation to respond to the charges brought by the Governor;
- (3) the revocation of the license was made immediately effective, giving EIB no opportunity to challenge it in court before it was publicly announced.

365. Having considered the totality of the evidence, the Tribunal concludes that while the Central Bank's decision to revoke EIB's license

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<sup>89</sup> See Dolzer and Stevens, *Bilateral Investment Treaties*, 1995, pp. 61 et seq.

invites criticism, it does not rise to the level of a violation of any provision of the BIT.

366. The Tribunal has also considered the question whether the Bank of Estonia's procedures violated the international law standards of "fair and equal treatment" and "non-discriminatory and non-arbitrary treatment" of investment as those standards are reflected in the US–Estonia Bilateral Investment Treaty.<sup>90</sup>

367. Article II(3)(a) of the BIT requires the signatory governments to treat foreign investment in a "fair and equitable" way. Under international law, this requirement is generally understood to "provide a basic and general standard which is detached from the host State's domestic law."<sup>91</sup> While the exact content of this standard is not clear,<sup>92</sup> the Tribunal understands it to require an "international minimum standard" that is separate from domestic law, but that is, indeed, a *minimum* standard. Acts that would violate this minimum standard would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.<sup>93</sup> Under the present circumstances—where ample grounds existed for the action taken by the Bank of Estonia—Respondent cannot be held to have violated Article II(3)(a) of the BIT.

368. Article II(3)(b) of the BIT further requires that the signatory governments not impair investment by acting in an arbitrary or discriminatory way. In this regard, the Tribunal notes that international law generally requires that a state should refrain from "discriminatory" treatment of aliens and alien property. Customary international law does not, however, require that a state treat all aliens (and alien property) equally, or that it treat aliens as favourably as nationals. Indeed, "even unjustifiable differentiation may not be

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<sup>90</sup> See Articles II(3)(a) and (b) of the BIT.

<sup>91</sup> Dolzer and Stevens, p. 58; see also *American Manufacturing and Trading, Inc. v. Zaïre*, Award of 21 February 1997 in ICSID Case No. ARB/93/1, ICCA Yearbook YB Vol. XXII, 1997, pp. 60–86 (noting that the standard is "an objective obligation which must not be inferior to the minimum standard of vigilance and of care required by international law.")

<sup>92</sup> See Ian Brownlie, *Principles of Public International Law* (5th ed.), p. 529 (noting that "[t]he basic point would seem to be that there is no single standard.")

<sup>93</sup> In this regard, see Brownlie, pp. 527–531.

actionable.”<sup>94</sup> In the present case, of course, any such discriminatory treatment would not be permitted by Article II(1) of the BIT, which requires treatment of foreign investment on a basis no less favourable than treatment of nationals.

369. In any event, in the opinion of the Tribunal, there is no indication that the Bank of Estonia specifically targeted EIB in a discriminatory way, or treated it less favourably than banks owned by Estonian nationals. Moreover, Claimants have failed to prove that the withdrawal of EIB’s license was done with the intention to harm the Bank or any of the Claimants in this arbitration, or to treat them in a discriminatory way.<sup>95</sup>

370. The Tribunal has further considered whether the Bank of Estonia’s actions constituted an “arbitrary” treatment of investment as that term is used in Article II(3)(b) of the BIT. In this regard, it is relevant that the Tribunal has found no evidence of discriminatory action.<sup>96</sup> In addition, the Tribunal accepts Respondent’s explanation that it took the decision to annul EIB’s license in the course of exercising its statutory obligations to regulate the Estonian banking sector. The Tribunal further accepts Respondent’s explanation that the circumstances of political and economic transition prevailing in Estonia at the time justified heightened scrutiny of the banking sector. Such regulation by a state reflects a clear and legitimate public purpose.<sup>97</sup>

371. It is also relevant that the Tribunal, having regard to the totality of the evidence, regards the decision by the Bank of Estonia to withdraw the license as justified. In light of this conclusion, in order to amount to a violation of the BIT, any procedural irregularity that may have been present would have to amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action. None of these are present in the case at hand. In sum, the Tribunal does not regard the license withdrawal as an

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<sup>94</sup> See Dolzer and Stevens, pp. 61–62. See also *Oppenheim’s International Law*, Volume 1 “Peace” (9th edition), p. 933 (noting that “[a] degree of differential treatment as between national and foreign investment may be called for, and is not necessarily contrary to the state’s international obligations”).

<sup>95</sup> See Brownlie, p. 541, footnote 96 (“[t]he test of discrimination is the intention of the government”).

<sup>96</sup> See para. 363 of this Award.

<sup>97</sup> See Brownlie, p. 551.

arbitrary act that violates the Tribunal's "sense of juridical propriety."<sup>98</sup> Accordingly, the Tribunal finds that the Bank of Estonia's actions did not violate Article II(3)(b) of the BIT.

372. It is to be hoped, however, that Bank of Estonia will exercise its regulatory and supervisory functions with greater caution regarding procedure in the future.

373. In conclusion, the Tribunal finds that Claimants have failed to show that the Bank of Estonia's conduct in cancelling EIB's license rose to the level of a violation of the BIT or of the international law principles enshrined therein.

#### 4) The "Harassment" Claim

374. As regards Claimants' allegations of harassment of Messrs. Genin and Dashkovsky by the Estonian authorities, the Tribunal is far from convinced that the allegations made by Claimants, even if true, could amount to a violation of the BIT. In any event, the Tribunal finds that Claimants have failed to prove that such contacts between Respondent's agents and Messrs. Genin and Dashkovsky as did take place amount to harassment. Claimants' claim in this regard is, accordingly, denied.

375. For all of the foregoing reasons, Claimants' claims against the Respondent Republic of Estonia are dismissed.

#### 5) Respondent's Counterclaim

376. In its various submissions, Respondent asks the Tribunal to award it, by way of counterclaim, an amount equivalent to sums allegedly transferred out of EIB by Messrs. Genin and Dashkovsky, and currently held by Eurocapital, failing which the liquidation of EIB cannot, it says, be finalized. Its

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<sup>98</sup> See the ICJ's decision in the *Elettronica Sicula* or *ELSI* Case (United States v. Italy), ICJ Reports (1989), pp. 15, 73–77 (defining the concept of arbitrariness as "not so much something opposed to a rule of law, as something opposed to the rule of law . . . It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety"). Compare *Amco Asia Corp. v. Indonesia*, Final Award of 5 June 1990 in ICSID Case No. ARB/81/8, ICCA Yearbook YB Vol. XVII, 1992, pp. 73–105 (following the *Elettronica Sicula* Case and finding that procedural irregularities amounted to a denial of justice in the circumstances of that case).

claim is expressed in varying fashions, and in varying amounts, in various places.<sup>99</sup> The apparent confusion need not, however, be resolved for the purposes of this Award, for the reason that Estonia has failed to demonstrate to the satisfaction of the Tribunal the merits of its request.

377. The Tribunal notes that Respondent's allegations are belied, *inter alia*, by the terms of a letter dated 15 November 2000 regarding the current amount of EIB's assets, addressed to counsel for Claimants by the Liquidation Committee of EIB.<sup>100</sup> That letter reads, in its pertinent part:

We have received your request for information concerning Estonian Innovation Bank [EIB]. The purpose of this letter I (sic) to respond to the questions forwarded to you by the Arbitral Tribunal.

All existing depositors of [EIB] have received their deposits back, except for a few depositors who are currently unlocatable. The total amount of deposits that have not been returned because the depositor is unlocatable is 893,827.40 EEK. If any of these depositors are located, there is money reserved to return the full amount of their deposit. The total amount currently held by the bank in assets is 57,429,515.24 EEK.

All of the creditors of the bank have been paid in full.

To date, no shareholder has received any payment or distribution.

378. In the light of the foregoing, Respondent's counterclaim is rejected.<sup>101</sup>

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<sup>99</sup> The sum of \$3.4 million is mentioned in Respondent's Counter-Memorial at p. 53, \$3 million in its Rejoinder at p. 15 and \$2.9 million at p. 28 of its Post-Hearing Memorial.

<sup>100</sup> Filed subsequent to the hearing, pursuant to a request by the Tribunal, as Claimants' Exhibit 116.

<sup>101</sup> A question also arises, which need not be and is not answered here, as to whether Respondent is the proper party to the request set out in its counterclaim. Without deciding the issue, the Tribunal notes that, even if the facts alleged by Respondent in support of its counterclaim were true, the proper claimant of the sums in question is arguably not the Republic of Estonia but the Liquidation Committee of EIB.

## J. COSTS

379. Two factors, in particular, have shaped the Tribunal's determination of the allocation of the costs of the arbitration. Both of those factors relate to the conduct of the parties as demonstrated by the written and oral evidence adduced by them.

380. First, the Tribunal cannot but decry Mr. Genin's failure to cooperate with the Estonian banking authorities during the period in which the salient facts underlying the dispute took place. His concealment, right up until his cross-examination by Respondent's counsel during the hearing, of his ownership of the companies in question was an element of both substantive and procedural significance, with effect on the conduct of the arbitration. Claimants themselves concede, in their Post-Hearing Memorial, that Mr. Genin's conduct could be considered to have affected the case and that it is thus appropriate for the Tribunal to take this conduct into account when considering the allocation of costs. The Tribunal cannot but concur with both parts of that statement.

381. On the other hand, as mentioned above, the awkward manner by which the Bank of Estonia revoked EIB's license, and in particular the lack of prior notice of its intention to revoke EIB's license and of any means for EIB or its shareholders to challenge that decision prior to its being formalized, cannot escape censure.

382. Either of these factors, alone, might have impelled an award of costs against the offending party.

383. Accordingly, and taking into consideration the circumstances of the case, the Tribunal determines that each party shall bear all of the expenses incurred by it in connection with the arbitration. The costs of the arbitration, including the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the ICSID, shall be borne by the parties in equal shares.

384. Inasmuch as the parties have advanced to the ICSID deposits of equal amounts in respect of, and adequate to pay, the costs of the arbitration, no monetary award is required.

## K. AWARD

385. For all of the foregoing reasons, the Tribunal unanimously decides:

- (1) Respondent's objections to jurisdiction are dismissed;
- (2) The Republic of Estonia, in the person of its agency, the Bank of Estonia, did not violate the BIT or Estonian law in relation to the sale of the Koidu branch of Social Bank to EIB or in regard to EIB's claims concerning losses relating to its purchase of that branch;
- (3) The Republic of Estonia, in the person of its agency, the Bank of Estonia, did not violate the BIT or Estonian law by revoking EIB's license;
- (4) The Republic of Estonia did not "harass" Messrs. Genin or Dashkovsky, in violation of the BIT or Estonian law;
- (5) All of Claimants' claims are dismissed;
- (6) Respondent's counterclaim is dismissed; and
- (7) Each party shall bear all of its own costs and expenses incurred in connection with the proceedings, and the costs of the arbitration shall be borne by Claimants and Respondent, respectively, in equal shares.

*L. YVES FORTIER, C.C., Q.C.*

*President*

Date: 18 June, 2001

*PROFESSOR MEIR HETH*

*Arbitrator*

Date: 13 June, 2001

*PROFESSOR ALBERT JAN van den BERG*

*Arbitrator*

Date: 07 June, 2001