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# *Bernardo Cremades*

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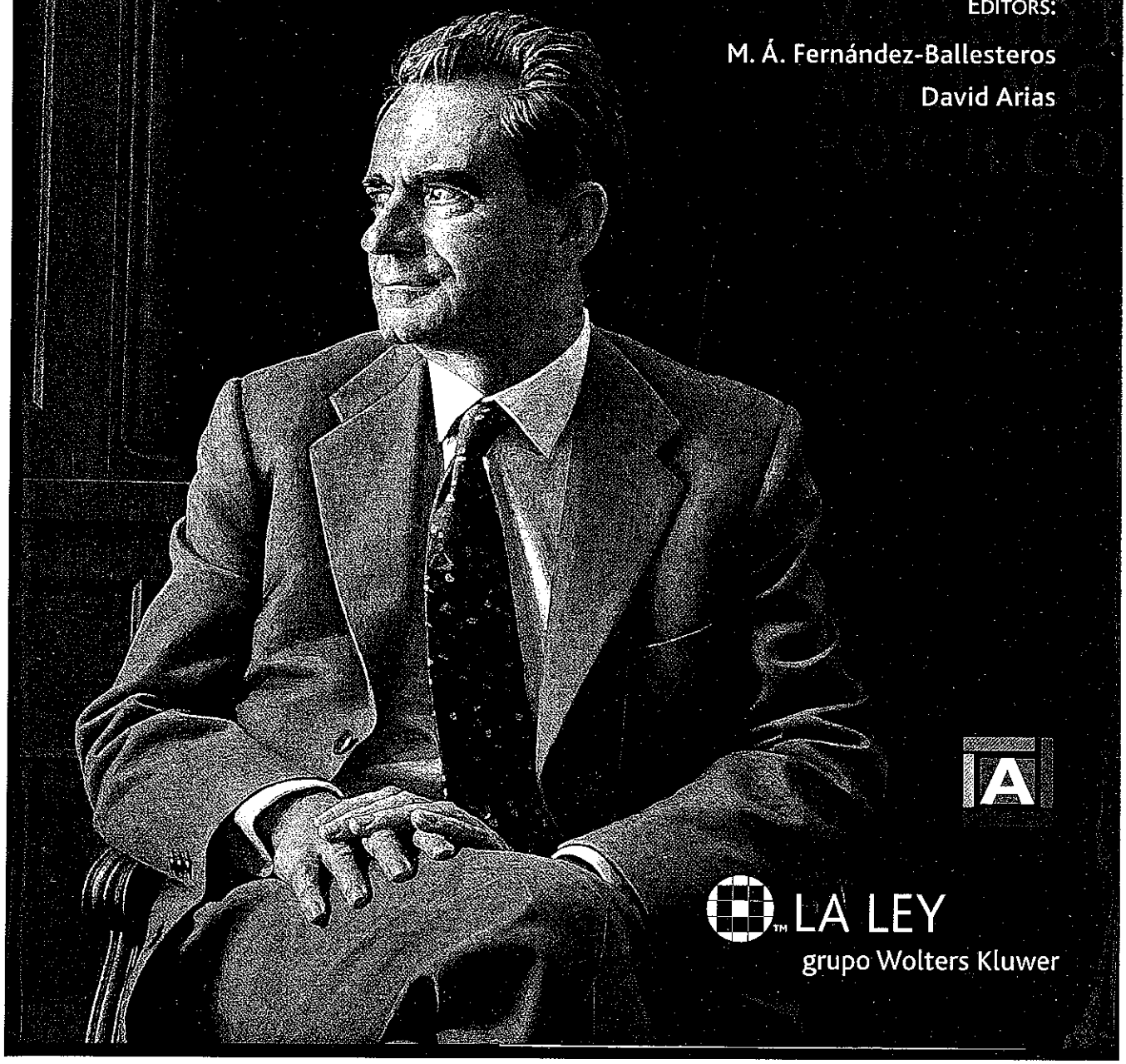

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# BERNARDO CREMADE'S CONTRIBUTION TO THE DEVELOPMENT OF ARBITRATION LAW IN LATIN AMERICA

Gonzalo BIGGS[685]

Bernardo CREMADES has been a leader in the development of arbitration law in Latin America; in his multiple presentations and writings he has relentlessly outlined the directions to be followed and problems that must be addressed. His knowledge of our culture and legal roots —which come from Spain— give him an unmatched influence in our region and, on behalf of our region, before the international arbitration community.

Due to the impossibility of accessing the totality of Professor CREMADES academic and professional contributions, these lines are limited to his interventions as speaker in three separate forums, two of his writings and decisions as member of five international arbitration tribunals. A final comment is made at the end of this writing.

## I. FORUM INTERVENTIONS

These interventions were in:

i) Seminar in Madrid, 1982, organized by the Inter-American Development Bank (IADB) and the Spanish Consejo Superior de Cámaras de Comercio, Industria y Navegación.

ii) Seminar in Guatemala, November 1987, organized by the IADB and the Central American Institute of Arbitration Law; and

(685) Partner of the law firm of «Figueroa & Valenzuela» in Santiago, Chile and member of the Board of Directors of the American Arbitration Association

iii) Seminar in Santiago 1998[686] organized by the American Arbitration Association (AAA) and the American Chamber of Commerce of Chile (AMCHAM).

**COMMENT**

The content of these interventions, which go from 1982 though 1989, emphasize the different challenges arbitration was facing in each of these periods. Thus, in 1982, in Madrid, he referred to the problems then faced in Spain (many of which had been replicated in the Latin American countries) and which were overcome by the Arbitration Law of 1988[687] In 1987, in Guatemala, he highlighted the basic requirements of an effective arbitration and the importance of institutional arbitration. Finally, in 1998, in Santiago, he addressed the challenges posed by the globalization process and the status of international arbitration in Hispanic countries

## 1. Madrid 1982

This intervention highlighted the positive influence international arbitration treaties ratified by Spain had had on the country's arbitration law of 1953. He noted that, pursuant to the country's Civil Code and Constitution, those treaties were fully effective domestically and, therefore, subject matters governed by them prevailed over matters governed by the 1953 law. Two applications of the latter were criticized. First, the prohibition of institutional arbitration: and, second, the prior approval of the judiciary as a pre-condition to the effectiveness of an arbitration agreement (the latter requirement was inherited and applied, until very recently, in many Latin American countries, including Brazil). However, Spanish jurisprudence had recognized that international commercial arbitration and domestic arbitration operated through separate channels. As a result, the initial rejections of extraterritorial jurisdictions, and their supposed impingement on national sovereignty, had been overcome. This development and the increase of international trade and commercial transactions had also transformed the practices of state and public agencies. Having abandoned their original sovereign immunity exceptions, they were now active participants in domestic and international commercial arbitrations. (This development, however, has not been the same in Latin America where, in many countries, disputes affecting state agencies are still under the exclusive jurisdiction of the local courts).

International treaties were also responsible for the effective enforcement of foreign arbitral awards which did not apply to foreign judicial decisions which lack that endorsement. He also noted that, in practice, the great majority of foreign arbitral awards are complied voluntarily. This is supported by the statistics of the International Chamber of Commerce which indicate that 90% of its awards were accepted by the parties and only 10% require enforcement procedures. Regarding the latter, he mentioned the solidarity which exists among international arbitrators and of institutions which have veritable black lists of unreliable associates.

(686) The American Arbitration Association published a book in English and Spanish of this Seminar titled «Papers of the International Commercial Arbitration Conference Amcham Chile, July 29-30, 1998». Hereafter «AAA-Amcham».

(687) The book «Arbitration in Spain» edited by Professor Cremades was published in 1991.

The presentation continued with an analysis of the requirements, under Spanish law and the New York 1958 Convention on the Recognition and Enforcement of Arbitral Awards, of exequaturs for the enforcement of foreign arbitral awards. The latter was illustrated with the description of two 1981 Spanish Supreme Court decisions which have significantly reduced the «public order» concept in order to prevent that the restrictions of the 1953 law may alter the execution of an exequatur.

## 2. Guatemala 1987

In this occasion, Professor CREMADES warned against the tendency to treat arbitration as a virtual panacea that can effectively resolve every commercial dispute. He clarified that arbitration was no more and no less than a technique for settling commercial disputes and there was no point in developing philosophies or, in some cases, even poetry around it.

He then described the basic components of the arbitral process and their significance to the effective solution of a dispute.

The arbitral agreement was the «magna carta» of the entire process. It is the basic instrument which determines the jurisdiction of arbitrators and must be deprived of rigid formalities. The Hispanic differentiation between the arbitral clause and compromise or «compromiso» would have no room in modern commercial arbitration.

For the parties, their main options when adopting an arbitration clause were:

a) ¿What procedure will be applied for the resolution of the conflict?

¿Will it be submitted to the decision of a qualified individual or of an established arbitration institution?

On account of the uncertainties surrounding the life of an individual, including conflicts of interests, he considered institutional arbitration to be the preferred option in commercial disputes.

b) On account of the different procedural rules and formalities which prevail among countries, the selection of the site of the arbitration was crucial to its outcome.

c) The choice of the language of the arbitration also had important consequences and reveal cultural differences or prejudices. Reference was made to the presumptions which sometimes exist in commercial matters that operate against parties of Hispanic origin.

d) The choice of the applicable law must be carefully analyzed. He gave the of the different rules which govern commercial liability warranties and where what is valid in Spain may be against the public order in France.

e) The choice of the arbitrators and President of collective tribunals was also instrumental to the outcome of the case. Professional independence and moral integrity being the major factors to be considered.

The absence of formalisms would be the key to the development of the process and allegations of the parties. Under certain procedures, like those of the International Chamber of Commerce, after the pleadings have been submitted there is an instance where the parties meet and sign a document which outlines their pretentions and outstanding issues.

This experience demonstrates that these documents can help the parties and lead to the satisfactory settlement of a dispute.

Regarding the rules of evidence, its legalization and use of endless dilatory tactics typical of the judicial process is a negative development and creates negative inferences against the parties that use them. Instead, what should prevail are not formal rules of evidence but the search and submission of the real truth.

Final awards are not supposed to establish doctrines but must be limited to the practical purpose of settling a specific dispute. Lengthy documents with endless number of pages would definitively be out of order.

Arbitral institutions have a major responsibility in guiding the development of the process. In this regard, greater consideration should be given to the interests of developing countries in terms of appointments and general participation. The possibility of establishing international arbitration centers in these countries was mentioned.

Finally, the tuition of the judiciary over arbitration was highlighted. Because arbitrators cannot adopt coercive measures they must rely on the power of the judiciary to enforce certain decisions. This support is essential for the adoption of preventive measures and enforcement of arbitral decisions.

## 3. Santiago 1998

This presentation addressed: i) the fundamental changes undergone as a consequence of the globalization process; ii) the abuse of dilatory tactics; iii) the duty of due diligence; and iv) the status of international arbitration in Hispanic countries.

### *3.1. The globalization process*

Among the fundamental changes brought forth to business activities and disputes arising from contractual relationships, are the development of information technology, the easy access to data banks, and loss of confidentiality in the decision-making process caused by mass-media reports. Now business men and law firms accept arbitration as a standard instrument for resolving disputes, and the Latin American countries which, in the past, rejected arbitration on grounds of sovereignty, are now active participants.

International arbitration institutions which in the past were identified with a very selective part of the legal community now appoint in key positions representatives of other cultures, and codes of ethics have adjusted their principles accordingly.

### *3.2. Dilatory Tactics*

The expansion of arbitration has brought forth the participation of attorneys which apply to arbitration the same practices they apply in judicial proceedings. Among them is the use and abuse of dilatory tactics which he described as the bane of arbitration.

The relationships of judges and arbitrators have changed. In many countries, the judiciary perceived arbitration as unfair competition. Indeed, there have been examples of gross

obstruction to its development. But judges now recognize their responsibilities in interpreting the parties' intentions and preventing the abuses of dilatory tactics.

Specifically, judges have a critical role in: i) determining the start of arbitral proceedings in the face of a defective arbitration clause: ii) granting precautionary or provisional measures that ensure the submission of evidence; and iii) ensuring the ultimate implementation of the arbitration award.

### *3.3. The Duty of Due Diligence*

Ultimately, the outcome of arbitration is determined by the professionalism of the arbitrators and «those who accept appointment as arbitrators agree to be neutral, to be available and to diligently perform their duties»[688]. Their fundamental rule of behavior is the equal treatment of the parties and utmost observance of their right to defend their positions.

Some major challenges which confront arbitrators arise when, for example, a party files criminal proceedings with the purpose of paralyzing arbitration. Even more common is the challenge before the courts of the arbitrator's jurisdiction with the same purpose or of lengthening the arbitration. In such cases, there are no magical formulas but «arbitrators must use their discretion to know when to suspend their activities, even if this incurs liability for failure to meet the deadlines established by the parties to issue the arbitration award»[689]

### *3.4. International Arbitration in Hispanic Countries*

The widespread ratification of international conventions and participation of Latin American companies and their legal advisers in international arbitrations leads to the conclusion arbitration is currently in good health in this region.

However, various issues still remain. Among them, is the excessive formality of arbitral proceedings to the point they become «nothing other than pseudo-judicial proceedings»[690] There is also a reluctance to use local arbitration institutions because of the danger appropriate independent professionals will not be appointed, «but rather a friend of the person that controls this arbitration institution»[691]. Regarding judges, in many countries they lack adequate international training and apply the concept of public policy abusively.

Finally, the negative effect of the exception based on the incompetence of the tribunal due to the existence of a previous arbitration, is also a cause of concern: affected parties have been forced to respond to the merits of the complaint —which is contrary to the New York Convention— to avoid being «estopped» in the event the judge does not grant that exception.

(688) AAA-Amcham, *ibid.*, page 153
(689) Amcham, *ibid.*, page 154
(690) AAA-Amcham, *ibid.*, page 156
(691) AAA-Amcham, *ibid.*, page 156.

## II. WRITINGS

I shall comment the following articles:

**i)** «Disputes arising out of Foreign Direct Investment in Latin America: A New Look at the Calvo Doctrine and other Jurisdictional Issues»(692)

The above is followed by this writer's personal comments on the Calvo Doctrine; and

**ii)** «Contract and Treaty Claims and Choice of Forums in Foreign Investment Disputes»(693)

### 1. Investment disputes in latin america and the Calvo doctrine (694)

This presentation referred to the ratification by the great majority of the Latin American countries of the 1965 Washington Convention which established ICSID and the apparent reawakening of the Calvo Doctrine. Examples of the latter would be the ICSID Maffezini and CMS cases mentioned below.

At the time of this article, 2004, at least 16 Latin American countries —but not Brazil or Mexico— were members of the International Centre for the Settlement of Investor Disputes —ICSID— adopted by the 1965 Washington Convention, and/or were parties to bilateral investment treaties —BITS— which provide for arbitration of investor-state disputes by ICSID.

Thus, according to the writer, the region as a whole had overcome its traditional hostility towards arbitration. Yet, despite all appearances, there could be a reawakening of the Calvo Doctrine with the potential of having national courts address those disputes which affect their national interest.

Very succinctly, the Calvo Doctrine is described as «providing that foreigners could seek redress from grievances only before local courts» and «gave rise to the Calvo Clause, which precluded arbitration and instead required disputes to be resolved in national courts»(695)

Its influence would be reflected by the inclusion in the earlier BITS of preconditions to the arbitration of investor-State disputes, such as requiring investors to exhaust local remedies in the host State before resorting to arbitration. This development is illustrated by the Maffezini and CMS cases referred below.

(692) Article by Bernardo Cremades published by Dispute Resolution Journal, May July 2004. Hereinafter «DRJ»

(693) Article by Bernardo Cremades and David. J.A.Cairns (hereinafter Cremades & Cairns) in *Arbitrating Foreign Investment Disputes: Procedural and Substantive Legal Aspects»* (Norbert Horn Editor, 19 Studies in Transnational Economic Law»). Kluwer Law International, 2004. Hereinafter «Kluwer»

(694) As the treatment of the Calvo Doctrine in Latin America is subject to a continual flux it must be highlighted that the above comments refer to the situation as it existed in 2004.

(695) DRJ, *ibid.*, page 80

In Maffezini[696] the investor brought an action against Spain pursuant to an Argentina-Spain BIT. Spain argued that, under the BIT, the investor could only have access to arbitration if the local courts did not resolve the dispute within 18 months. The investor claimed that the most-favored-nation clause in the BIT prevailed over the exhaustion-of-remedies clause and entitled him to arbitrate because Chilean investors had that option under a BIT of their country with Spain. The tribunal agreed and rejected Spain's argument that the most-favored-nation-clause only applied to substantive issues. Instead, it ruled it applied to both substantive and procedural issues.

In CMS[697], the investor had a 19.4% stake in a privatized gas transportation company (TGN) and sought to recover under a US-Argentina BIT for its devaluation losses brought by the country's financial crisis. Argentina, however, argued the ICSID tribunal lacked jurisdiction because, under TGN's license agreement, disputes could only be settled by the Federal Court of the City of Buenos Aires. The ICSID tribunal found otherwise and ruled it had jurisdiction over the dispute and that CMS was not bound by a licensing agreement to which it was not a party, and added, that even if CMS had been a party «referring certain kinds of disputes to the local courts is not a bar to the assertion of jurisdiction by an ICSID tribunal under the BIT, as the functions of these various instruments is different.» [698]

## 2. Comments on the Calvo doctrine

Without disputing Professor CREMADES above references to the Calvo Doctrine, this writer believes it is relevant to mention its origins and evolution.

On this subject-matter, there would be three distinct periods.

The first started in the early XIX century with the independence of the Latin American countries and ended with the 1904 award of the Permanent Court of Arbitration.

The second would run from 1904 until the Panama Convention of 1975, and the last would run from 1975 until our days.

The tumultuous events of the first period are those which more appropriately explain the Calvo Doctrine.

As from the XVIII century, the European countries applied the doctrine of diplomatic protection to countries they regarded as «non-civilized». This doctrine was developed by the Swiss jurist Vattel and invoked to justify the intervention of one State in the affairs of another with the argument that an injury to one of its citizens was an affront to that State[699] The Calvo Doctrine, by contrast, invoked the exclusive jurisdiction of States to try and judge the conduct of foreigners within their borders. This Doctrine reflected the personal experiences of its author, referred below, and a series of events which transpired during the XIX century.

(696) Maffezzini vs. The Kingdom of Spain. ICSID Case N.° ARB/97/7
(697) MS Gas Transmission Co vs. Argentina, ICSID case N.° ARB/01/2008
(698) DRJ, *ibid.*, page 82
(699) Emerich de Vattel, 2 Law of Nations 229(Charles G. Fenwick trans. 1916), at parag.347

In 1859, Calvo, then a young Argentine jurist, was assigned by the government of Paraguay the diplomatic task of obtaining a formal apology from Great Britain for the attack by two British gun-boats of the Tacuarí, a boat which transported General Solano Lopez. The attack was made in retaliation for the imprisonment by Paraguay of a British citizen.(700)

Calvo arrived in Europe in 1860 and, after protracted negotiations, succeeded in obtaining the recognition in a public convention, that Great Britain «sincerely deplored that the hostile actions taken by its naval forces ...should have offended the dignity of Paraguay»(701)

The Tacuari episode, however, marked a common pattern of this period of which the following examples can be cited: i) the 1838-39 «pastry war» between France and Mexico which resulted in the shelling of the port of Veracruz in retaliation for non-payment of monies owed to French citizens (among them a baker)(702); ii) the invasion of Mexico by its creditor countries for non-payment of its public debt and which resulted in the French-Mexican War of 1861-67(703); and iii) the bombing of Valparaiso, on March 31, 1866, in retaliation for Chile's solidarity with Peru after Spain occupied the Chincha Islands for the non-payment of Peruvian debts dating from colonial times(704)

Around the above period, in 1863, Calvo published in Paris — where he remained for the rest of his life— his International Law Treaty which was re-edited and updated several times and whose last version, in six volumes, dates from 1896. A direct consequence of his writings was that his Doctrine became a generally accepted principle in Latin America and incorporated to the constitutions or laws of most of the countries.

In the opinion of this writer, irrespective of the fact residues of the same reappear from time to time, the Calvo Doctine can only be judged in accordance with the realities of the XIX century.

What can be termed a second period starts with the 1904 arbitral award of an international panel established by the Permanent Court of Arbitration. This award justified the military occupation of the ports of Venezuela to collect the loans of different European countries, and recognized preferential rights to those States that exercised force, over those that did not(705). It was, thus, a direct challenge to the doctrine proclaimed in 1903 by the Argentine jurist, Luis María Drago, which rejected the use of force for the collection of public debts.(706)

(700) Carlos Calvo. *Una Página del derecho Internacional,* Librería Durand. Paris.1864
(701) Convention between Great Britain and Paraguay of 14 October 1862. British and Foreign State Papers 1863-1864. Volume LIV, page 965. London. Picadilly. 1869.
(702) Christopher Minster, «The Pastry War»
(703) Daniel Cossio Villegas, «Historia Moderna de Mexico», Editorial Hermes. 1963.
(704) Francisco Antonio Encina. *Historia de Chile. Editorial Nascimento,* and Jorge Basadre, *Historia de la República del Perú.*
(705) Award of February 22, 1904, 9 Rep. International Arbitration Awards 99(1960)
(706) Luis María Drago: *La Argentina y el Caso de Venezuela.* Buenos Aires. 1903

It has been generally recognized that the hostility towards international arbitration which plagued Latin America for most of the XX century was a direct consequence of the above award.

At the same time, the Drago doctrine was a sequence of the Calvo Doctrine and both were precursors of the now well established principles of the juridical equality of states and of non-intervention.

The cumulative effect of the events which justified the Calvo and Drago doctrines and the inclusion of the Calvo principles in the region's legislation, explains their collective rejection, in 1964, of the ICSID Washington Convention, through the famous «NO of Tokyo»[707]

In my view, the third period starts with the region's adoption of the Inter-American Convention on International Commercial Arbitration or Panama Convention of 1975. Its significance stems from the fact it was the first international arbitration treaty collectively accepted by the Latin American countries at a time most of them were not members of ICSID.

From 1975 onwards, globalization and macroeconomic reforms stimulated a gradual and positive change towards the acceptance of international jurisdictions. This process led to the gradual incorporation of the great majority of the countries to ICSID, their adoption of BITS and Free Trade Agreements (which included their consent to international arbitration) and their active participation in international commercial arbitrations.

## 3. Contract and treaty claims and choice of forums

This article has had and should continue to have a profound influence in international investor-State disputes. Indeed, its analysis provides the blueprint for handling the complex relationships between contract and treaty claims which, as the jurisprudence demonstrates, has not always been addressed appropriately.

This article is divided in the following three parts: Treaty and Contract Claims, The Content of the Treaty Rights, and the Choice of Forum

### *3.1. Treaty and Contract Claims*

A scholarly analysis is made of a complex subject that has arisen in ICSID (or its Additional Facility) cases. Among them, Waste Management [708] and Lanco[709], on whose tribunals Bernardo CREMADES was a member, and Vivendi[710]

(707) World Bank Press release, Washington, D.C. September 9, 1964
(708) Waste Management vs.United Mexican States ARB (AF) /97/1)
(709) Lanco International vs. Argentina, Case N.°ARB/97/6
(710) Compañía de Aguas del Aconquija S.A and Vivendi Universal vs. Argentina . Case N.° ARB/97/3. Hereinafter «Vivendi»

Bilateral Investment Treaties (BITS) are treaties between two states establishing a legal framework for the treatment of investment flows between them. The rights they create to investors of both States are treaty rights which can give rise to treaty claims.

Foreign investments usually involve contracts between the investor and State entities which may take the form of concession contracts. The rights created by these contracts are contract rights and can give rise to contract claims.

In an investment dispute, the foreign investor must determine whether to enforce treaty rights (when there is a BIT) or contract rights, when there is a concession. If treaty rights are enforced, he will have to select which right best supports his demand for relief and, thereafter, the most appropriate forum.

The article lists the following five criteria for distinguishing treaty and contract rights:

**i) Basis.** When the basis or causes of action are established in a treaty, they are treaty rights; when established in a contract, they are contract rights;

**ii) Content.** Treaty rights are generic and defined by international law; contract rights, by contrast, are specific to the investment and defined by the domestic law of the host State. They can, however, overlap as when the investment is expropriated in which case both a treaty and contract claim may be available;

**iii) Parties.** The parties to a treaty claim are always an investor of the home State and of the host State; in a contract claim, the parties are the parties to the contract. The State is the State itself or any of its entities or agencies pursuant to the rules on State Responsibility of the International Law Commission. In a contract claim the parties are the parties to the contract which in concession contracts can be a State party.

**iv) Applicable Law.** In a BIT, the applicable law will be the BIT itself, the general principles of international law, and the domestic law of the host state. In a contract claim the applicable law will be the domestic law of the host State.

**v) Liability.** A treaty claim can result in State responsibility under international law; a contract claim can result in responsibility according to the host State's law of administrative responsibility.

On the question of whether treaty and contract claims may be pursued simultaneously, the following description made in Vivendi was highlighted:

> «whether there has been a breach of the BIT and whether there has been a breach of the contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law in the case of the BIT by international law; in the case of the Concession Contract, by the proper law of the contract»(711)

As in practice treaty and contract claims can be intertwined, the authors add «it will usually be more prudent for an investor to confine its legal action to a single forum»(712). However, the Vivendi case would demonstrate that treaty and contract claims can overlap

(711) Vivendi Ad-hoc Committee. Decision on annulment of July 3, 2002
(712) Cremades & Cairns, *ibid.*, page 7

and create risks in terms of the content of the rights, the parties to the claims, the applicable law, and the liability of the host state, and create duplication of proceedings and confusion between treaty and contract claims.

To prevent such duplication, some BITS provide that the claimant must elect between either pursuing a claim in domestic courts or international arbitration (the «fork in the road clause»), or, alternatively, must waive claims in any other forum as a pre condition to international arbitration. These two options are illustrated with interpretations of the France-Argentina BIT and the decision in the Waste Management case, which led the authors to conclude that «the prudent course for the investor is not to jeopardize its treaty claim by pursuing any proceedings in another forum, except where those proceedings are required by the BIT itself»[713]

Confusion between treaty and contract claims is illustrated by the Vivendi case where French investors were granted under a BIT with Argentina the right to initiate an ICSID claim, and, under a concession contract, the right to submit a claim before the courts of Tucumán.

The arbitral tribunal resolved that decisions arising from the concession contract were within the exclusive jurisdiction of the courts of Tucuman. According to the authors, the tribunal, by referring concession contract issues to the courts of Tucuman, and not resolving those related to the interpretation of the concession contract — which amounted to a breach of the BIT— confused treaty and contract claims, and failed to decide the treaty claims. The authors, accordingly, endorsed the ad-hoc Committee's annulment of the arbitration award.

### *3.2. The Content of Treaty Rights*

A treaty claim must demonstrate there is an investment within the meaning of a BIT and must identify the treaty rights supporting that claim.

#### 3.2.1. The concept of investments

The definition of investments is of fundamental importance to the jurisdiction ratione materiae of an arbitral tribunal under a BIT and an element for defining jurisdiction under ICSID. Yet, the ICSID Convention does not give a definition and there is an abundance of broad open-ended definitions of investments in most BITS.

The above notwithstanding, a consensus[714] has emerged of the main features of investments for investor-State arbitrations which would include the following:

i) An investment has a certain duration;

ii) An investment involves a certain regularity of profits and return;

(713) Cremades & Cairns, *ibid.*, page 9

(714) Reference is made to the award on jurisdiction of July 23, 2001, in Salini Construttori and Italstrade vs. Kingdom of Morocco, ICSIDS Case N.° ARB/004.

iii) An investment typically involves an element of risk for both sides;

iv) An investment normally involves a substantial commitment or contribution; and

v) An investment should be significant for the host State's development.

### 3.2.2. The content of treaty rights

Investor-State arbitration differs from traditional international commercial arbitration in that they arise from treaties between States rather than from private agreements. This means public international law has a prominent role in such arbitrations. Normally, treaties do not create direct rights and obligations for private individuals. However, State parties to certain treaties are increasingly recognizing the rights of private parties against States, and their procedural capacity to enforce those rights by means of treaty claims.

The content and definition of those treaty rights depend on the terms of the particular BIT that creates them. There is, however, a core of generic treaty rights that in practice have formed the basis of treaty claims by investors against host States; they include:

i) the right to national treatment;

ii) the right to the most favored nation treatment;

iii) the right to non-discriminatory treatment;

iv) the right to fair and equitable treatment; and

v) the right to compensation for expropriation.

### 3.2.3. Choice of Forum

BIT dispute resolution clauses include the following steps prior to the constitution of an arbitral tribunal:

i) A period of consultation;

ii) A waiting period;

iii) An election of forum; and

iv) An election of arbitral institution rules.

Of the above four steps, we shall refer to the election of forum.

The choice of forum may include the domestic courts of the State party, international commercial arbitration or any applicable previously agreed dispute settlement procedures.

Some BITS give preference to dispute resolution by domestic courts by deferring or placing conditions on the election of international arbitration. An example is the provision of the Spain-Argentina BIT applied in the Maffezini case referred earlier which subordinated access to arbitration to the prior submission of the dispute to domestic courts and the lapse of an eighteen month period. However, the exhaustion of domestic remedies prior to arbitration was not a requirement under that BIT.

An essential requirement for investor-State arbitration is the consent of the State party. This obvious requirement is confirmed by article 25 of the Washington Convention, which requires the parties' «consent in writing» for the submission of a dispute to ICSID arbitration, and by the 1958 New York Convention on the Recognition and Enforcement or Arbitral Awards.

The juridical nature of the consent to arbitration was examined in the Preliminary Decision on Jurisdiction in Lanco International vs. Argentina which involved a claim of a US investor under the Argentina-US BIT. A description of this case is made ahead.

This Decision recognized and gave effect to the distinction between treaty and contract rights.

This arbitration agreement provided for a choice of forum by the investor, between the domestic courts of Argentina, arbitration, or any applicable, previously agreed dispute settlement procedures. The investor chose arbitration. However, there was also a concession agreement between the parties which provided for resolution of disputes before the courts of Buenos Aires. The claimant relied in the provision of the BIT which stated:

> «Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice of the investor»

Argentina argued there was no consent in writing to arbitration for purposes of article 25 of the Washington Convention because the parties had subsequently agreed to resolve the disputes before the courts of Buenos Aires. The arbitral tribunal disagreed and stated that the consent to arbitrate in the BIT constituted an open offer to investors which the investor accepted when it indicated in writing its selection of arbitration as the form to resolve disputes. This consent was not withdrawn by the subsequent execution of the Concession Contract between the State and the investor and its dispute resolution clause.

## III. ARBITRAL AWARDS

The following ICSID cases were resolved by arbitral tribunals on each of which Bernardo CREMADES was a member. They are:

1) Lanco International («Lanco») vs. Argentina [715],

2) Waste Management («Waste Management») vs United Mexican States [716]

3) Autopista Concesionada de Venezuela («Autopista») vs. Venezuela[717]

4) Empresas Lucchetti S.A. and Lucchetti Peru, S.A. («Lucchetti») vs. Republic of Peru[718], and

(715) Lanco International vs. Argentina, Case N.°ARB/97/6

(716) Waste Management Inc vs.United Mexican States. Case ARB(AF)/98/2. .Arbitral award of June 2,2000. 40 ILM 55 (2001)

(717) ICSID Case N.° ARB/005, hereinafter «Autopista»

(718) Empresas Lucchetti S.A. and Lucchetti Peru, S.A. vs. Republic of Peru. ICSID Case N.°ARB/03/4. Hereinafter «Lucchetti»

5) Fraport A.G.Frankfort Airport Services Worldwide («Fraport») vs. Republic of the Philippines[719]

## 1. Lanco international

In this case an exhaustive analysis was made of the rules which govern the consent of the parties to the jurisdiction of an ICSID tribunal.

The facts were the following: the US company, Lanco International, filed on October 1st 1997, a request for arbitration before ICSID seeking compensation for damages due to the alleged breach by Argentina of its BIT with the United States.

An ICSID Arbitral Tribunal was constituted on March, 1998, with Guillermo Aguilar Alvarez, appointed by Lanco, Luiz Olavo Baptista, appointed by the Argentine Republic and Bernardo Cremades, appointed by the Secretary General of ICSID and who acted as President.

A preliminary issue was the resolution of the objections to jurisdiction raised by Argentina which alleged that, under Article 12 of the Concession Agreement («the Agreement») between the parties, the only competent tribunals were those of the city of Buenos Aires

Article 12 of the Agreement stated as follows:

> «For all purposes derived from the agreement and the BID CONDITIONS, the parties agree to the jurisdiction of the Federal Contentious-Administrative Tribunals of the Federal Capital the ARGENTINE REPUBLIC»

The Tribunal agreed that, for BIT purposes, the Agreement was an investment agreement and that, under its article VII(1), an investment dispute had been submitted before it.

Regarding the requirements for recourse to ICSID arbitration established in Article VII of the BIT, it noted that the following three options were available: i) the local courts as per the law of the State where the investment was made; ii) previously agreed dispute settlement procedures; and iii) international binding arbitration.

The first option was discarded because it was always available, without the need of a treaty, and the investor had not chosen it.

For determining the availability of the second option, an interpretation of Article 12 of the Agreement and Article VII of the BIT was required.

In its analysis, the Tribunal concluded that, under above Article 12, the jurisdiction of the tribunals of the City of Buenos Aires could not be considered a previously agreed dispute settlement procedure, and that Article VII(2) of the BIT should be understood to refer to the agreements in existence at the time the dispute arose.

Moreover, as the investor had not submitted the dispute to a previously agreed dispute settlement mechanism, the second option had to be also discarded.

(719) Icsid Case No. ARB/03/25. Hereinafter «Fraport Award»

Regarding the third option, the Tribunal relied in BIT Article VII(3)(a) which states:

> «Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2(a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration:
>
> (i) to the International Centre for the Settlement of Investment Disputes ("Centre") established by the Convention on the Settlement o Investment Disputes between States and Nationals of other States, done at Washington, March 18, 1965 ("ICSID Convention"), provided that the Party is a party to such Convention».

In connection with the above provision, the Tribunal noted that the investor had not submitted the dispute to the courts of Buenos Aires nor to any other previously agreed dispute-settlement system. At the same time, six months had elapsed since the investor submitted its request for arbitration and his attorney transmitted the written consent to arbitration required by article VII(3)(a) of the BIT.

The above was reinforced by the following BIT provisions:

> «Once the national or company concerned has so consented, either party to the dispute may initiate arbitration in accordance with the choice so specified in the consent» (Article VII(3)(b)
>
> «Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company under paragraph 3» (Article VII(3)(c)

Based on the above facts and BIT provisions, the Tribunal stated that «once the investor has expressed its consent in choosing ICSID arbitration, the only means of dispute settlement available is ICSID arbitration»[720]

Argentina, however, considered that the general offer made in the BIT did not constitute the written consent required by ICSID article 25(1) which states:

> «The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by the State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally».

In addition, Argentina stated it was unquestionable that the investor can only exercise the right to choose «unless otherwise stated in the terms of Article 26 of the ICSID Convention»

> «Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.» (ICSID article 26)

(720) LANCO, *ibid.*, paragraph 31.

The Tribunal did not agree with Argentina's above interpretation of the second sentence of the above provision because, if a stipulation contrary to arbitration were to exist, it would not replace any consent but «instead dilute the presumption of exclusivity of ICSID arbitration»[721]. Moreover, the BIT did not provide for the exhaustion of domestic remedies but only for the lapse of a six month period before turning to ICSID arbitration.

In conclusion, the Tribunal ruled, as a preliminary matter, that it had jurisdiction to examine the merits of the dispute pursuant to the provisions of the Washington Convention of 1965 which established ICSID.

## 2. Waste management

This case was brought under ICSID's Additional Facility and the investor-State dispute settlement provisions of Chapter Eleven of the North American Free Trade Agreement (NAFTA).

Waste Management Inc. was a US company and sole owner of the Mexican company, Acaverde, which had a public waste concession from the Municipality of Acapulco. Both companies («the Claimants») submitted on September 29, 1998, a damages claim against Mexico for alleged expropriations and other violations of their concession rights by a group of state-owned agencies («Banobras»), the state of Guerrero («Guerrero») and the City Council of Acapulco («Acapulco»).

The site of the arbitration was Washington D.C. and the Tribunal was established on June 3, 1998. Its members were Mr. Keith Highet, appointed by of the United States, Mr. Julio Treviño, appointed by Mexico and Mr. Bernardo Cremades, appointed by the parties and who acted as President. On December 1999, Mr. Treviño resigned for reasons of health and was replaced by Mr. Eduardo Siqueiros, also from Mexico.

The claim charged that Banobras, Guerrero and Acapulco had breached the obligations laid down in NAFTA Articles 1105 on fair and equitable treatment, and 1110 on indirect expropriation.

The notice and consent to arbitration stated that the condition precedent to submission of a claim to arbitration of NAFTA Article 1121(1) (a) —namely the waiver required by that Article— had been fulfilled. The said provision states as follows:

> «A disputing investor may submit a claim under article 1116[722] to arbitration only if: the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116,

(721) Lanco, *ibid.*, paragraph 38

(722) The relevant language of NAFTA article 1116(1) states: «An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:a) Section A (Investment),...and the investor has incurred loss or damage by reason of, or arising out of, that breach.»

except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing party.»

After confirmations and clarifications were requested in connection with the waiver submitted by the Claimants, the Tribunal concluded it lacked jurisdiction. The reason was that the Complainants had breached a prior requisite of above Article 1121(1) (b), deemed essential to proceed with the submission of a claim to arbitration: namely, a waiver of the right to initiate or continue before any tribunal or court, dispute settlement proceedings with respect to the measures taken by Mexico, allegedly in breach of NAFTA.

The Tribunal stated that, after submission of its waiver, the Claimants had continued litigating against Banobras before the Mexican courts. Moreover, Acaverde had even initiated arbitration proceedings against Acapulco which were still going on.

The majority ruled that, as the legal actions before the local courts resulted from the same measures, they could not continue and enable the Claimants to obtain double benefits from the arbitration Tribunal in violation of article 1121. The award ordered the claimant to pay the costs of the arbitration. However, Arbitrator Keith Highet dissented from the majority because, in his view, the waiver did not apply because the proceedings in Mexico were substantially different from those of the arbitration.

## 3. Autopista

### *3.1. Antecedents*

This ICSID case was initiated by Autopista Concesionada de Venezuela («AUCOVEN»), the Claimant, a company incorporated under the laws of Venezuela in which ICA held 99% and Baninsa, a Venezuelan investment bank, held 1% of its shares. ICA is a subsidiary of ICA Holding, the parent company of a Mexican engineering conglomerate. The Respondent was the Bolivarian Republic of Venezuela.

On December 28, 1995, the Ministry of Infrastructure («the Ministry»), awarded to a consortium consisting of ICA and Baninsa, the public bid for the design, construction, operation and maintenance of the Caracas-La Guayra Highway system («the Project»). Shortly after the incorporation of the above companies, AUCAVEN entered into a Concession Agreement («the Agreement» or the Concession») with the Ministry. Under this Agreement, AUCAVEN would collect the tolls generated by the Highway over a 30 year period and was guaranteed by the Ministry, the «Economic-Financial Equilibrium» of the Concession. The Ministry would also compensate for any event not attributable to AUCAVEN that could affect the Economic-Financial Equilibrium.

The Concession Agreement became effective on April 1st. 1997. Some days later, AUCAVEN requested authorization from the Ministry to transfer 75% of its shares to ICATECH, a US corporation wholly-owned by the Mexican ICA Holding. Prior to extending this authorization, the Government requested and obtained the guarantee of ICA Holding. Fifteen months after AUCAVEN's request, on June 30, 1998, the Ministry authorized the transfer of the shares of AUCAVEN to ICATECH and, on August 31, AUCAVEN's shareholders resolved that AUCAVEN was subject to the control of ICATECH for all purposes of the Washington

Convention, and was also subject to the arbitration provisions of Clause 64 of the Agreement. This resolution was forwarded to the Ministry which, on January 13, 1999, confirmed that, Clauses 63 and 64 of the Agreement, which dealt with ad-hoc and ICSID arbitration, respectively, were legal and valid and in full effect between the parties.

### *3.2. The Dispute*

Disagreements arose regarding the implementation of the toll provisions of the Agreement which led AUCAVEN, on June, 2000, to file a request for arbitration before ICSID pursuant to Clause 64 of the Agreement.

On January, 16, 2001, ICISID notified the constitution of the arbitral tribunal that would hear the dispute. It was formed by Karl-Heinz Bockstiegel, appointed by AUCOVEN, Bernardo CREMADES, appointed by Venezuela and, Gabrielle Kaufmann-Kohler, appointed by the parties and who acted as President.

### *3.3. Summary of Venezuela's Main Arguments*

On February 14, 2001, Venezuela objected to the Tribunal's jurisdiction stating that AUCAVEN was locally incorporated and had never been treated as being controlled by a company of another Contracting State pursuant to Article 25(2)(b) of the ICSID Convention.

From Venezuela's perspective, the transfer of 75% of AUCAVEN's shares to ICATHECH did not change the control of ICA Holding over the operations of the former. Indeed, this continued control was a condition for the approval by the Ministry of the transfer of the shares together with the guarantee demanded from ICA Holding.

When the Agreement was executed, the parties, according to Venezuela, agreed there would be no ICSID jurisdiction based on the foreign control of AUCAVEN by ICA Holding. Thus, the transfer of the shares to ICATECH changed nothing because Venezuela's consent was limited to independent arbitration in Caracas pursuant to Clause 63 of the Agreement. As a consequence, according to Venezuela, Clause 64 of the Agreement never came into effect.

### *3.4. Summary of AUCAVEN's Main Arguments*

The position of the Claimant was that, pursuant to Article 64 of the Agreement, in the event AUCOVEN's majority shareholder were to become a national of an ICSID Contracting State, Venezuela would consent to arbitration. Thus, when on August 28, 1989, Venezuela authorized the transfer of 75% of its shares to the US corporation, ICATECH, Venezuela's consent to ICSID jurisdiction became effective on that date and could not be revoked.

Regarding the requirement of «foreign control» of Article 25(2)(b) of ICSID, it noted that Article 64 of the Agreement defined control to mean direct control by means of share ownership which, in the present case, had been fully exercised by ICATECH.

*3.5. The Jurisdiction of the Tribunal*

For determining its jurisdiction, the Tribunal quoted Article 25 of ICSID and Clauses 63 and 64 of the Agreement mentioned below.

**Article 25 of the ICSID Convention**

**1)** The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

**2)** «National of another Contracting State» means:

**a)** any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and

**b)** any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration **and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.»** (emphasis added)

**Clause 63 of the Agreement.**

The Tribunal's summary of the content of this provision was:

That the parties agreed to submit their disputes to ad-hoc arbitration in Caracas in accordance with the Venezuelan Code of Civil Procedure and the Model Law on International Commercial Arbitration of the United Nations Commission on International Trade Law (UNCITRAL).

**Clause 64 of the Agreement.**

The Tribunal's summary of the content of this provision was:

That the parties agree to submit to ICSID arbitration any dispute, claim, controversy, disagreement and/or difference related to, derived from, or in connection with the Concession or related in any way with the interpretation, performance, non-fulfillment, termination, resolution of the same, if the shareholder or majority shareholder(s) of the Concessionaire, i.e. AUCOVEN, come to be a national of a country in which the ICSID Convention is in force. Restating the conditions of ICSID Article 25(2)(b), the penultimate paragraph of Clause 64 expressly specifies that, in this event, AUCOVEN shall be deemed a company under foreign control.

The cited paragraph stated as follows:

> «Both The Republic of Venezuela, acting by means of the MINISTRY, and THE CONCESSIONAIRE, agree to attribute to THE CONCESSIONAIRE, a legal person of Venezuela subject to foreign control for the date when this clause enters into force, the character of «National of another Contracting state» for the purpose of applying this Clause and the provisions of the Convention»

From the analysis of the above, the Tribunal concluded that, pursuant to the clear wording of Clause 64, the parties consented to ICSID jurisdiction in the event that AUCOVEN's majority shareholders came to be a national of another Contracting State. In such a case, the parties' consent to ICSID jurisdiction became effective once the condition provided in the Agreement was met which was the date of the transfer of the shares, August 28, 1998.

In addition, as pursuant to Clause 7 of the Agreement, the transfer of the shares required Venezuela's approval, once this approval was given, Clause 64 became immediately effective.

**ICSID Article 25.**

In addition to the consent of the parties in writing, Article 25 of the Convention states the following objective requirements:

— The dispute between the parties must be a «legal dispute»;

— The dispute must arise directly out of an «investment»; and

— In the event that the investor is a corporation registered under the laws of the host State, the parties must agree to treat the locally incorporated company, because of «foreign control», as a «national» of another Contracting State for the purposes of the Convention.

The first two requirements were clearly met when the dispute arose in connection with the parties' respective obligations under the Agreement.

Regarding the third requirement and the fact the Convention did not define «foreign control», the Tribunal stated that «as long as the definition of foreign control chosen by the parties is reasonable and the purposes of the Convention have not been abused the Arbitral Tribunal must enforce the parties' choice»[723]

In the present case, the parties chose to define «foreign control» by reference to AUCOVEN's direct shareholding as the exclusive criteria and the Tribunal treated this as a reasonable test for control purposes. The fact ICATECH was incorporated in Florida on November 2, 1989, well before the conclusion of the Concession Agreement and exercised its voting rights consistently with ICA Holdings strategy, demonstrated that it was not a corporation of convenience.

Pursuant to the above considerations, the Tribunal concluded that Clause 64, which makes the parties consent to ICSID jurisdiction conditional upon the transfer of AUCOVEN's majority shares to a national of another Contracting State, met the requirements of Article 25 of the ICSID Convention. In addition, according to the criterion commonly used to determine the nationality of a corporation, ICATECH was a national of another Contract-

(723) Autopista, *ibid.*, paragraph 116.

ing State (the United States) and, as a result, Clause 64 became effective on the same day of the transfer of the shares.

Based on the foregoing and that the conditions of Article 25 of ICSID and Clause 64 of the Agreement had been met, the application of Clause 63 which provided arbitration in Caracas was discarded.

The Arbitral Tribunal, thus, decided it had jurisdiction over the dispute.

## 4. Lucchetti

These ICSID arbitral proceedings were started on December 24, 2002, by Empresas Lucchetti S.A. («the First Claimant»), and Lucchetti Peru, S.A. («the Second Claimant»), against the Republic of Peru («the Respondent»). Claimants invoked the dispute settlement provisions of the Bilateral Investment Treaty («BIT») between Peru and Chile and charged Peru with breaching, as noted ahead, several of its provisions.

The First Claimant is a company constituted in accordance with the laws of Chile and the owner of more than 98% of the shares of the Second Claimant. By virtue of this Chilean ownership and the terms of the BIT, the Second Claimant, is also treated as a Chilean investor.

On August 1, 2003, the Arbitration Tribunal was constituted with Jan Paulsson, appointed by the Claimants, Bernardo CREMADES, appointed by the Respondent, and Thomas Buergenthal, appointed by the parties, who acted as President.

### *4.1. Summary of the Facts*

The First Claimant is a market leader in Chile in the production of pasta and related products which in 1999 expanded its operations to Peru. The Second Claimant is the owner of a property in a district of Lima where it constructed a plant for the manufacture and sale of pasta in both the local and export markets, with a total investment of more than $150 million.

Claimants stated that, in spite of having obtained all the necessary permits for the construction of their industrial plant, the Municipality of Lima, invoking environmental problems, issued on January 2, 1998, decree 01, which annulled the permits granted to the Second Claimant. This annulment was successfully challenged before the judicial courts which ruled in favor of the Second Claimant. This decision became res judicata.

After the above, the Municipality of Chorrillos granted, on December 1999, an operating license which allowed the Second Complainant to continue its business without interruption until its revocation, by decrees N.° s 258 and 259, of August 2001, of the Major of Lima.

The first, decree No. 258, ordered the Council to request the Congress of the Republic to declare the preservation, maintenance and protection of the Ecological Reserve of Pantanos de Villa (where the Lucchetti plant was located) as a matter of public necessity, and to propose for legislative expropriation, by reason of public necessity, all areas necessary for the preservation of the above Reserve.

The second decree, No 259, specifically revoked the operating license of the Second Claimant and ordered the closure of its plant.

Claimants alleged Peru was liable because, under international law, it was responsible for the acts of its Municipality, and the State had not complied with its obligations under the BIT.

Specifically, the Claimants charged Peru with breaching the following provisions of the BIT: Article 3.2 (protection from unjust and discriminatory measures); Article 4.1(guarantees of just and equitable, national and most —favored— nation treatment); and Article 6.1 (protection from illegal, discriminatory or uncompensated expropriation).

*4.2. Respondent's Objections to Jurisdiction*

The Respondent submitted that the Arbitration Tribunal lacked jurisdiction for the following reasons; i) Ratione Temporis; ii) for having made prior submission to local courts; and ii) ratione materiae.

It added, however, that should the Tribunal find that any one of the above three objections to jurisdiction was well founded, it would have to dismiss the case. As the description which follows demonstrates, the Tribunal based its decision solely on the Respondent's objection to its jurisdiction ratione temporis. These objections were that:

i) The provisions of the BIT did not apply to disputes that arose before the BIT entered into force;

ii) The BIT entered into force on August 3, 2001;

iii) The dispute between the Claimants and Peru began in 1997-1998

iv) Therefore, because the dispute arose before the BIT entered into force, the Tribunal had no jurisdiction.

The relevant provision of the BIT invoked by the Respondent, was Article 2, which states:

> «This Treaty shall apply to investments made before or after its entry into force by investors of one Contracting Party, in accordance with the legal provisions of the other Contracting Party and in the latter's territory. **It shall not, however, apply to differences or disputes that arose prior to its entry into force**» (emphasis added).

The Claimants, however, differed and submitted that the dispute arose after the BIT entered into force and was related to decrees 258 and 259, of August 21, 2001, of the Municipality of Lima.

*4.3. Jurisdiction Ratione Temporis*

Respondent submitted that the request for arbitration was related to a continual dispute which arose in 1997 and was therefore outside the scope of the BIT. The Claimant's, on the other hand, asserted that the dispute arose as a result of Decrees 258 and 259 after the BIT entered into force.

The Tribunal noted there were a series of administrative measures, which took place in 1997 and 1998, which affected negatively the progress of the construction of the project and led the Claimants to seek judicial relief. Indeed, on January 1998, the Claimants filed an Amparo Constitucional against the Council of the Municipality of Lima, the Major of Lima and the Municipality of Chorrillos, which resulted in four separate judgments, all in favor of the Claimants. These 1998 judgments, according to the Claimants, were final and conclusive and there was no possible continuity between them and the dispute with the Republic of Peru of August 22, 2001.

The Respondent, on the other hand, stated that those judgments were part of an ongoing non-settled dispute and that the Tribunal «should consider the corrupt and egregious circumstances under which the judgments were attained»[724]

*4.4. Findings of the Tribunal.*

The issue before the Tribunal was to determine, pursuant to Article 2 of the BIT, when the present dispute arose. If it arose before the BIT entered into force, the Tribunal would lack jurisdiction. If it arose after, the Tribunal would have jurisdiction.

The Tribunal noted that, in accordance with previous jurisprudence, a dispute can be held to exist when the claim of one party is positively opposed by the other. In this regard, it was clear that, when, in 1998, decree 01 of 1998 was challenged by an Amparo, a dispute then arose between the Claimants and the Municipality of Lima. However, according to the Claimants, that dispute ended when judgments were rendered by the Peruvian courts in their favor. Respondent, on the other hand, asserted that Decrees 258 and 259, of 2001, were addressing the same dispute which arose in 1998 and continued thereafter.

The Tribunal examined the subject matter and origins of the 2001 dispute which was the promulgation of Decrees 258 and 259. The purpose of the first Decree was the ecological protection of the area of the plant, Pantanos de Villa. Decree 259, on the other hand, revoked the Claimants license, ordered the closure of the plant and listed the justifications for its decision. This Decree cited the Claimants failure, since 1997, to protect the surrounding ecological reserve, the annulment of Decree 01 of 1998, the litigation against the Municipality's efforts to protect the environment and the revelations contained in videos and testimonies of corruption in the procurement, by the Claimants, of fraudulent judgments in their favor.

The Tribunal concluded that the disputes had the same source: the Municipality's efforts to ensure that its environmental policies were complied and the Claimants efforts to block their application. The present dispute had crystallized by 1998 and the adoption of Decrees 258 and 259 and their challenge by the Claimants were merely continuations of that earlier dispute. In addition, the issues in dispute in 1998 dealt with the same environmental concerns reflected in Decrees 258 and 259 which focused on both the construction and operation of the plant.

(724) Lucchetti, *ibid.*, paragraph 37

On the basis of the foregoing considerations and Article 2 of the BIT, the Tribunal held it had no jurisdiction to hear the merits of the submitted claim.

## 5. Fraport

### *5.1. Antecedents (Summary)*

These ICSID arbitral proceedings were started on 17 September 2003, by the foreign investor, Fraport, the Claimant, against the Republic of the Philippines, the Respondent.

Fraport claimed the Respondent breached several of its obligations under its Bilateral Investment Treaty with Germany, of 2 February 2000 (the «BIT» or the «Treaty»)

The arbitration tribunal was constituted on 11 February 2004 with Dr. Bernardo Cremades, appointed by the claimant, Professor Michael Reisman, appointed by the respondent, and Mr. Yves Fortier, appointed by the parties, who acted as President.

Fraport, a leader in the international airport business, made an investment in the Philippine airport terminal company, PIATCO, which had been awarded concession rights under a Concession Agreement for the construction of an international passenger airport in Manila, known as Terminal 3.

The Respondent challenged the jurisdiction of the tribunal, denied all liability under the Treaty and alleged that the Claimant, by means of a secret shareholders agreement, made its investment in violation of the laws of the Philippines, in particular of the foreign ownership and control legislation known as the Anti-Dummy Law (the «ADL»).

During the 1999-2004 period, Fraport's direct financial investments in PIATCO, reached 30%, and its indirect investments in a «cascade «of companies with ownership interests in PIATCO, was 31.44%.

However, around June 2001, a major public opposition campaign was raised against the project. It was claimed that the relocation of international operations to Terminal 3 would «signal the collapse of Philippine Airlines»

In reaction to the above, Fraport transmitted its concerns to the Government which appointed Ms. Gloria Climaco, with cabinet rank, to negotiate with PIATCO and Fraport.

These negotiations were not successful, however, because, on September, 2002, Secretary Climaco, issued a report which concluded that the project could not survive because the Concession Agreement was null and void and could not be renegotiated.

Later, on 5 September 2003, the Supreme Court, at a time Terminal 3 was almost fully built, declared the Concession Agreements to be null and void, ab initio.

### *5.2. The Jurisdiction Issue*

The main issue before the Tribunal was to resolve the Respondent's challenge of its jurisdiction based on the Complainant's alleged failure to comply with the requirements of article 1(1)(b) of the BIT. In other words, the Tribunal had to determine whether the investment was or

was not an asset accepted under the laws of the Philippines pursuant to the above requirement of the BIT, which states:

Article 1

«Definition of Terms

For the purpose of this Agreement:

1. The term «investment» shall mean any kind of asset **accepted in accordance with the respective laws and regulation of either Contracting State,** and more particularly, though not exclusively;

b) shares of stocks and debentures of companies or interest in the property of such companies»

Regarding the above, the Tribunal observed that its jurisdiction was delimited by the BIT and the Washington Convention whose Article 25 provides parameters of jurisdiction ratione materiae but does not define «investment», Thus, an economic transaction that qualifies financially as an investment may fall outside the jurisdiction of a BIT Tribunal because it fails ratione materiae which is the objection raised in the present case.

The Tribunal highlighted that, prior to committing itself to the project, Fraport received a due diligence legal report from the local law firm, QT, which stated that, under Philippine law, in the operation and ownership of public utilities, foreign ownership was limited to 40%. Thus, as the operations of the Project constituted a public utility, Fraport's ownership had to be limited to 40%.

The legal report also described the relevance of the Anti-Dummy Law or «ADL», which imposes criminal and civil penalties to those violating nationalization laws and prohibits foreign nationals from intervening in the management, operation, administration or control of such companies and that all executive and management positions must be occupied by Filipino citizens.

The Arbitration Tribunal then noted that: «the proposed arrangements set forth in Fraport's final project report did not comply with the requirements of Philippine law which the law firm, QT, had spelled out»[725]. Instead, Fraport concluded, on 6 July 1999, a secret Shareholders Agreement, the «Pooling Agreement«, that circumvented the foreign investment restrictions of Philippine law. Moreover, the Tribunal noted, an addendum to the above agreements, gave Fraport exclusive authority as finance manager.

The above led the Tribunal to conclude that «Fraport was consciously, intentionally and covertly structuring its investment in a way which it knew to be in violation of the ADL» Adding that although its **«equity investment in terms of the statutorily limited percentage in the Terminal 3 was lawful under Philippine law,** Fraport's controlling and managing the investment was not»[726] (emphasis added).

The Tribunal listed the various legal provisions that would determine or limit its jurisdiction rationae materiae. In addition to BIT Article 1(1)(b), which requires that the investment

(725) FRAPORT AWARD, *ibid.*, paragraph 313..
(726) FRAPORT AWARD, *ibid.*, paragraph 323

must be made in accordance with the laws of the Philippines and which would apply to every form of investment, the Tribunal cited Article 2 of the Protocol to the BIT which states:

> «As provided for in the Constitution of the Republic of the Philippines, foreign investors are not allowed to own land in the territory of the Republic of the Philippines. **However investors are allowed to own up to 40% of the equity of a company which can then acquire ownership of land»** (emphasis added)

Regarding the time of compliance with the relevant laws required by Articles 1 and 2 of the BIT, the Tribunal stated that jurisdictional compliance had to be met at the time of initiation of the investment. This meant that, if at the time of initiation there had been compliance, future allegations of violation of the laws would not deprive a tribunal of its jurisdiction.

On the other hand, a covert agreement —such as the Complainant's Shareholders Agreement— which breached the applicable laws and was unknown to the government, would deprive the legal validity of the initial approval of a project.

The Tribunal then added there was « no indication in the record that the Republic of the Philippines knew, should have known or could have known of the covert arrangements which were not in accordance with Philippine law when Fraport first made its investment in 1999».(727)

### *5.3. Fraport's Breach of the Law*

In its interpretation of the ADL, the majority of the Arbitral Tribunal focused in the company's managerial control, in opposition to a quantitative test, and stated that, if a foreign investor owned 15% of the equity of a public utility, but had secret managerial and control agreements, there would be a violation of the ADL.

Reference was made to the judicial dismissal of a complaint made by two lawyers against the officers of Fraport and PIATCO for violating the ADL. Its dismissal was attributed to the fact that, because they had no access to the Shareholders» Agreement of 6 July 1999, the complaint focused on the issue of nationality and not of managerial control.

The Tribunal rejected the Claimant's contention that, because of the absence of an acceptance regime, the acceptance requirement of Article 1(1) of the BIT could not apply. At the same time, it recognized that: i) the cumulative actions of the host government constituted an «informal» acceptance of a foreign investment that, otherwise, would violate the law; and ii) the failure to prosecute a supposed violation of the ADL, would imply that the investor was acting lawfully.

However, the above arguments would fail, according to the majority of the Tribunal, because the Respondent could not have taken action against a violation of the ADL that was deliberately concealed by the investor. In addition, the assessment of the legality of the investment belonged exclusively to the only tribunal with jurisdiction on the subject matter, which was the Arbitration Tribunal.

(727) FRAPORT, *ibid.*, paragraph 347

The Arbitration Tribunal also rejected the Claimant's argument that it never actually exercised control over PIATCO and, consequently, the secret shareholders agreement was in conformity with the ADL which, in any event, does not criminalize attempts to violate it (emphasis added). The majority of the Tribunal also rejected these arguments because, first, for ratione materiae purposes, compliance with the law must exist at the moment of the investment and, second, the ADL punishes with imprisonment any person who knowingly aids, assists, or abets in the planning, consummation or perpetration of any of the prohibited acts.

In conclusion, the majority of the Tribunal ruled that, as Fraport knowingly and intentionally circumvented the ADL by means of a secret Shareholders» Agreements, it could not claim to have made an investment» in accordance with law «; and, because there was no investment «in accordance with law», the Tribunal lacked jurisdiction rationae materiae.

The final award stated:

> «1. To accept the objection to the jurisdiction of the International Centre for Settlement of Investment Disputes raised by the Republic of the Philippines.
>
> 2. To declare that the Centre does not have jurisdiction to hear this dispute and that this Arbitral Tribunal is not competent to resolve it;
>
> 3. To dismiss the claim of Fraport AG Frankfurt Airport Services Worldwide»

### 5.4. *Doctor Cremades' Dissent*

In his dissent, doctor Cremades stated that the contractual provisions of the confidential Shareholders Agreement, cited by the majority decision, did not constitute a violation of the Anti-Dummy Law and that, even if they did, they could not strip the Complainant's investment of all treaty protection, among other reasons because his shareholdings in PIATCO, and related companies, was legal under Philippine law (as was recognized by the majority).

Moreover, a violation of the Anti-Dummy Law became impossible after the Supreme Court declared the Terminal 3 Concession to be, ab initio, null and void. This meant PIATCO was not a dummy, the Concession Contract was never valid and, therefore, as PIATCO never held a public utility franchise, the Anti-Dummy Law was not applicable.

The arbitration was started by Fraport in connection with his investment in Terminal 3 and pursuant to Article 9 of the BIT between Germany and the Philippines which states that:

> «**all kinds of divergences** between a Contracting State and an investor of the other Contracting State concerning an investment) shall first be addressed through negotiations, and if a settlement is not reached within six months, then the investor may submit the divergences to arbitration pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States, of March 18, 1965 done in Washington D.C.» (emphasis added)

On July 1997, PIATCO entered a Concession Agreement with the Philippines for the construction of Terminal 3, and, as from July 1999 through September 2001, Fraport

through a succession of investments acquired a 30% ownership in PIATCO and a 40% in three of its related companies. However, when construction of Terminal 3 was virtually completed and PIATCO ready to start commercial operations, the Respondent resolved that the Terminal 3 Concession was null and void. This decision was reiterated by the President of the Republic and the Supreme Court. In addition, on December 2004, the Respondent sought and obtained a court order expropriating Terminal 3 and took physical possession of it.

Based on the above facts, the Claimant stated that the annulment of the Concession and physical expropriation of Terminal 3 violated the BIT. To this, the Respondent alleged that the Tribunal lacked jurisdiction because no investment was made in compliance with Article 1(1) of the BIT which requires that an investment asset must be «accepted in accordance with the respective laws and regulations of either Contracting State» This would not have happened, according to the Respondent, because the Claimant breached the Anti-Dummy Law and, therefore, his shareholdings could not qualify as an investment.

In his dissent, Doctor CREMADES stated that, under Article 31 of the Vienna Convention on the Law of Treaties, Article 1(1) of the BIT must be interpreted in accordance with its object and purpose which is the promotion and reciprocal protection of investments. Regarding the legal restrictions on the foreign ownership of assets, he noted that, at all times, «at least sixty percent of PIATCO's capital was owned by Philippine citizens and Fraport's direct and indirect shareholdings in PIATCO complied at all times with the law.»(728) Consequently, the fact the Claimant's assets may have been engaged in illegal conduct would not change the fact that its shareholdings were an asset accepted by Philippine law. Thus, the Respondent's interpretation of Article 1(1) of the BIT would not respect its ordinary meaning, nor its object and purposes, which consist in the promotion and protection of investments.

Concerning the assertion that the Claimant breached the Anti-Dummy Law, he noted that direct shareholdings in PIATCO never exceeded 30% and that, regarding indirect holdings, the subject was governed by the «Control» test which considers actual voting power and not managerial control. There could, thus, be no violation of the Anti-Dummy Law on the grounds of illegal control where 60% of the capital was owned by Philippine citizens.

Regarding the criminalization established by the Anti-Dummy Law, he noted that it punishes the conduct of the Dummy, in this case, PIATCO, and of Philippine citizens and, only indirectly, that of foreign investors. Therefore, as the Respondent did not demonstrate that PIATCO violated that law, Fraport was not guilty of any offense.

On the significance of the Shareholders» or Pooling Agreement that would have given Fraport illegal control of PIATCO, he noted that PIATCO itself was never a party to these agreements and there was no evidence to indicate Fraport sought to exercise those control powers. In addition, the mere execution of the Pooling Agreement, or its inclusion of a confidential clause, or the legal advice received from QT, could not by themselves be a violation of the Anti-Dummy Law or demonstrate illegal intent.

(728) FRAPORT, *ibid.*, paragraph

The Tribunal's majority fixes July 1999 as the date of the alleged illegality which is the date of the Shareholders» Agreement. However, this ignores that the Agreement was amended and that Fraport increased its investment thereafter.

The Anti-Dummy Law also requires the Dummy to hold a public utility franchise which, in this case, are PIATCO and Terminal 3, respectively. However, after the Supreme Court declared the Terminal 3 concession to be null and void, ab initio, there was no public utility franchise and, consequently, there could be no violation of the above law.

Pursuant to Article 42 of the Washington Convention, the Arbitration Tribunal must apply Philippine Law which means it is bound by the Supreme Court decision which declared the Terminal 3 Concession to be null and void. The latter decision being for these purposes «res judicata».

The requirement that the investment must be made in compliance with the laws of the host-State imposes a mutual respect for the laws of the host-State on both the investor and the host-State itself, and the observance of the principle of good faith. This principle prevents a State from taking a legal position which is inconsistent with its internal law or contrary to a previous position taken towards an investor regarding the application of its internal laws

The facts of the case demonstrate that, after the Respondent granted the Terminal 3 Concession to PIATCO, on July 12, 1997, it yielded to the opposition which arose against the project and, finally, declared that the Concession was null and void, ab initio. This decision was confirmed by the Supreme Court and became res judicata as a matter of Philippine law. This radical change in the Respondent's position against the investor breached the principle of good faith. It was reiterated by its public insinuation that the December 27, 2006, decision of the State Prosecutor, of not prosecuting PIATCO and its shareholders, should be changed because it damaged its position in this arbitration.

In summary, Doctor CREMADES stated that,

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1. The Claimant's shareholdings in Philippine companies constitute an «investment» within the meaning of Article 1(1) of the BIT;

2. These shareholdings are a «kind of asset accepted in accordance with the respective laws and regulations of (the Philippines)», irrespective of whether the Claimant is guilty of any breach of the Philippine Anti-Dummy Law;

3. The Respondent has not demonstrated that PIATCO as the public utility holder is guilty of any breach of the Anti-Dummy Law, and if PIATCO is not guilty of any breach then Fraport cannot be guilty as an accomplice;

4. This Arbitral Tribunal must apply the current Philippine law relating to the Anti-Dummy Law. Philippine law applies the «Control» Test to determine the legality of the shareholding of a foreign investor in a public utility franchise holder, and does not criminalize managerial control by the foreign investor. Fraport's shareholding at all time complied with

the «Control» test, and in any event it was conceded the Fraport never exercised any of the allegedly illegal powers under the shareholders agreements;

5. As a matter of Philippine law, the Terminal 3 Concession was null and void ab initio, and therefore a violation by PIATCO of Fraport of the Anti-Dummy Law is legally impossible on the grounds of the non-existence of a public utility franchise;

6. The Respondent's Anti-Dummy Law submission is premised on the validity of the public utility franchise, and therefore is an argument against its own internal law;

7. The Respondent's Anti-Dummy Law submission violates the good faith required of a party in investment arbitration in (i) being contrary to its own law; (ii) being contrary to the consistent position of its senior officials in their dealings with the Claimant, with the public and in the exercise of their official duties; (iii) that the actions of its officials have misrepresented to and manipulated before this Arbitral Tribunal.

### *5.5. Conclusions*

Based on the above reasons, Dr. CREMADES concluded that the Arbitral Tribunal had jurisdiction over the dispute, and that the decision of the majority was not only contrary to Article 1(1) (b) of the Philippines-Germany BIT but also «fundamentally wrong in its approach to illegality as a matter of principle»

## IV. FINAL COMMENTS

The above summary of the five ICSID awards, reveals that:

1. All five cases addressed challenges to the jurisdiction of ICSID tribunals. In three cases, Waste Management, Lucchetti and Fraport, the tribunals declined jurisdiction. In the other two, Lanco and Autopista, the tribunals rejected the challenges and exercised their jurisdiction

2. With the exception of Waste Management and Fraport, the arbitral awards were approved by all its members.

In Waste Management and Fraport, arbitrators Keith Highet and Bernardo CREMADES, respectively, dissented from the majority and favored jurisdiction.

3. With the exception of Fraport, where the parties were a German investor and the host-State, the Philippines, in the four other cases either the investor or the host-State were from Latin America.

In Lanco, the host-State was Argentina and the investor from the United States; in Waste Management, the host-State was Mexico and the investor also from the United States; in Autopista, the host-State was Venezuela and the investor a Venezuelan company controlled by a Mexican holding company; and, in Lucchetti, the host-State was Peru, and the investor from Chile.

4. With the exception of Waste Management, where the consent to arbitration was governed by the North American Free Trade Agreement, in the rest of the cases consent was governed by a Bilateral Investment Agreement.

5. The complex relations between contract and treaty claims and access to a domestic or international forums thereof, which were superbly analyzed in the 2004 CREMADES & CAIRNS article, became, with the exception of Luccheti, a central issue in all the other cases.

6. The interpretation and application of ICSID Article 25(2) (b) to a dispute where the investor had the nationality of the host-State but is under the **foreign control** of a national of another Contracting State, was a major issue in Autopista. An exhaustive analysis was made of this concept which is not defined in the ICSID Convention. The Tribunal considered that, on the basis of the discretion granted by the Convention, «direct shareholding was certainly a reasonable test of control» and this criterion was instrumental in its decision to exercise jurisdiction in this case.

7. As opposed to the aforementioned quantitative test applied in Autopista, the requirement of foreign control applied by the majority of the Tribunal in Fraport was different. It applied the test of «managerial control» and, on this basis, concluded that the claimant had breached the applicable law and declined to exercise its jurisdiction.

8. Professor CREMADES strongly dissented from the Fraport majority and favored accepting the tribunal's jurisdiction. Instead of determining the existence of «foreign control» through the «managerial control» test, he supported the shareholding majority test, applied in Autopista. He also raised other objections to the award, such as the absence of procedural good faith on the part of the host-State. This resulted from the fact the State took a legal position inconsistent with its internal law, or with a position previously taken before the investor regarding the proper application of its internal law.