Czech Mate: Expropriation and Investor Protection in a Converging World

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Abstract

This paper examines the expropriation of a foreign investor by a local partner and the subsequent resolution of that case through international arbitration in favor of the investor. Despite the investor's 99% interest in joint venture, the local partner managed to divert the entire value of the underlying entity for his personal benefit. This clinical examination of an expropriation and its aftermath illustrates the interaction of property and contract rights in a global setting, how corporate control is shaped by geography, and how multinational firms may be advantaged by availing themselves of stronger investor protections than local firms.

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1. *Introduction*

Analyses of the role of institutions typically consider local laws to be the primary measure of legal protections for investors. Similarly, these analyses do not discriminate between types of investors, other than on the basis of their ownership shares or control rights. In contrast to these emphases, multinational firms constitute large fractions of investment in most economies, particularly in developing and transition economies, and these firms have legal means available to them beyond local laws as well as unique control problems. Studying the experience of multinational firms and their legal protections through a clinical examination promises to illuminate the unique aspects of their control problems, the transnational protections they can access and the interactions between different types of institutional protections in institutionally fragile settings.

This paper examines the investment experience of Ronald Lauder in the Czech Republic, his expropriation by his locally prominent partner, Vladimir Zelezny, and the aftermath of that investment experience including subsequent international arbitration. In emphasizing one example, this paper contributes a clinical perspective on the mechanisms of expropriation by an insider. The records of the Lauder-Zelezny trials and arbitrations provide a unique opportunity to understand the mechanisms of diversion by insiders in Europe and the role of local and international laws in protecting investors.[1]

In 1991, Lauder created a holding company, Central European Media Enterprises (CME), to invest in media properties in Eastern Europe. CME's investment in the Czech Republic was in a Prague-based TV station, TV Nova, which CME jointly owned with a media company controlled by Zelezny. The Czech enterprise prospered until Zelezny, despite a very limited ownership stake, managed to expropriate the value of the entity for

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[1] These records include the decisions of arbitrators in the disputes between CME and Zelezny and this account is based in part on these records: ICC International Court of Arbitration Case No. 10435/AER/ACS CME Media Enterprises B.V. (The Netherlands) vs Vladimir Zelezny (Czech Republic), Award Sentence, Feb. 9, 2001; UNCITRAL Arbitration, Ronald S. Lauder vs. The Czech Republic, Final Award, September 3, 2001;UNCITRAL Arbitration, CME Czech Republic B.V. (The Netherlands) vs. The Czech Republic, Partial Award, September 13, 2001; UNCITRAL Arbitration, CME Czech Republic B.V. (Netherlands) vs. The Czech Republic, Final Award, March 14, 2003, p. 120. These documents are available at http://www.cetv-net.com/arbitration.asp. A series of Harvard Business School case studies on CME by the authors provide additional details of the dispute; see "Czech Mate: CME and Vladimir Zelezny" (A-E), HBS Nos. 204-118; 204-119; 104-120; 204-121; 204-122; 204-129; 205-069, Harvard Business School Publishing, 2004.

his own private benefit. Lauder resorted to international tribunals and Bilateral Investment Treaty (BIT) arbitration to recoup his investment and managed an historic verdict against both Zelezny and the Czech Republic. The Czech Republic ultimately paid damages to Lauder's company in excess of the annual budget of the Czech Health Ministry.

In addition to providing a detailed look at an expropriation by an insider, this clinical examination illuminates several underappreciated aspects of control in an international setting. First, this clinical examination of expropriation demonstrates how property rights institutions (protections from expropriation by the state) interact with contractual institutions (the environment for enforcing contacts between private parties). Acemoglu and Johnson (2005) highlight this distinction between types of institutions and show that property rights institutions are more determinative of economic outcomes than contractual institutions. Their analysis leaves open the question of why property rights institutions are more important.

The Lauder-Zelezny case provides some perspective on this question by demonstrating how weak property rights institutions can undermine contractual institutions. Specifically, prominent insiders – such as leading employees and local representatives of multinationals – can manipulate policy-makers in weak property rights institutional environments so that private contracts no longer dictate economic outcomes. Zelezny's ability to divert the firm's value arose from his access to critical resources, his local public image, his manipulation of the media, and his ability to bend the rules of the game at will. In contrast to the traditional notion of "tunneling,"[2] insiders with minimal ownership can be just as effective at expropriating value as majority owners because of the background weakness of property rights institutions. This interpretation of the reasons for the primacy of property rights also reflects the legal literature's emphasis on the fundamental importance of property rights.

Second, this clinical examination also demonstrates how and why control of firm assets appears to have a geographic and political dimension. The geographical and cultural

[2] Indeed, the term "tunneling"originated with reference to the experience of the Czech Republic, as noted in Coffee(1996, 1998) and Johnson et al. (2000), to signify the idea that majority shareholders can employ various means to transfer the assets and profits out of firms for their personal benefit through self-dealing transactions.

distance between Lauder and Zelezny distributed decision rights in a way that allowed Zelezny to structure the joint venture opportunistically, to force monetization of his ownership in the company and, ultimately, to expropriate the value of the asset. Geography's role in determining control over corporate assets has been emphasized in venture capital settings (see Lerner (1995)) and in historical evidence (see Franks et. al. (2004)) but appears to be equally relevant today to multinational firms with operations around the world. Similarly, the case exemplifies how political channels operate alongside legal channels in determining control.

Finally, this clinical examination demonstrates how local laws may be irrelevant to investor protections for many investments. Local laws were of little help to Lauder and, ultimately, had no influence on the ultimate resolution of the case. Although Lauder initially appealed to the local courts, he also sought the protections afforded by the web of BITs that govern most capital flows between countries. These treaties afford significant protections for foreign investors from weak property rights institutions by allowing investors to sue states and are an increasingly used recourse for expropriation. Evidence from the CME case is suggestive of how differential access to legal protections can change the convergence dynamics of investor protections and how the additional means available to multinational firms to protect their investments can provide them with an advantage relative to local firms.

2. The Development of CME, 1991-1998

Ronald Lauder, a former U.S. ambassador to Austria and one of the heirs of the Estée Lauder cosmetics fortune, and Mark Palmer, who had served as U.S. ambassador to Hungary, founded Central European Media Enterprises (CME) in 1991 in the Netherlands. Across the region, there were plans to privatize broadcast frequencies and CME focused on these opportunities in commercial television.

In 1992, the Czech Republic became the first former Soviet Bloc country to announce that it would privatize a broadcasting frequency with national coverage. A Media Council, whose members were elected by Parliament, was established to set programming standards and to issue broadcasting licenses. Among the interested bidders for the frequency was a group of five prominent Czech professionals and intellectuals led by Vladimir Zelezny, a journalist, producer, and a former press official for Vaclav Havel's government.[3] The group named itself Central European Television for the 21st Century (CET 21). CET 21 needed financial backing to make its bid for the television license credible while CME sought local partners to ensure locally appropriate programming. The two groups worked together to submit a bid for the first Czech commercial TV station.

In 1992, the Media Council reviewed bids for the broadcasting license from more than twenty applicants. CET 21 and CME negotiated terms between themselves and consulted with the Media Council on their joint proposal. Originally, CME planned to provide substantial capital for the new television station in return for 49% ownership of CET 21. The Media Council awarded the television license to CET 21 but the decision provoked an outcry in the Czech Parliament. There were charges that the decision was too hasty, objections to the leftist political ties of CET 21's founders, and outrage over the extent of foreign investment in Czech television being allowed by the Media Council.

The new Czech media law *did not* forbid foreign ownership of television stations, and the Media Council accepted that foreign capital was required to launch a successful station. Nonetheless, the Media Council responded to the uproar by asking CET 21 and CME to revise their plans for the television station before it actually issued the license. CET 21 and CME, in consultation with the Media Council, devised an alternative arrangement whereby CET 21 would be owned by its founders, all local nationals. The license would be granted to CET 21 which would function solely as a license holder. A new company, to be established by CME and CET 21, would operate the television station and have exclusive use of the license. This arrangement left the license in Czech hands but allowed for the participation of CME through the operating company.

Figure 1 shows the initial ownership and structure of the new operating company, named CNTS. CME and the Czech Saving Bank contributed capital for their ownership shares while CET 21 contributed the use of its television license to CNTS for its 12% ownership share. The public name of the new station operated by CNTS was TV Nova. At that time, Zelezny became director of TV Nova and began planning the station's launch.

[3] Zelezny, a prominent political figure, had worked as a producer and show host at Czech TV with some success in the 1960s, and under pseudonyms as a TV scriptwriter in the 1970s and 1980s. Zelezny had also been the official spokesman for Petr Pithart, the first prime minister in the government formed after the "velvet revolution."

2.1. *TV Nova's Opening and CME's Growth 1994-1996*

TV Nova enjoyed considerable success under Zelezny's direction, gaining a 70% audience share within a year. The station's programming was a mix of dubbed American shows and locally produced news, sports, and variety programs aimed at a mass-market audience. TV Nova's news programs prominently featured gruesome car crashes, crime reports, and stories of political scandals. Zelezny presented a weekly political affairs program, "Call the Director," which became the most-watched program in the country. Zelezny accounted for this success by stating: "We never overestimate our viewer. We accept the fact that our viewer is a well-educated normal European, he's not over-educated with very sophisticated or unique cultural needs. Our programming reflects this."[4]

The combination of TV Nova's dominance and the tripling of Czech television advertising revenue from 1993 to 1996 led to strong financial performance with TV Nova revenues reaching 109 million USD in 1996. CNTS received all of TV Nova's revenues and paid CME a dividend of 8.4 million USD in 1996. The successful launch of TV Nova in the Czech Republic spurred the overall growth of CME. The company reincorporated in Bermuda, raised 68 million USD in its IPO, and, by 1996, owned television stations throughout Eastern Europe that reached 93.9 million people. While CNTS was extremely profitable, CME as a whole was not yet profitable. The company's regional German stations suffered ongoing losses, and CME curtailed its investments in them. Operating results for CME's largest TV stations at the end of 1996 are shown in Table I.

Several commentators disapproved of TV Nova's programming and influence, charging that the station was too sensational in its news coverage and too limited in its educational programming. Zelezny defended TV Nova, using his own television show as a platform to answer critics of the station or its foreign ownership. He argued, "The intellectuals believed Czechs were special, more sophisticated. We proved they were wrong. We showed that Czechs are like all other Europeans, whose first interest is soccer, with erotica a close second. For that, we will never be forgiven."[5]

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[4] Normandy Madden, "Bridge Builder," [Interview with Vladimir Zelezny], *Television Business International*, September 1, 1996.
[5] Robert Frank, "Cultural Fare," *The Wall Street Journal*, April 30, 1997, p. A1.

2.2. Challenges and Changes to the Ownership Structure of CNTS, 1996-1998

When the Czech Parliament liberalized the media law at the start of 1996, the Media Council decided to re-examine the arrangements between CET 21 and CNTS to ensure that the Council did not lose all authority over the country's most popular television station. The Council particularly wanted to affirm that CET 21 had not, for all practical purposes, transferred its television license to CNTS. As a member of the Media Council explained, "It's like transferring your driver's license…You can't just give it to someone else."[6] Zelezny and CME executives protested that the Media Council had itself approved the structure of TV Nova, but they agreed to provide a draft contract that defined the services that CNTS provided to CET 21 and their legal relationship for discussion. The Media Council continued to raise objections, however, and in July 1996 commenced administrative proceedings against CNTS for broadcasting without a license. The police also launched a criminal investigation to determine if CNTS was broadcasting illegally.

The discussions with the Media Council on TV Nova occurred as CME acquired a larger ownership share in CNTS. Table II shows how the ownership of CNTS changed between 1994 and 1997, and a timeline of major events at CNTS. In 1996, CSB decided to sell its 22% holding in CNTS and CME agreed to purchase the shares for 36 million USD, increasing CME's holding in CNTS to 88%. CSB lent CME funds for the purchase of its holding. A CME executive described this as "the best deal of my life," explaining, "we increased our holding in our most valuable asset by one-third, buying an immense amount of future cash flow for very little of other people's money."[7]

CNTS continued to seek compromise with the Media Council to avoid possible sanctions. Zelezny considered the license to be seriously endangered and conveyed these fears to CME executives. In May 1997, CNTS agreed to alter its agreement with CET 21 so that CET 21 no longer granted "exclusive use of the license" but rather the "know-how concerning the license." While the Media Council expressed satisfaction with these concessions, it did not withdraw its administrative proceedings against CNTS at that time.

Further ownership changes followed. First, CME lent Zelezny $5.2 million to buy

[6] Robert Frank, "Cultural Fare," *The Wall Street Journal*, April 30, 1997, p. A1.
[7] Janet Guyon, "CME Sticks with Fast-Growth Plan in Central Europe," *The Wall Street Journal Europe*, August 14, 1996, p. 4.

out the original founders of CET 21. CET 21 owned 12% of CNTS; when the founders sold out to Zelezny, they also transferred 5.8% of their CNTS stake to Zelezny through his private company, Nova Consulting. Zelezny now had a controlling interest in CET 21, which itself still held 6.2% of CNTS. Next, CME forgave its loan to Zelezny when Zelezny transferred 5.2% of CET 21's holding in CNTS to CME.[8] As a consequence of these transfers, CME's stake in CNTS rose to 93.2%, CET 21 retained 1% ownership, and Zelezny owned 5.8% of CNTS through Nova Consulting.

Zelezny then expressed his desire to sell his 5.8% CNTS stake. He claimed that an interested buyer – a Czech company called Chemapol, rumored to be controlled by Russian organized crime – would purchase his shares if CME did not do so. Through these means, Zelezny persuaded CME to purchase his 5.8% share of CNTS for 28.5 million USD, leaving Zelezny with no direct shares in CNTS. Zelezny also signed a share agreement with CME that included non-compete clauses preventing him from engaging in activities against the interests of CNTS. He continued to serve as General Director of CNTS, Director of TV Nova and, having bought out the other founders, controlled CET 21.

3. The CME-Zelezny Dispute

By January 1999, CME entered into merger negotiations with SBS Broadcasting SA, a company with interests in the newly deregulated broadcasting markets in Scandinavia. During 1998, SBS's interest in Eastern European ventures led to initial merger discussions as CME was the region's largest owner of television stations. While TV Nova was profitable from the start, CME encountered problems in the region's other markets. In 1997, the company lost its bid for a national broadcasting license in Hungary and the next year it wrote down the value of its Hungarian programming library. In 1998 CME sold its interest in its Polish station, taking large write-downs on its investments. At the end of 1998, CME's net losses for the year amounted to 125 million USD. CME's

[8] When the details of this loan were revealed, critics charged that CME sought to control CET 21 through Zelezny and the controversy over foreign control of Czech television resurfaced. Zelezny protested that he purchased the CET 21 shares "because I wanted to own a television station…not because the Americans wanted control. I'm Czech…I am not a puppet." (See Robert Frank, "Cultural Fare," *The Wall Street Journal,* April 30, 1997, p. A1.) The controversy over the CME loan to Zelezny erupted just as CNTS was in discussions with the Media Council over the television license, raising suspicions about CME's motives. The Media Council demanded an explanation from Zelezny, who assured its members that the terms of the loan would not be fulfilled, meaning that he would not be required to vote his acquired CET 21 shares as directed by CME.

founder, Ronald Lauder, continued to support the company with additional equity infusions as CME searched anxiously for a possible merger partner.

Sensing an opportunity, Zelezny repeatedly demanded changes in the existing agreement between CNTS and CET 21 during the merger negotiations. Zelezny argued that CNTS could not continue as the exclusive operator of TV Nova because the Media Council opposed exclusive agreements between television license holders and operating companies. Zelezny proposed that CET 21 assume more responsibility for TV Nova's operations. Instead, CME proposed a merger between CNTS and CET 21 so that there would no longer be two entities. Combining the two companies would simplify the structure of TV Nova and resolve the ongoing question of the respective rights of the operating company and license holder. The question of how Zelezny should be compensated for his consent to the agreement became central to the merger negotiations given CME's reliance on the profitability of CNTS. This negotiation was for Zelezny's consent to the deal rather than any compensation for ownership shares of any entity.

3.1. Negotiating with Zelezny

As the merger negotiations between CME and SBS advanced, Zelezny's hold over TV Nova worried executives of both companies. SBS executives noted that, "the Feudal Lord may continue to resist operational control making it difficult to institute 'best practices.'" CME needed to assure SBS that it had secure control of TV Nova through its subsidiary and tried to get Zelezny's agreement on combining CNTS and CET 21. CME sought to satisfy Zelezny without ceding its exclusive rights to operate TV Nova. According to Zelezny, CME's founder, Ronald Lauder, "offered him 100 million USD to 140 million USD to buy CET 21 and lock up Nova's license."[9] SBS, in its own valuation of CME in February 1999, calculated that Zelezny should be offered 18% of TV Nova's new operating and license company (worth 72 million USD) and a bonus worth 28 million USD upon renewal of the broadcast license. SBS executives characterized the proposed 100 million USD offer to Zelezny as the "price of peace in the Czech Republic."

Zelezny had not accepted any offer from CME when the CNTS Board met in February 1999. At this meeting, Zelezny stated that CNTS could not continue as the

[9] Craig Mellow, "Ron Lauder's Disappearing TV Station," *Institutional Investor*, Jan. 1, 2000, p. 54.

exclusive operator of TV Nova and existing contractual arrangements had to be changed. No compromise was possible, according to Zelezny, as the Media Council opposed exclusive agreements between operating companies and license holders. Zelezny declared that "his proposal was an ultimatum, which meant that CME could either accept or not."

Given that CNTS represented the crown jewel in the CME portfolio, these machinations had substantial implications, as expected, for the value of CME.[10] Figure 2 shows the stock price of CME for the period starting January 1, 1999 to mid-2003 along with the indexed MSCI Eastern Europe US dollar and MSCI Czech US dollar indices for the same period. Five-day cumulative abnormal returns (CAR) for CME (against the Nasdaq index where CME was listed) after Zelezny's ultimatum was -16.9% (Marker 1 in Figure 2).

After Zelezny's ultimatum, Zelezny solicited the support of the Media Council with a request that the Council clarify its position in writing. The Council provided a letter stating that exclusive agreements between operating companies and license holders were "incorrect." This letter dealt a serious blow to CME as it challenged the company's right to control TV Nova. Nonetheless, CME continued to negotiate with Zelezny. Zelezny was quoted as saying "I am not interested in selling my child." By March 1999, CME and SBS had increased their estimates of the 'price of peace' with Zelezny to 125 million USD and a fee of 4% of TV Nova's revenues. Although Zelezny had not yet signed an agreement, SBS and CME publicly announced their merger. SBS agreed to pay 615 million USD for CME but SBS had the right to withdraw from the merger upon payment of a termination fee. The merger was widely considered a victory for CME, and the market reacted accordingly. The five-day CME CAR after the merger announcement was 47% (Marker 2 in Figure 2.)

The impasse between CME and Zelezny continued. At an April meeting of the CNTS board, CME CEO Fred Klinkhammer accused Zelezny of violating CNTS's exclusive right to acquire programming for TV Nova by authorizing AQS, a separate entity controlled by Zelezny, to buy programs for the station. Zelezny denied this but Klinkhammer nonetheless fired him as General Director of CNTS. Klinkhammer deplored

[10] Although CME represented not just CNTS, but all of the CME investments in the region, the present value of CNTS expected cash flows represented over 90% of CME's firm value.

Zelezny's dealings with AQS, declaring, "such bad faith actions could hardly be expected, especially after CME purchased a 5.8% interest in CNTS from Dr. Zelezny for over 28 million USD less than two years ago and he agreed not to compete with CNTS as a condition of that purchase."[11] Zelezny claimed, "the law says TV Nova is CET 21" and reportedly claimed, "I am the executive of CET 21, owner of the name and Nova's license. I am Nova."[12] Despite being dismissed as Director of CNTS, Zelezny continued as Director of TV Nova and still controlled CET 21. Five-day CME CAR after Zelezny's firing was -32.1% (Marker 3 in Figure 2.), indicating that the market also seemed to agree with Zelezny that "[he] was Nova." Zelezny's firing caused an uproar in the Czech Republic, with both sides seeking media support. The Media Council ordered the parties to cease public pronouncements but declined to intervene in the dispute.

3.2. Zelezny Retaliates

Zelezny retaliated several months later. On August 5, 1999, CET 21 terminated its service agreement with CNTS, and withdrew the use of its license. CET 21 cited the failure of CNTS to deliver the daily log for TV Nova the previous day – a technical violation of their agreement – as cause for the withdrawal. The inability of CNTS to operate led to an immediate impact on the stock price. Five-day CME CAR after the termination of the service agreement was -50.5% (Marker 4 in Figure 2.) CME immediately sought a hearing with the Media Council and decried Zelezny's actions in the press. Klinkhammer declared, "Zelezny had less than 200 USD when he started with TV Nova. We have paid him more than 35 million USD in salary and other benefits. Now he is probably the first or second richest man in the country. We have created a monster."[13] Zelezny responded with a book entitled "We Shall Not Surrender This Television Station" and maintained, "CME is a flop…When it started it had a fantastic chance to win the television market in half of Europe, but it has been awfully managed and many decisions amounted to disasters."[14]

Without the use of a broadcast license, CNTS could not operate TV Nova. The Media Council refused to intervene in what it characterized as a commercial dispute, and

[11] "Zelezny Dismissed from CNTS," *PR Newswire*, April 19, 1999.
[12] "CME Company Wants to Prevent Zelezny from Heading Nova," *CTK Business News*, April 20, 1999.
[13] Kevin Done, "Czechs Watch CME TV battle," *Financial Times*, September 17, 1999, p. 30.
[14] *Ibid.*

the Czech courts offered no quick remedy so CNTS was out of business. TV Nova, however, continued to broadcast, with CET 21 securing the services of other companies (through AQS) to provide programming. Following the loss of TV Nova, SBS reassessed its merger with CME and exercised its right to withdraw from the merger.[15]

4. The Endgame, 1999-2003

Ronald Lauder used his political influence to gather support for his cause. These efforts included enlisting the help of several senior U.S. administration officials, including Secretary of State Madeleine Albright, to press his case with Czech officials. In November 1999, when the Czech Prime Minister visited Washington D.C., Lauder paid for full page notices in *The New York Times* and *Washington Post* warning potential investors that the Czech Republic lacked safeguards for foreign investors (Figure 3.) Some observers judged that Lauder and CME would gain little satisfaction now that Zelezny controlled TV Nova. The Director of the American Chamber of Commerce in Prague concluded, "No Czech politician who has any desire to continue being a politician is going to cross swords with Zelezny."[16] CME attempted to regain control of TV Nova through continued appeals to the Media Council and the Czech courts, without success.

4.1. International Tribunals: The Denouement

CME and Ronald Lauder, as its principal shareholder, also turned to international tribunals to hear their case. CME charged Zelezny with breaking the non-compete clauses in his agreement with the company and sought damages from him personally. In separate actions, CME and Lauder claimed that the Czech Republic and the Media Council violated international treaties by failing to protect CME's investment in TV Nova. Three separate tribunals held hearings in different cities, and the press dubbed the actions accordingly: "The Amsterdam Tribunal," "The London Tribunal," and "The Stockholm Tribunal":

- CME initiated arbitration in The International Court of Arbitration of the International Chamber of Commerce (ICC). The ICC heard CME's complaint against Zelezny, as provided for in the share agreement between CME and Zelezny. The two parties had signed the agreement in 1997 when CME purchased Zelezny's shares in CNTS (the "Amsterdam Tribunal").

[15] SBS paid CME a termination fee of 8.25 million USD. SBS did purchase selected assets from CME in separate transactions.
[16] Craig Mellow, "Ron Lauder's Disappearing TV Station," *Institutional Investor*, Jan. 1, 2000, p. 54.

- Lauder began arbitration against the Czech Republic in London under the UNCITRAL Arbitration Rules, claiming breaches of the 1991 BIT between the United States and the Czech and Slovak Federal Republic (the "London Tribunal"). This BIT was one of 70 that the Czech Republic has entered into after the fall of the Soviet Union.
- The Dutch parent company through which Lauder had made his investment, CME Czech Republic, initiated arbitration against the Czech Republic in Stockholm, also under the UNCITRAL Arbitration Rules, claiming breaches of the 1991 BIT between the Kingdom of The Netherlands and the Czech and Slovak Federal Republic (the "Stockholm Tribunal"). On behalf of its shareholders, the parent company sought 500 million USD in damages from the Czech Republic for failing to protect its investment.

In February 2001, the Amsterdam Tribunal found that Zelezny had breached his non-compete agreement with CME by authorizing AQS to purchase programming for TV Nova. The Court ordered Zelezny to repay to CME the 23 million USD he had received to date for his CNTS shares and CME was ordered to return to the CNTS shares it had purchased from him. While CME also claimed damages against Zelezny of 470 million USD for the destruction of CNTS, the Court granted no damages to CME. On September 3, 2001 the London Tribunal found that the Czech Republic had arbitrarily discriminated against Lauder as a foreign investor at the time of the founding of TV Nova. At that time, the Media Council refused to allow CME's direct investment in TV Nova's license-holding company although such foreign investments were permitted under Czech law. The tribunal ruled, however, that Lauder failed to prove that CME's subsequent losses were caused by this discrimination and awarded no damages. This ruling was a clear victory for the Czech Republic and a Czech government spokesman explained, "Mr. Lauder invested here; the investment was not really a success, and it has nothing to do with Czech laws."[17] Zelezny declared: "Everything ended well. We've won and it is clear that only Ronald Lauder himself is to blame for his business failures."[18] Five-day CME CAR after the Amsterdam Tribunal ruling was -16.8% (Marker 6 in Figure 2).[19]

The Czech Republic's victory was short-lived. Ten days later, the Stockholm Tribunal, examining the same facts and legal issues, reached a very different conclusion. The tribunal ruled that the Media Council's 1996 demand for changes in the agreement

[17] Marius Dragomir, "TV Nova Courtroom Drama Set to Continue after London Episode," *Prague Business Journal,* September 10, 2001.
[18] "Swedish Ruling Deals Blow to State as Zelezny's Accomplice," *CTK Daily News,* September 1, 2001.
[19] It should be noted that at this point the stock was trading well below 1 USD, had been delisted from Nasdaq, and was considered a "highly speculative" over-the-counter stock.

between CNTS and CET 21 weakened CNTS' control over TV Nova and caused CME to be wrongly deprived of its investment in TV Nova three years later. Unlike the London Tribunal, the Stockholm Tribunal found causation: "The collapse of CME's investment was caused by the Media Council's coercion against CME, in requiring in 1996 the amendment of the legal structure as the basis of its investment and by aggravating the Media Council's interference with the legal relationship between CET 21 and CNTS by issuing an official regulator's letter which eliminated the exclusivity that was the cornerstone of CME's legal protection for its investment." The Tribunal concluded that the Czech Republic "is obligated to remedy the injury that Claimant suffered as a result of Respondent's violations of the Treaty by payment of the fair market value of the Claimant's investment." CME sought 556 million USD in damages. Five-day CME CAR after the Stockholm Tribunal ruling was 843% (Marker 7 in Figure 2.)[20]

In March- 2003, the tribunal ruled that the fair market value of CNTS in August 1999 was 400 million USD. Using this as a starting point, the tribunal determined the compensation due to CME from the Czech Republic as follows:

Market value of CNTS	400.0 million USD
Less: Residual value of CNTS[21]	38.5 million USD
Less: "Zelezny Factor"	72.0 million USD
Adjusted value of CNTS	289.5 million USD

Thus, CME compensation for its remaining 93.2% stake in CNTS[22] amounted to 269.8 million USD plus 10% simple interest from February 2000 to date of payment. The tribunal reduced CME's compensation by the "Zelezny Factor" –or 72 million USD – on the basis that Zelezny's business and managerial skills accounted for that share of the value of CNTS. The tribunal ruled that the Czech Republic and its Media Council was not responsible for this part of CME's lost investment. Five-day CME CAR after the damages award was 8.6% (Marker 8 in Figure 2.)

The Czech government tried to persuade Zelezny and TV Nova to accept some financial responsibility for the award, but its efforts did not succeed; a TV Nova

[20] At this point, CME had been delisted and was trading as a speculative stock in the Pink Sheets, hence the extreme CAR after the announcement.
[21] The residual value of CNTS included dividends paid to CME by CNTS after August 1999, the value of property and assets subsequently sold by CNTS, and the value of property and assets still held by CNTS.
[22] CME owned 93.2% of CNTS after the ICC Tribunal ("The Amsterdam Tribunal") ruled that Zelezny should repay CME for the CNTS shares it purchased from him and that CME should then return 5.8% of CNTS shares to Zelezny.

spokesperson described the judgment as “a dispute between the Czech Republic and CME.”[23] The Czech Premier pointed out that the amount awarded to CME “represented three times the annual budget of the Ministry of Environment, or the annual budget of the Ministry of Health.”[24] A two-year 1.5% increase in the Czech value-added-tax was contemplated to finance the payment. One analyst estimated the cost of the award at about “40 USD per person in a country where the average monthly wage is less than 600 USD.”[25] The damages also dwarf, by at least a factor of ten, those in any other known investment arbitration up to that time.[26] Nonetheless, Czech media reported that most Czech politicians accepted that any damages owed would have to be paid and Foreign Minister Cyril Svoboda stated that “prompt payment is a must in order to safeguard the nation’s reputation abroad.”[27] The ruling was upheld on appeal and the Czech government promptly paid CME a total of 354.9 million USD, including the compensation for its lost investment, interest, and a share of legal costs. Five-day CME CAR after the final ruling was 20.9% (Marker 9 in Figure 2.) Ultimately, the government dismissed the existing Media Council, holding it responsible for the loss in arbitration. Following the ruling, other foreign investors sought relief through international arbitration in their disputes with the Czech Republic.[28]

Zelezny was elected to the Czech Senate in November 2002 but stripped of his parliamentary immunity in early 2003 to allow police to investigate fraud charges against him, some stemming from his failure to repay CME for the CNTS shares. In October 2003, PPF, a Czech financial conglomerate, agreed to buy CNTS for 53.2 million USD. Zelezny’s interest in CET 21 passed to PPF, which paid the money he owed to CME. CET 21’s new owners dismissed Zelezny as Director of TV Nova, hoping to distance the station from the lost arbitration. In 2003, CME’s Slovenian station launched a successful sitcom based on the Zelezny debacle. Zelezny, however, remained a political force and in 2004, he won a seat in the European Parliament. Exemplifying the dictum that history repeats

[23] Marius Dragomir, “Pay TV,” *Prague Business Journal*, March 24, 2003.
[24] “Revenge of the Nerd, Part One,” *Prague Business Journal*, May 19, 2003.
[25] Richard Morgan, “Ron Lauder’s Prague Spring,” *Daily Deal*, May 26, 2003.
[26] Luke Eric Peterson, “Czech Republic Hit With Massive Compensation Bill in Investment Treaty Dispute,” *Investment Law and Policy Weekly News Bulletin*, March 21, 2003.
[27] *Ibid.*
[28] Luke Eric Peterson, “Investors Emboldened by Arbitral Verdict Against Czech Republic,” *Investment Law and Policy Weekly News Bulletin*, April 11, 2003.

itself, first as tragedy and then as farce, CME regained control of TV Nova in December 2004 when it bought a controlling interest in the television station from PPF, a deal CME valued at USD 642 million.

5. *The Post Mortem*

What new insights does CME's experience in the Czech Republic provide? Prior to turning to some of the lessons from this example, it is useful to note that these events can be interpreted as a classic hold-up problem where two highly complementary assets – financial capital and the license – should have been jointly owned. In this interpretation, the hold-up that occurred was merely a reflection of ex-post opportunism reflecting the central intuition of transaction cost economics, as in Williamson (1985) and the property-rights view of the firm, reviewed in Hart (1995). While this case helps exemplify such theories, it is useful to ask why the contracts that were designed to mitigate this problem – CME's exchange of 12% ownership in CNTS for exclusive use of the license, ongoing non-compete clauses, and the enforcement of the license through the Media Council – did not prevent such opportunism. Zelezny's power arose from his ability to effectively renege on that agreement and have the broader Czech regulatory and political structure support him. For this reason, we do not frame the issue as a hold-up problem as it is not clear if rearranging ownership shares could have solved this problem.

5.1 Institutional Interactions and the Nature of Control

Zelezny's ability to expropriate CME's value of its Czech investment arose from his power over the Czech regulatory apparatus. CME was forced repeatedly to pay Zelezny in order to maintain "peace" – from the initial compensation for the use of the license through subsequent purchases of the shares. Of course, the inability of CME and SBS to consummate their merger stemmed from their inability to pacify Zelezny with over 120 million USD for what was, on the surface, a mere 1% ownership stake. The final act of expropriation occurred when Zelezny blocked CNTS and CME from accessing Czech airwaves, which effectively destroyed all the value in CNTS. While CME owned 99% of CNTS and, initially, the exclusive rights to employ the license, Zelezny expropriated the value of this enterprise by manipulating the Media Council to narrow the terms of the license to limit the effective control of foreign owners, by using his public persona (as gained through his TV show) to galvanize public opinion on his side and attack politicians that might criticize him, and by creating related entities (AQS) that competed with CNTS and ultimately allowed him to control TV Nova without using CNTS.

The striking aspect of Zelezny's expropriation of the value of CNTS is that it occurred without a significant ownership share and without the legislated need to have a domestic partner in Czech broadcasting. The irrelevance of ownership in this setting is further illustrated by the fact that Zelezny was gaining more and more control of the underlying entity, and the value supposedly embodied in the shares of CME, precisely when he was selling his shares back to CME.

This example helps illuminate the interaction between property rights and contractual institutions highlighted in Acemoglu and Johnson (2005). In the CME setting, it was weakness in property rights institutions that made existing contracts irrelevant. As such, the example of CME illustrates how little ownership shares and contracts can matter in settings where property rights are ill-defined. In this case, Zelezny was convinced that "[he] was Nova" and, by implication, CNTS and CME. His access to Czech politicians and the Media Council and the threat of the license withdrawal led to his effective control over all the corporate assets. Zelezny's control of the Czech regulatory apparatus meant that without Zelezny's cooperation, the assets of CNTS (physical plant, programming library, and management) were worthless. Because of the weak general property rights in place, CME did not have clear access to the resources required to monetize its investment in CNTS – despite contractual provisions that would normally have guaranteed their provision. In settings where property rights are ill-defined and the state can change the rules of the game, it is possible that majority ownership shares may not translate into control and private contracts generally become unreliable regardless of the contracting institutions in place.

While Acemoglu and Johnson (2005) suggest that the availability of alternatives to contracts may explain the limited the role of contractual institutions relative to property rights institutions in dictating economic outcomes, this example suggests that there are important interaction effects. Contracts are meaningless when the state can rewrite the rules of the game in favor of elites or favored parties. As such, the limited role of contractual institutions in explaining economic outcomes may reflect the fact that contractual institutions are not independent of property rights institutions but, instead, contractual institutions build upon the foundation of property rights institutions. Indeed, a rich legal literature also draws attention to the distinction between property law and contract law and specifically to such possible interactions. Specifically, Posner (1998, p. 74) notes that "a property right excludes (in the limit) the whole rest of the world from the use of a thing except on the owner's term. A contract right excludes only the other party to the contract. *Freedom to contract but not to create property rights would not optimize resource use* (emphasis added). If A buys from B the right to work B's land, but B has no right to exclude others from working it, A (like B before him) will not have an incentive to exploit the land optimally."[29]

The CME example also demonstrates the relevance of geography and politics to control considerations. In their examination of ownership patterns in the UK, Franks, Mayer, and Rossi (2004) speculate that trust between investors and managers arising from geographical proximity was an effective substitute for formal systems of regulation and investor protections.[30] The role of geography in mediating effective control over entities has been emphasized in the venture capital setting (see Lerner (1995)) and in the ways in which multinationals structure repatriation policies for their overseas subsidiaries (see Desai et. al. (2005a)). The CME example illustrates the centrality of geography to determining control of assets. Zelezny's control over the value of CNTS arose, in part, from his ability to access Czech officials and court public opinion while CME was viewed as a remote foreign entity. CME officials have speculated in private interviews that the absence of a Prague office allowed Zelezny disproportionate control over CNTS. As such, the CME example suggests that proximity can be an important component of control particularly in institutionally-fragile economies.[31]

[29] For related arguments on the distinction between property and contract law and the foundational nature of property law, see Merrill and Smith (2000).

[30] In a related vein, Banerjee and Newman (1998) examine how the transition to modernity is associated with greater information asymmetries and the need for legal mechanisms to substitute for trust in business relationships. Interviews with participants in the Lauder-Zelezny saga indicate that Zelezny reportedly emphasized (or dissembled) a Jewish heritage in order to engender the trust of Lauder, a large benefactor of Jewish causes in Eastern Europe.

[31] The CME example demonstrates that employees can wield considerable "real authority" despite being endowed with limited "formal authority" through ownership, as discussed in Aghion and Tirole (1997). While Aghion and Tirole (1997) emphasize information asymmetry as the source of the allocation of real authority, the nature of the employment

The resolution of the CME case also illustrates the nexus between politics and finance in a global setting. Most directly, Lauder spoke directly to the Czech Prime Minister about the case in Washington D.C. and sought the support of various senior political appointees in the U.S. government to resolve the case. These individuals, such as Madeleine Albright, had historic ties to the Czech Republic and pressed Lauder's case with leading Czech politicians. Of course, Zelezny protected himself with his own access to Czech politicians who were anxious about Zelezny's own domestic influence.[32] More indirectly, Lauder's public advertisements about the Czech Republic were targeted at pressuring Czech politicians concerned with the Czech Republic's pending accession to the European Union. Indeed, the Czech Republic had to pay the compensation awarded to CME, as noted above by the then Finance Minister, to safeguard the reputation of the country. The notion that courts, local or otherwise, would be the *sole* arbiters of the resolution of this expropriation never occurred to the protagonists in this example. A final political lesson is that Czech citizens literally *paid* the price for the expropriation. While scholars argue that broader populations bear the costs of weak institutions, this setting provides an extreme example of these costs being borne by the broader population.

5.2. Institutional Dynamics in Open Economies

The resolution of the CME case employed a relatively new approach to supra-national judicial enforcement – BITs. These treaties are made between two states and provide specific protections to investments made by nationals of one participating state in the other. BITs define foreign investment and outline various principles regarding treatment, expropriation, and avenues for dispute settlement.[33] BITs are distinct from other agreements between governments as they grant specific rights not just to the contracting states, but also to individuals who are nationals of each of the signatory parties, and they

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contract itself may be the source of such authority. Stole and Zweibel (1996) note that the nonbinding nature of employment contracts can lead to intrafirm bargaining as employees can withhold inputs, as was the case with Zelezny.

[32] Interviews with company officials indicate that Zelezny had the habit of providing legislators with copies of their confidential secret police files from the period prior to the fall of the Iron Curtain.

[33] BITs emphasize national treatment (where investors have equivalent rights to those of nationals of the host state); most-favored nation treatment; absolute standards of treatment of foreign investors; ability to repatriate profits; and guarantees against expropriation or nationalization without compensation. Standards include "prompt, adequate, and effective" or "payment of full value" or "just compensation." BITs are now also being used to resolve a variety of disputes arising out of "regulatory takings," such as trade bans initiated by the host government, breaches of concession agreements; taxation measures, measures of economic or monetary policy, and domestic court decisions (Friedman (2003)). See Been and Beauvais (2003) for a discussion of regulatory takings under Chapter 11 of NAFTA.

permit individual investors to pursue claims in international arbitration directly against the host nation. It is important to note that BITs provide investors protections from, and recourse for, harmful actions by states, not individuals in those states. In the context of the distinction between property rights and contractual institutions highlighted above, it is worth noting that BITs are particularly valuable in that they provide an alternative means of securing property rights that institutions are meant to provide. Rose-Ackerman and Tobin (2004) review BITs and conclude that "foreign investors are assured a strong, binding property rights system outlined in international or industrialized country law."

Most BITs refer such investment disputes to arbitration under the rules of the International Center for the Settlement of Investment Disputes (ICSID), an arm of the World Bank created by a multinational convention, or under the United Nations Commission in International Trade Law (UNCITRAL) rules.[34] BITs have increased sharply in importance over the last few decades. Panel A of Figure 4 shows a time-series from UNCTAD data of the number of BITs signed per year and the cumulative total of BITs for the years 1976 to 2002. Panel B of Figure 4 shows the number of BITs signed between developing economies and developed, developing, and Central and Eastern European economies per decade. The 1990s has seen an explosion of BITs signed by developing countries with each other. Expropriation cases are also increasingly handled through BITs. Over its forty year history, the ICSID has registered 120 disputes. Over half of these disputes have been registered after 2000, with BITs involved in an increasing number of cases. Seven of the 12 cases started in 2000, 12 of 14 in 2001, and 16 of 19 in 2002 explicitly involve BITs. Recourse to BITs has primarily been taken up by investors from developed countries against developing countries.[35]

What does the resolution of the CME case through international tribunals illustrate about the role of BITs in promoting convergence of investor protections? In order to

[34] Binding arbitration protects foreign investors from the risk that disputes arising under the contract will be resolved in courts that are not impartial, because they are aligned with the host country government, or incompetent, as a well-trained judiciary may be absent. Second, international commercial arbitration permits the parties to specify resolution of the dispute against a foreign law, thereby limiting the risks of reliance on incomplete or poorly written laws. While host states can adopt constitutional protections that commit governments to uphold their contracts with private investors, foreign investors may be skeptical of the capacity and willingness of the local courts to enforce these agreements.

[35] Of the 102 BIT arbitrations with investors of identifiable nationalities, 87 were initiated by developed country investors, with a US citizen as claimant in 36 of these cases and a citizen of EU member states a claimant in 50 of the cases. Seventy four of the arbitrations featured Respondents that were developing nations and 18 were transition economies.

consider this question, we examine if the CME case provoked reforms that strengthened investor protections or if capital markets evidence suggests convergence through a reduction of the cost of capital. While no particular law may have prevented these events, it is useful to consider whether pursuit of cases through BITs prompts states to strengthen laws. In particular, Coffee (1999) and Gilson (2001) outline the mechanisms by which convergence of investment protections can occur. Given the sizable penalty and notoriety of the CME case within the Czech Republic, one might expect to find significant changes to Czech securities or corporate law if BITs were a force for convergence.

With the specific exception of changes to the regulatory structure facing broadcast companies (e.g., the dismissal of the Media Council), the CME case does not appear to have had any material effects on securities and corporate laws in the Czech Republic. Recent changes to securities laws appear to be driven by the stated goal of harmonization of the securities legislation with the European Union, and not directly in response to the issues raised by CME. As the local legal environment has changed little, foreign investors continue to rely heavily on BITs and the CME case has greatly increased awareness of the litigation possibilities arising from BITs. Foreign investors now routinely "shop" the country of incorporation of the subsidiary that is to invest in the Czech Republic to reflect the strength of the relevant BIT. The only change in the legal landscape of the Czech Republic appears to be the determination of foreign investors to strengthen their protections through means not available to local investors.

If the CME case had a material impact on governance of local firms in the Czech Republic, this should be manifest, as noted by Stulz (1999), in evidence provided by the capital markets. In the CME case, we have a set of events (Markers 1-9 in Figure 2) that could have influenced investor risk perceptions and for which we can measure their impact on security prices. Table III provides the cumulative abnormal returns (CAR) for both Czech stock and bond indices for the nine events identified by the markers in Figure 2 and "z-scores" which captures how extreme a move is for a given event. Had the incidents at CME resulted in a material change in the perception of risk in the Czech Republic, we would have expected bond returns to experience statistically significant shifts; in particular, positive returns would have been expected with the rulings in favor of CME were announced and upheld. Two of the events had some impact on the Czech stock market in the expected direction, but only one of them had an impact on prices of Czech Government bonds, the traditional proxy for country risk. None of the events provide convincing evidence that the CME saga represented a permanent change in the governance environment for local Czech firms.

In contrast to the intuition of "contractual convergence," the CME case and greater awareness of BITs are not associated with legal reforms or significant capital markets evidence of convergence. Indeed, the proliferation of contracts with legal protections, if only available to a subset of investors and firms, might carry negative implications for firms unable to avail themselves of these enhanced protections. One example of such a possibility is the effect of ADRs on local firms.[36] The ability of multinational firms to avail themselves of investor protections may similarly be detrimental to local firms if the unequal provision of investor protections leads to an uneven playing field.

In order to consider this possibility further, we revisit the comparison of Poland and the Czech Republic of Glaeser et.al. (2001). As they point out, the similar initial conditions of the two countries and the divergent attitudes toward regulation of financial markets make a comparison of their subsequent experiences illuminating. A naïve application of the intuition of their work might suggest that FDI would be robust in Poland and moribund in the Czech Republic, much as their investigation of capital markets performance suggested. Indeed, such a comparison, as provided in Table IV, tells the opposite story. The Czech stock market continues to suffer from a severe contraction in the number of listed firms and market capitalization/GDP ratios have dipped while the Polish market has continued to grow. In contrast, FDI is a significantly larger fraction of investment in the Czech Republic where UNCTAD estimates FDI inflows at more than 59% of gross fixed capital formation in 2002. Even if local investor and minority shareholder rights are extremely weak (as evidenced by the undeveloped local capital markets), foreign investors can avail themselves of a favorable property rights environment through recourse to BITs. The experience of the Czech Republic suggests that FDI might be serving as a substitute for local investment or FDI may be crowding out local investment.

[36] Karolyi (2004) and Moel (2001) find that firms from developing countries employing ADRs generate negative spillover effects on their home market, with reduced capitalizations, turnover ratios, and net new listings for local firms.

Other evidence on BITs is consistent with this view. Legal analysts such as Rose-Ackerman and Tobin (2004) and Daniels (2004) conclude that BITs provide foreign investors with a “safe harbor” property rights system that protects their investment under international or developed country laws while local investors are left to the devices of host country legal institutions. Additionally, Rose-Ackerman and Tobin (2004) find no relationship between increases in BIT activity and improvements in domestic property rights indicators, as is the case with the CME debacle. As such, local firms reliant on anemic local capital markets and weak legal institutions must compete with foreign firms protected by supranational agreements. This evidence is consistent with other evidence that multinational firms overcome rigidities facing local firms – with respect to capital controls, costly external financing or currency crises (see Desai et. al. (2004a, 2005b) and Desai et al. (2004 b)) – so that local firms bear the burden of such rigidities disproportionately.

With foreign investors availing themselves of these protections, the political economy dynamic that might lead to pressure for reforms of investor protections might also have less force than otherwise. As such, differential protections may both contribute to the persistence of differences in investor protections and may have distributional consequences that favor multinational firms. While attention has previously been focused on distributional consequences of uneven protections (as in Rajan and Zingales (2003)) or on the dynamics of investor protections in the face of inequality and varying political institutions (as in Pagano and Volpin (2005)), the dynamics between multinational firms and local firms may be another wedge through which institutions can be redistributive.

6. Conclusion

In a world characterized by large FDI flows and sophisticated multinational firms bent on protecting their worldwide investments, the assumption that the relevant institutional environment can be summarized by examining local laws seems increasingly tenuous. The fact that subsets of investors within an economy enjoy differential protections also raises several questions about how local and multinational firms interact, adapt and capitalize on those distinctions. The example of how easily a local minority owner with access to a key resource can exploit a foreign majority owner provides a dramatic example of expropriation and suggests that ownership alone does not dictate control and that geography is an important dimension of control. This example also suggests that property rights institutions are more determinative of economic outcomes, relative to contractual institutions, as restraints on the state provide the background for any meaningful contracts. The rising importance of multinational firms, particularly in emerging economies, suggests that the Lauder-Zelezny saga may represent an opening gambit in the unfolding story of investor protections in a converging world.

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Table I

Operating results for CME units

Operating results (in thousands USD) for CME subsidiaries, December 31, 1996 fiscal year. Broadcast cash flow is a broadcasting industry measure of performance and defined as net broadcast revenues, less broadcast operating expenses excluding depreciation and amortization, broadcast selling, general and administrative expenses, and cash program costs. Source: CME, Dec. 31, 1996 10-K (Bermuda: CME, 1996).

Consolidated Entities	**Nova TV**	**Pro TV**	**Pop TV**	**Markiza TV**	**Total**
Territory	Czech Republic	Romania	Slovenia	Slovak Republic	
Net revenues	**109,242**	**15,803**	**9,080**	**7,462**	**141,587**
Station operating expense	(54,578)	(16,497)	(12,764)	(9,570)	(93,409)
Selling, general and administrative expense	(9,247)	(6,351)	(3,989)	(1,605)	(21,192)
Station operating income	**45,417**	**(7,045)**	**(7,673)**	**(3,713)**	**26,286**
Depreciation of assets	8,024	2,678	2,516	1,473	14,691
EBITDA	**53,441**	**(4,367)**	**(5,157)**	**(2,240)**	**41,677**
Amortization of programming rights	16,207	3,725	1,667	2,401	24,000
Cash program rights costs	(16,520)	(4,648)	(2,904)	(4,663)	(28,735)
Broadcast cash flow	**53,128**	**(5,290)**	**(6,394)**	**(4,502)**	**36,942**

Table II

Timeline of Major Events and CNTS Ownership Changes

Timeline showing major events and changes in ownership at CNTS. Source: Author's analysis of UNCITRAL Arbitration, CME Czech Republic B.V. (The Netherlands) vs. The Czech Republic, Partial Award, September 13, 2001.

		Ownership Percentage		
Date	**Event**	**CME**	**CET 21**	**Other**
1992	CNTS begins operations	66	12	22 (CSB)
July 1996	Media Council commences administrative proceedings against CNTS for broadcasting without a license	66	12	22 (CSB)
1996	CSB sells its 22% holding in CNTS to CME	88	12	
May 1997	CNTS agrees to alter its agreement with CET 21 so that CET 21 no longer granted "exclusive use of the license" but rather the "know-how concerning the license."	88	12	
1997	Zelezny buys out original CET21 founders, using a loan from CME for the purchase, then sells most of CET 21's stake in CNTS stake to CME, Zelezny retains a 5.8% share of CNTS.	93.2	1	5.8 (Zelezny)
1998	Zelezny persuades CME to purchase his 5.8% share of CNTS for 28.5 million USD, leaving Zelezny with no direct shares in CNTS.	99	1	
February 1999	Zelezny states at a CNTS board meeting that CNTS cannot continue as exclusive programming provider to TV Nova	99	1	
March 1999	SBS and CME reach merger agreement	99	1	
April 1999	Zelezny fired as director of CNTS.	99	1	
August 5, 1999	CET 21 terminates relationship with CNTS and withdraws broadcasting license	99	1	

Table III

Cumulative Abnormal Returns for Selected CME Events

Cumulative abnormal returns (CAR) for both Czech stocks and bonds for the nine events identified by the markers in **Figure 3.** Column C shows the 5-day CAR of CME against the Nasdaq market index. Column D shows the Czech Market 5-day CAR, as represented by the MSCI US dollar Czech Republic index excess return over the MSCI US dollar World Index. Column E calculates Column D's "z-score", which is computed by dividing the CAR in Column D by the standard deviation of 5-day CARs for the period January 1, 1999 to May 30, 2003. This measure attempts to capture how "extreme" a move is for a given event. Column F shows the implied 5-day bond returns for 5-year Czech Government bonds. These returns are given by the price difference of the 5-year bond over a 5-day period assuming that the bond trades at par (i.e. coupon rate equals yield rate) at the beginning of the calculation period. Column G shows the same calculation for Polish 5-year Government bonds, while Column H shows the "z-score", which is the return in Column F divided by the standard deviation of all 5-day returns for the period January 1, 1999 to May 30, 2003. Extreme moves are in bold.

A	B	C	D	E	F	G	H
Marker	Event	CME CAR	Czech Market CAR	Czech Market z-score	CZ 5-Yr Bond Return	Poland Bond Market Return	CZ 5-Yr Bond z-score
1	2/24/1999 Zelezny states at a CNTS board meeting that CNTS cannot continue as exclusive programming provider to TV Nova	-16.9%	0.84%	0.25	-0.08%	-0.61%	-0.12
2	3/29/1999 SBS and CME reach merger agreement	47.0%	6.76%	**2.01**	-0.33%	-0.51%	-0.51
3	4/19/1999 Zelezny fired as director of CNTS.	-32.1%	-1.30%	-0.38	0.11%	-0.14%	0.16
4	8/5/1999 CET 21 terminates relationship with CNTS and withdraws broadcasting license	-50.4%	-0.69%	-0.21	-1.54%	0.28%	**-2.37**
5	2/13/2001 Amsterdam tribunal reaches minor ruling against Zelezny	-16.8%	-1.03%	-0.31	-0.19%	-0.10%	-0.30
6	9/3/2001 London tribunal rules in favor of Czech Republic	843.2%	1.50%	0.45	0.85%	1.52%	1.30
7	9/13/2001 Stockholm tribunal rules in favor of CME	8.6%	5.44%	1.62	-0.93%	-0.07%	-1.43
8	3/14/2003 Stockholm tribunal makes final ruling of $350 million in favor of CME	20.9%	-7.78%	**-2.31**	0.85%	0.25%	1.31
9	5/15/2003 Stockholm tribunal ruling upheld on appeal	-16.9%	3.43%	1.02	-0.08%	-0.61%	-0.12

Table IV

Comparison of Czech Republic and Poland Stock Markets and FDI

Time series comparison of the Czech Republic and Poland stock markets and FDI. All data calculated from current USD. GDP, FDI, and GFCF data from UNCTAD. Stock market data from International Federation of Stock Exchanges (FIBV), Prague Stock Exchange, Warsaw Stock Exchange, at year-end exchange rates. Listed firms and market capitalization data include all main, parallel, and free market companies.

	Market Cap/GDP		Number of Listed Firms		FDI Inflows as percent of GFCF		FDI Stock as percent of GDP	
Yearr	Czech Republic	Poland	Czech Republic	Poland	Czech Republic	Poland	Czech Republic	Poland
1991		0.2%		9		2.0%		0.6%
1992		0.3%		16		4.8%		1.6%
1993		3.2%	969	22	6.6%	12.6%	9.8%	3.1%
1994	29.9%	3.1%	1028	44	7.4%	10.6%	11.1%	3.8%
1995	34.5%	4.1%	1716	77	15.4%	15.5%	14.1%	6.2%
1996	34.0%	6.4%	1670	100	7.8%	15.1%	14.9%	8.0%
1997	27.1%	8.2%	320	175	7.9%	14.5%	17.4%	10.1%
1998	24.2%	12.9%	304	264	22.3%	15.9%	25.3%	14.1%
1999	24.2%	19.1%	195	308	41.3%	18.4%	32.2%	16.8%
2000	22.9%	19.9%	151	315	34.3%	23.4%	42.1%	20.9%
2001	16.6%	14.8%	102	317	35.6%	14.9%	47.4%	22.4%
2002	16.2%	15.3%	80	300	59.1%	11.4%	64.3%	24.0%

Figure 1

Initial Corporate Structure of CNTS

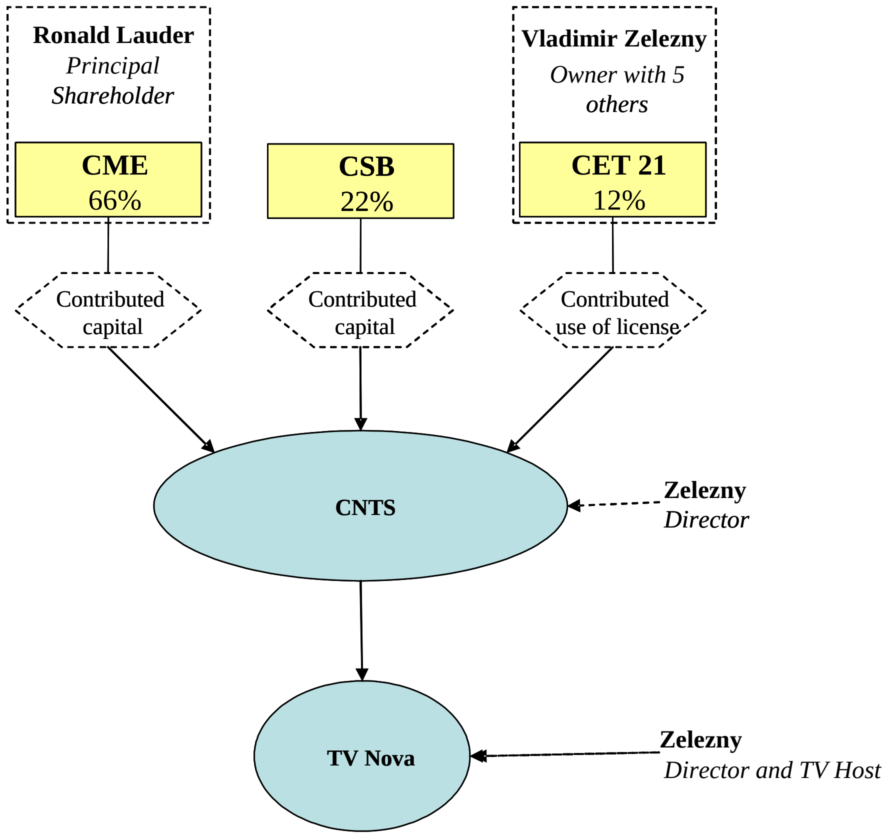
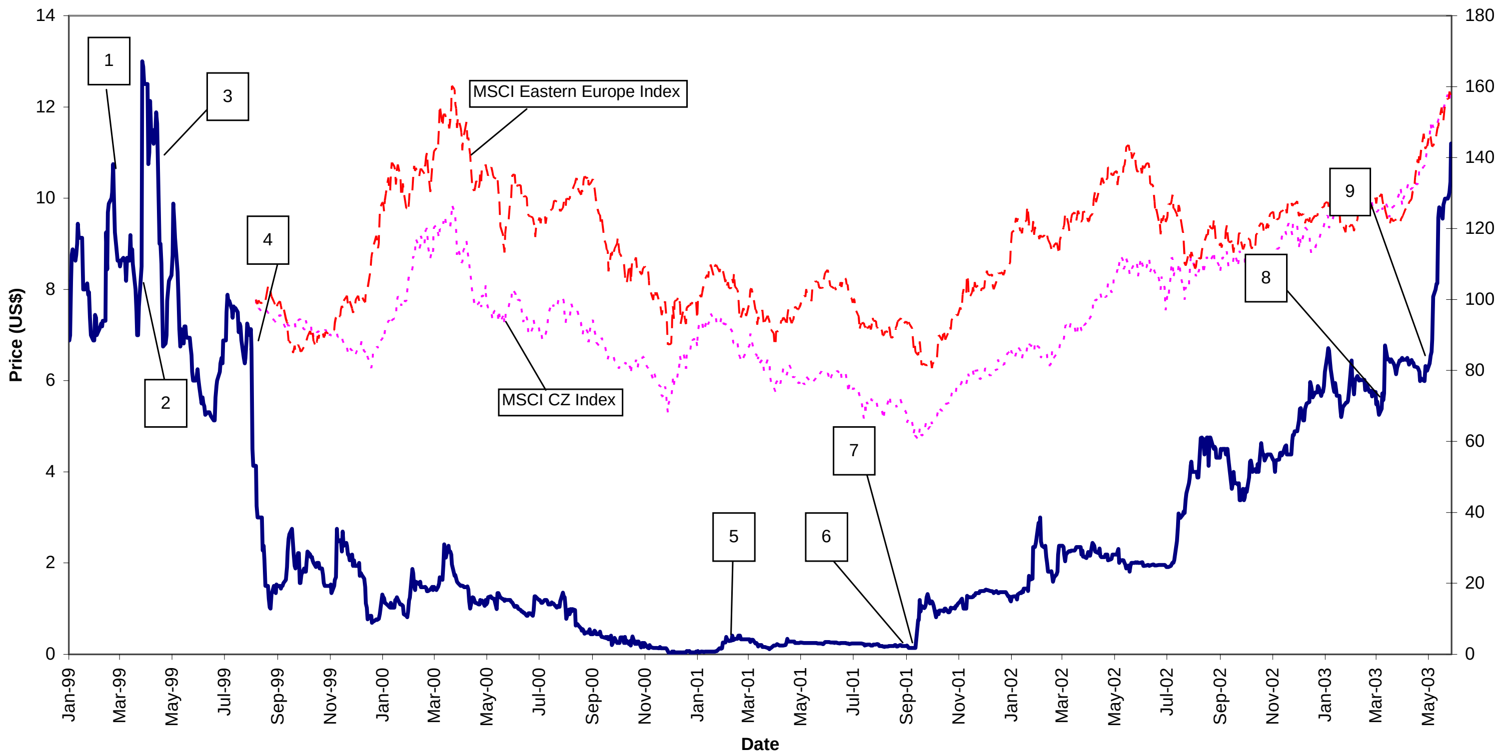


Figure 1. Initial corporate structure of CNTS, showing ownership by the three parties. Source: Author's analysis of UNCITRAL Arbitration, CME Czech Republic B.V. (The Netherlands) vs. The Czech Republic, Partial Award, September 13, 2001.

Figure 2
Time Series of CME Stock Price and Eastern Europe and Czech Republic Indices



1 2/24/1999 Zelezny states at a CNTS board meeting that CNTS cannot continue as exclusive programming provider to TV Nova because the Media council opposes it.
2 3/29/1999 SBS and CME reach merger agreement.
3 4/19/1999 Zelezny fired as director of CNTS.
4 8/5/1999 CET 21 terminates relationship with CNTS and withdraws broadcasting license.
5 2/13/2001 Amsterdam tribunal reaches minor ruling against Zelezny.

6 9/3/2001 London tribunal rules in favor of Czech Republic.

7 9/13/2001 Stockholm tribunal rules in favor of CME.
8 3/14/2003 Stockholm tribunal makes final ruling of $350 million in favor of CME.
9 5/15/2003 Stockholm tribunal ruling upheld on appeal.

Figure 3. Annotated CME stock price chart (adjusted for stock splits), with MSCI Eastern Europe and Czech Market US dollar indexed data for the period January 1, 1999 to June 1, 2003. Source: Bloomberg. Index value at July 1st , 1999 equals 100.

Figure 3

Advertising by CME on Investing in the Czech Republic

THINK TWICE BEFORE YOU INVEST IN THE CZECH REPUBLIC

This may seem like a time of exciting opportunities for investment in the Czech Republic. For example, the Czech government is in the process of selling its interests in certain banks and, in the near future, intends to privatize its interest in a national cellular phone company.

However, if our recent experience as principal investor in the Czech Republic's most successful broadcasting company is any indication, Czech business, regulatory and legal practices fall woefully short of international standards. Before making a significant investment in the Czech Republic, you may want to consider this cautionary tale:

CZECH GOVERNMENT WOOS FOREIGN INVESTORS...

When Central European Media (CME) wanted to establish a Western-style television station in the Czech Republic, the government welcomed CME's influx of capital and business expertise with open arms. Working with a local partner, CME developed TV Nova—which quickly emerged as the most popular private television station in Eastern Europe.

But then CME's local partner, Vladimir Zelezny, exploited his political influence and his network of contacts to undermine the partnership. With the assistance of the government-controlled Czech Media Council, the regulatory body that grants television licenses and oversees broadcast operations, Zelezny cut out his foreign investors so that he could profit more fully from TV Nova's unparalleled success.

Under Zelezny's influence, the Czech Media Council has refused to protect CME's legal rights. According to a recent editorial in the European Wall Street Journal, the council "seems willing to let CME twist in the wind."

...BUT THEN ABUSES THEM

Under a 1991 U.S.-Czech treaty, the Czech government promised to protect U.S. investments from violations of the law. But it has been unwilling to handle this hot potato because—due to TV Nova's success—CME's local partner has acquired too much political clout.

Ronald S. Lauder, the controlling shareholder of CME and a U.S. citizen entitled to treaty protection, has instituted arbitration proceedings, through the UN Commission on International Trade Law, to ensure that the Czech government is held accountable for its discrimination against foreign investors and for failing to protect CME's rights.

The U.S. Ambassador to Prague has said that a just and speedy solution to this dispute would send a strong signal to foreign investors that the Czech Republic has an environment conducive to foreign investment. And leading U.S. Congressmen have rightly called for hearings into the Czech government's conduct. But, so far, ***the Czech government has failed to act.***

Until this matter is resolved, we urge the international financial community to think twice before investing in the Czech Republic. Otherwise, you too could be left to "twist in the wind."

On behalf of its shareholders,

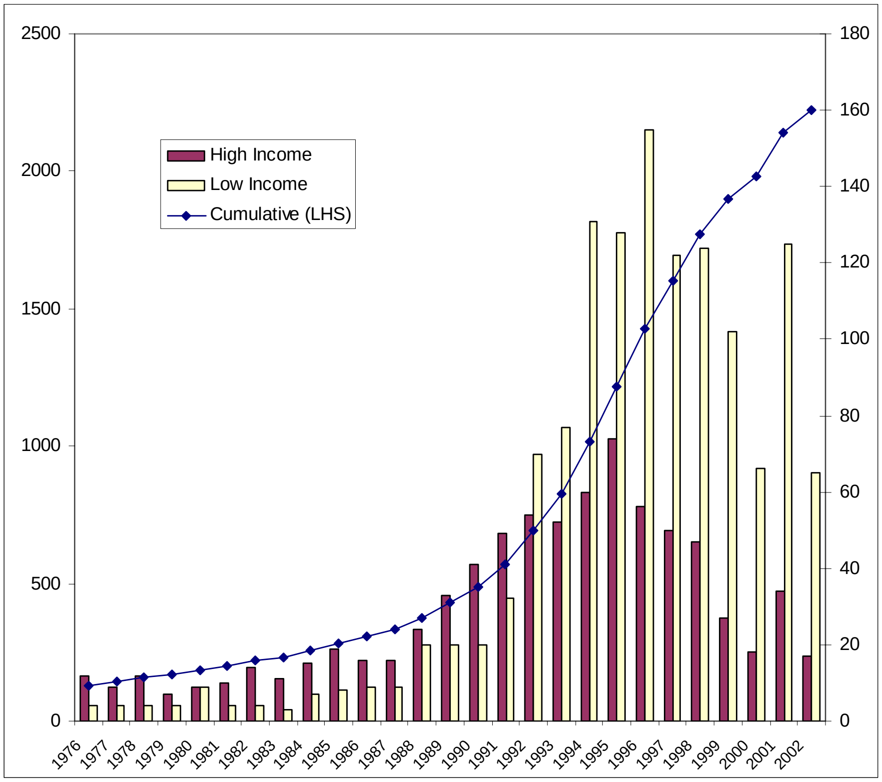
CME **Central European Media Enterprises Ltd.**

c/o RSL Investments Corporation, 767 Fifth Avenue, New York, NY 10153

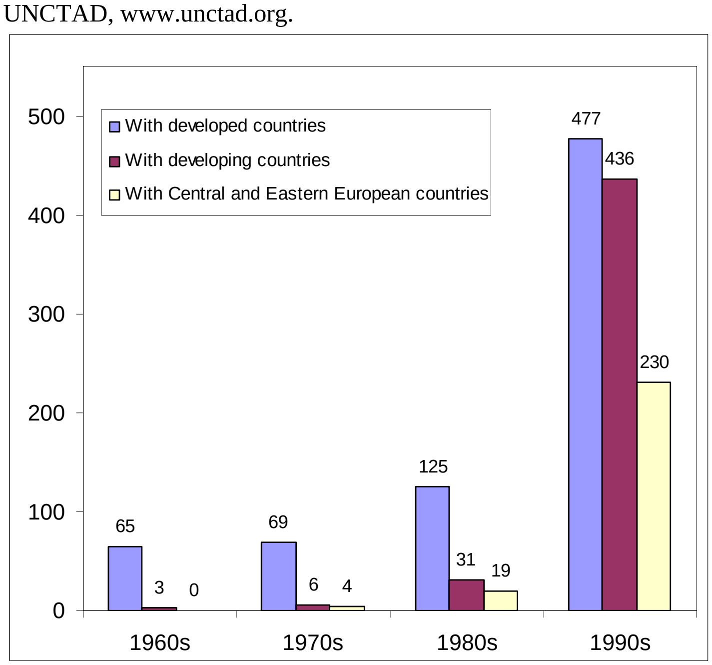
Figure 4. Paid Announcement by CME in *The New York Times* November 8, 1999. Source:*New York Times*, Nov. 8, 1999 available from ProQuest Historical Newspapers at http://80-proquest.umi.com.

Figure 4

Time Series on the Diffusion of BITs



Panel A. Time series showing the yearly and cumulative total (left hand side) of Bilateral Investment Treaties (BITs) signed from 1976 to 2002. The number of BITs is broken down according to whether the signatory country is a "high income" or "low income" economy following Rose-Ackerman and Tobin (2003) and the World Bank, with "high income" defined as having a 2000 GNI per capita of 9,266 USD or higher. Data from UNCTAD, www.unctad.org.



Panel B. Number of BITs signed between developing economies and developed, developing, and Central and Eastern European economies per decade. The data for this figure was taken from figure 2 in UNCTAD (2000).