



School of International Arbitration

School of International Arbitration, Queen Mary, University of London

International Arbitration Case Law

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TOTO COSTRUZIONI GENERALI S.P.A.

V.

REPUBLIC OF LEBANON

AWARD ON LIABILITY

Case Report by Daniel Brawn**
Edited by Natasha Dupont ***

In a decision rendered on June 7, 2012, under the Treaty between the Italian Republic and the Lebanese Republic on the Promotion and Reciprocal Protection of Investments of November 1997 (Treaty), the Tribunal held that Respondent did not breach its obligations under Articles 2 and/or 3 of the Treaty.

Tribunal: Professor Dr. Hans van Houtte (President), Judge Stephen M. Schwebel, Mr. Fadi Moghaizel

Claimant's Counsel: Mr. Bechara S. Hatem and Professor Hadi Slim, of HATEM, KAIROUZ, MESSIHI & PARTNERS, Beirut, Lebanon.

Respondent's Counsel: Mr. Nabil Abdel-Malek, Mrs. Mireille Rached and Mr. Joseph Bsaibes, of NABIL ABDEL-MALEK LAW OFFICES, Beirut, Lebanon.

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Digest

1. Facts of the Case

The Claimant, Toto Costruzioni Generali S.P.A. (“Toto”), was an Italian joint stock company; the Respondent was the Republic of Lebanon (“Lebanon”). In April 2007, Toto commenced an ICSID arbitration against Lebanon in relation to alleged breaches of the Treaty between the Italian Republic and the Lebanese Republic on the Promotion and Reciprocal Protection of Investments of November 2007 (the “Treaty”). The dispute related to a contract dated December 1997 (the “Contract”) between Toto and the Lebanese Republic-Conseil Executif des Grandes Projets (“CEPG”) to construct the Saoufar-Mdeirej Section (the “Project”) of the Arab Highway linking Beirut to Damascus.

The Project comprised a 5,525 metre section of the 62 kilometre long “Hadath-Syrian Border” highway project linking Beirut to the Syrian border. Expropriation of parcels of land was required to construct the road. When the Contract was made, the necessary parcels (total of 9 lots) had not been expropriated but were to be delivered progressively during the course of the works.

CEGP ordered Toto to commence the works on February 10, 1998. The project was to take 18 months followed by a 12-month maintenance period, giving a completion date of October 24, 2000. The project was ultimately completed in December 2003.

Soon after starting, Toto proposed modifications to the Project which required additional parcels to be expropriated. Two Addenda were agreed but the completion date remained unchanged. Over the course of the project, Toto submitted various claims to CEPG and its successor the Council for Development and Reconstruction (“CDR”) related to additional costs from various factors. In 2001, Toto commenced two court proceedings in relation to additional works and also submitted to the Engineer a claim for an extension of time, which the Engineer rejected. In September 2002, Toto requested compensation for additional works and delay.

Toto brought claims against Lebanon alleging that CEPG and later its successor CDR, was responsible for delays in expropriating the land on which the Project was to be constructed, failure to protect Toto’s investment, providing defective design and instructions, changing the regulatory framework and refusing to

adopt corrective measures. According to Total these actions were breaches of Articles 2, 3 and 4 of the Treaty and caused substantial delays in construction and damage to Toto's investment. Toto submitted that the various delays were caused by Lebanon in its capacity as a sovereign authority and that they prejudiced Toto's investment contrary to Article 2 of the Treaty; failed to ensure fair and equitable treatment (Article 3.1); and failed to provide full protection and security (Article 4.1). Toto considered the following matters to be breaches of the Treaty:

- (i) Late expropriations;
- (ii) Failure to remove Syrian troops from the site;
- (iii) Failure to remove owners from the site;
- (iv) Faulty design of a viaduct because of Lebanon's outdated standards;
- (v) Change in the regulatory framework.

The parties agreed to bifurcate the proceedings, addressing first the issue of jurisdiction and secondly the merits of the case. On September 11, 2009, the Tribunal rendered its Decision on Jurisdiction, in which it held that it had jurisdiction to decide whether (i) delay in expropriation of private property on which the Project was to be constructed, (ii) failure to remove Syrian troops and (iii) changes in the regulatory framework constituted breaches of Article 2, Article 3.1 and/or Article 4 of the Treaty.¹

In February 2012, one of the arbitrators resigned and on March 6, 2012, the Secretary-General of ICSID nominated Judge Stephen M. Schwebel as an arbitrator. Neither party objected. Judge Schwebel accepted the appointment and the proceedings resumed.

2. *Legal Issues Discussed in the Decision*

(a) *Preliminary Issues* (¶¶52-85)

Lebanon raised several preliminary objections in the Arbitration:

i. *Toto's locus standi*

¹ Award at ¶28. The Tribunal held it had no jurisdiction with respect to (i) erroneous instructions and design, (ii) disruption of negotiations, (iii) delays in bringing two court cases, (iii) lack of transparency in those cases, and (iv) indirect expropriation or any breach of Contract claims.

Lebanon contended that the Claimant in the arbitration was not the same party as entered into the Contract. The Tribunal found that it was the same party, the apparent differences arose from statutory changes in company registration.

ii. Applicable Law

Lebanon raised issues in relation to the exercise of sovereign authority and the applicability of domestic law, which the Tribunal considered unnecessary to decide, as the Treaty and the principles of international law would suffice to decide the case.

iii. Temporal Limitation of Jurisdiction

By Article 10 of the Treaty, the Treaty does not apply “to disputes that have arisen before its entry into force” on February 9, 2000. Lebanon argued that allegations related to events that predated February 9, 2000 should be excluded, such as failure to remove Syrian troops and owners in 1998 and 1999. The Tribunal, distinguishing from *breach*, which arises when the obligations are not honored, held that the *disputes* crystallized on June 30, 2004, when Toto invited CDR to settle the dispute in accordance with the Treaty.

iv. Extensions of Time and Waiver of liability by Toto

The parties disputed whether waivers of CEGP liability given in exchange for extensions of time to complete the project are valid. Lebanon argued that, in accepting extensions of time, Toto waived any right to additional payments. Toto argued that any waivers were given under duress and were therefore invalid. The Tribunal held that Toto had waived its claims to compensation under the Contract, but its claims under the Treaty were a different matter, although those claims may be affected by a waiver under the Contract, especially when they cover damages for the same act.

(b) *Late Expropriation as Failures to Promote and Protect Investment and to Ensure Fair and Equitable Treatment* (¶¶ 172-194)

Toto argued that the late expropriation of the necessary parcels caused the works to take 48 months instead of 18 months resulting in various additional costs.

Lebanon replied that Toto knew when it signed the Contract that parcels would be delivered progressively and agreed not to claim compensation for late

delivery. For Lebanon, the true reason for late delivery of parcels was that Toto proposed variations to the project which required expropriation of different parcels to those originally intended. These additional expropriations took 12 months, which the Tribunal found to be reasonable.

For the Tribunal a breach of Article 2 to promote and protect Toto's financial interest in performance of the Projects would require (1) an established delay in expropriation, (2) which was attributable to Lebanon. The Tribunal found that there were no grounds to find that Lebanon had failed to protect the investment. Even if Article 2.1 imposed an obligation of due diligence, Toto had not submitted evidence that Lebanon had not behaved diligently. As for Article 2.3, Toto did not allege that Lebanon had acted in a discriminatory fashion and did not indicate how Lebanon ought to have acted "in a reasonable manner." As for Article 2.4, Toto had failed to show how Lebanon had failed to create or maintain favourable legal or economic conditions and rather accepted an extension of time to complete the works and waived any claim to damages, which undercut the factual grounds for arguing that Lebanon failed to protect the investment.

Toto argued that Lebanon was in breach of Article 3.1 of the Treaty, by failing to ensure fair and equitable treatment of Toto's investment, from frustration of its expectation on delivery of the necessary parcels. Lebanon argued that Toto had no legitimate expectation of consistent and consequential delivery of parcels and that by proposing variations to the Project, Toto accepted the risk of delays. The Tribunal failed to see how Toto could have had such legitimate expectations and noted that Toto did not complain at the time. Toto did not submit any proof that Lebanon acted in a discriminatory or capricious way, or that it did not comply with international standards. On the contrary, the extension of time and waiver of compensation detracted from any legitimate expectation to receive compensation.

(c) *Failure to Remove Syrian Troops as Failures to Maintain Favourable Conditions for the Investment and to Ensure Fair and Equitable Treatment (¶¶195-206)*

Toto argued that the failure to remove Syrian troops was a breach of Article 2 of the Treaty, by which Lebanon must maintain favourable conditions for the investment. Lebanon argued that this was Toto's risk under the Contract; that Toto knew the location of Syrian troops when it signed the Contract; that Toto did not complain about the presence of Syrian troops at the time; and in any event the time taken to evacuate the troops was fair. The Tribunal found that Toto was or should have been aware of the location of Syrian troops and that

Lebanon did whatever was within its power to obtain their departure. The measures taken by Lebanon were not unreasonable or discriminatory and there was no breach of Article 2.

Toto argued that Lebanon's failure to evacuate the Syrian troops when the works started was a breach of the requirement in Article 3.1 to ensure fair and equitable treatment of Toto's investment. Lebanon replied that Toto could not reasonably have expected the troops to be removed earlier than they were. The Tribunal found that Toto had not proven any breach of Article 3.1.

(d) Failure to Remove Owners from the Site as Failures to Promote and Protect the Investment, to Protect Legitimate Expectations, and to Provide Full Protection and Security (¶¶207-230)

Toto contended owners of expropriated parcels prevented it from accessing those parcels and that Lebanon's failure to stop such obstructions caused delay. Lebanon argued that Toto had not established that it was actually prevented from working, and that Toto was not ready to work on those parcels.

Although an alleged failure to prevent owners and occupants from obstructing work could constitute failure to protect an investment under Article 2, the Tribunal found that Toto had not established any breach of Article 2 by identifying actions Lebanon specifically did not take to prevent the obstruction and how the temporary obstructions prevented Toto from finishing by the contractual completion date

The Tribunal found that Toto had not established any breach of the "legitimate expectation" provisions in Article 3.1. It would be unreasonable to expect Lebanon to guarantee that no owner would cause an obstruction and indeed Lebanon did stop the obstructions. The Tribunal therefore did not find evidence that Toto had legitimate expectations with regard to removal of the owners and that such expectations were frustrated leading to unfair and inequitable treatment towards Toto's investment.

The Tribunal also found that Lebanon had not acted in breach of the requirement in Article 4 to provide full protection and security. This requirement did not amount to a warranty that property would never be in any way impaired and the temporary objection did not amount to an impairment which affected the integrity of the investment.

(e) *Faulty Design Due to Inappropriate Standards as Matters within the Tribunal's Jurisdiction* (¶¶231-238)

Toto argued that on occasions Lebanon had been late in submitting or approving designs and plans. The Tribunal reiterating its decision on jurisdiction indicated that the erroneous design dispute was a contractual matter and could not be the subject of this arbitration. The Tribunal found that Toto had not established that the initial standards applied by CEGP were wrong, or how their selection were a matter of sovereign immunity, or that this was a breach of Articles 2 or 3.1 of the Treaty.

(f) *Changing the Regulatory Framework as Failure to Afford Favourable Economic Conditions and Fair and Equitable Treatment* (¶¶239-246)

Toto argued that the Contract implied that the Project would be subject to the Lebanese tax legislation in effect at the time the Contract was entered into, but that customs duties on building materials were unreasonably increased. Toto said this was a breach of the obligation in Article 2 of the Treaty to maintain favourable economic and legal conditions, and of the "fair and equitable treatment" obligation in Article 3.1. Lebanon acknowledged that there were some increases, but there were also some decreases. The Tribunal held that "fair and equitable treatment" did not entail that tax law and customs duties would not be changed; there was no discrimination, because any changes applied to Lebanese nationals as much as to foreign investors; Lebanon had not acted unreasonably towards Toto; and Lebanon was not in breach of Articles 2 or 3.

3. Decision

The Tribunal found that Lebanon had not breached its Treaty obligations and therefore no compensation was due to Toto.

As for costs, which by Article 61(2) of the ICSID Convention should form part of the Award, the Tribunal noted that Lebanon's objection to jurisdiction had been partially rejected, but that Toto's claims were dismissed on the merits, not because Lebanon's behaviour was irreproachable, but because Lebanon's acts and omissions, some of which could amount to breaches of the Contract, were not proven to be breaches of the Treaty. Taking into account all the circumstances of the case, the Tribunal concluded that the parties should bear the fees and expenses of the Tribunal and of ICSID equally, and they should each bear their own legal fees and expenses.

4. *Concurring Opinion of Judge Schwebel*

Judge Schwebel was appointed to the Tribunal at a very late stage after the hearing had been concluded and the Tribunal had deliberated. He did not necessarily share the other Tribunal members' interpretation of the legal effect of the Treaty in relation to jurisdiction, but he did agree with their findings of the facts, findings which did not establish the liability of the Respondent.