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International Arbitration Case Law

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FRAPORT AG FRANKFURT AIRPORT SERVICES WORLDWIDE v. REPUBLIC OF THE PHILIPPINES (ICSID CASE NO. ARB/03/25)

AWARD

Case Report by Pei Wang **
Edited by Mark Feldman ***

An Award issued on 16 August 2007, under the bilateral investment treaty ("BIT") between the Federal Republic of Germany and the Republic of the Philippines, and in accordance with the ICSID Convention and Arbitration Rules. Dr. Cremades signed a dissenting opinion.

Tribunal: L. Yves Fortier, C.C., Q.C. (President), Dr. Bernardo M. Cremades (Arbitrator), Professor W. Michael Reisman (Arbitrator).

Claimant's counsel: Jeffrey Barist, Michael Nolan, Lesley A. Benn, Milbank, Tweed, Hadley & McCloy LLP; Cesar P. Manalaysay, Edgardo G. Balois, Siguion Reyna, Montecillo & Ongsiako.

Respondent's Counsel: Carolyn B. Lamm, Abby Cohen Smutny, White & Case LLP; Judge Florentino P. Feliciano, Supreme Court of the Philippines (Retired); Agnes Devanadera, Rex Bernardo L. Pascual, Eric Remegio O. Panga, Office of the Solicitor General, Republic of the Philippines.

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INDEX OF MATTERS DISCUSSED

1. Facts of the Case 3
2. Legal Issues Discussed in the Decision 4
   (a) Whether a failure by Fraport to comply with Philippine law when making its investment would deprive the Tribunal of jurisdiction under Article 1(1) of the BIT (¶¶ 334-348) 4
   (b) Whether Fraport exercised managerial control over PIATCO in violation of Philippine law(¶¶ 349-395) 5
3. Decision 6

Digest

1. *Facts of the Case*

In July 1997, a Philippine company, Philippine International Air Terminals Co., Inc., ("PIATCO"), entered into a concession agreement with the Government of the Philippines authorizing PIATCO to construct and operate an international passenger terminal at Ninoy Aquino International Airport in Manila ("Terminal 3"). The concession agreement was amended and supplemented. (¶98, ¶102, ¶111).

In July 1999, Fraport AG Frankfurt Services Worldwide ("Fraport"), a German company active in the airport industry, acquired direct and indirect equity interests in PIATCO. Fraport also entered into confidential shareholder agreements under which "Fraport sought to exercise managerial control over PIATCO." (¶¶124-125).

Beginning in September 2002, several petitions were filed with the Philippine Supreme Court seeking to nullify the Terminal 3 concession contracts. In November 2002, the President of the Philippines announced that the Terminal 3 concession contracts would not be honored because the legal offices of the Executive Branch (the Solicitor General and the Justice Department) had determined that the contracts were null and void. The President stated that there had been "illegality" during the procurement and subsequent negotiation of the concession agreement. (¶¶190-192).

On May 5, 2003, the Philippine Supreme Court concluded that the Terminal 3 project concession contracts were null and void *ab initio* due to "serious violations of Philippine law and public policy," including the failure to properly pre-qualify the project concessionaire. (¶217).

Following the Supreme Court's decision, Fraport discussed compensation with the Philippines. Shortly before the discussions were "postponed indefinitely," Fraport submitted its Request for Arbitration to ICSID, alleging that the Philippines had violated its obligations under the bilateral investment treaty between the Federal Republic of Germany and the Republic of the Philippines (the "BIT"). (¶221).

The Philippines challenged the Tribunal's jurisdiction pursuant to Article 1(1) of the BIT. Under that provision, the Philippines argued, the protections afforded by the BIT did not extend to investments made in violation of Philippine law. In particular, the Philippines alleged that Fraport structured its investment in PIATCO "in a manner that

was intended to evade Philippine nationality and anti-dummy laws"(¶290), specifically through indirect forms of ownership and the use of secret shareholder agreements. The Philippine Anti-Dummy Law ("ADL") prohibited foreign entities from managing public utilities.

Fraport argued that its investment was made in accordance with Philippine law, emphasizing that the Philippines had "long known the details of PIATCO's shareholding structure" but never charged Fraport with violations of its foreign ownership laws.(¶295). In addition, Fraport argued that "the Philippine SEC and DOJ have rendered opinions to the effect that 'companies that are at least 60% owned by Philippine nationals are considered Filipino-owned irrespective of minority ownership.'"(¶296). Fraport also argued that the BIT created an obligation for the Philippines to admit foreign investments.

2. *Legal Issues Discussed in the Decision*

The Tribunal found that it lacked jurisdiction because Fraport's investment in PIATCO had not been "accepted in accordance with" the laws of the Philippines as required by Article 1(1) of the BIT. The Tribunal addressed two issues in particular when determining jurisdiction. First, whether a failure by Fraport to comply with Philippine law when making its investment would deprive the Tribunal of jurisdiction under Article 1(1) of the BIT. Second, whether Fraport had exercised managerial control over PIATCO in violation of Philippine law, specifically the ADL.

(a) Whether a failure by Fraport to comply with Philippine law when making its investment would deprive the Tribunal of jurisdiction under Article 1(1) of the BIT (¶¶ 334-348)

Article 1(1) of the BIT provided that "[t]he term 'investment' shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State [.]" The Tribunal found that Article 1(1) and related provisions in the BIT, the Protocol to the BIT, and in the Philippines Instrument of Ratification, required economic transactions to "meet certain legal requirements of the host state in order to qualify as an 'investment' and fall under the Treaty." (¶340). According to the Tribunal,

the BIT's object and purpose of encouraging investment could not "nullify" those express provisions. (¶340). The Tribunal also found that the requirement of complying with domestic law applied to all investments, regardless of whether an investment included a specific agreement with the host state. (¶343).

The Tribunal recognized that "principles of fairness should require a tribunal to hold a government estopped from raising violations of its own law as a jurisdictional defense when it knowingly overlooked them and endorsed an investment which was not in compliance with its law." (¶346). The Tribunal found, however, "no indication in the record" that the Philippines, at the time Fraport first made its investment in 1999, was awareof the "covert arrangements which were not in accordance with Philippine law[.]"(¶347).

(b) *Whether Fraport exercised managerial control over PIATCO in violation of Philippine law* (¶¶349-395)

With respect to the level of Fraport's equity interest in PIATCO, the Tribunal found that Fraport did not exceed the level "lawfully permitted to a foreign investor in a constitutionally defined category of public utilities." (¶350). The potential violation of Philippine law instead concerned whether Fraport had exercised managerial control over PIATCO in violation of the ADL.

The Tribunal found that quantitative measures such as the level of Fraport's equity interest in PIATCO did not "per se" establish managerial control in violation of the ADL. Managerial control instead was established, according to the Tribunal, by a July 1999 shareholders agreement. That agreement made, with respect to PIATCO shareholder votes, "the preliminary meeting of the shareholders the moment of actual decision," rather than the subsequent meeting of board members. (¶351). That agreement also made Fraport's view the controlling view with respect to, among other matters, the "operation, maintenance, and management of the Terminal Complex." (¶319).

The Tribunal found that "the existence of the secret shareholder agreements was the critical factor for answering the question of whether there was a violation of the ADL." (¶361). Those agreements, as found by the Tribunal, "show that Fraport from the outset understood, with precision, the Philippine legal prohibition" against foreign entities having managerial control over public utilities and that "Fraport planned and knew

that its investment was not 'in accordance with' Philippine law." (¶355).

The Tribunal also addressed the findings of the Philippine National Bureau of Investigation ("NBI") and the Prosecutor's Office, each of which concluded that Fraport had not violated the ADL. The Tribunal found that neither the NBI, nor the Prosecutor's Office, had been aware of the secret shareholder agreements, which were "the critical factor for answering the question of whether there was a violation of the ADL." (¶¶361, 367).

The Tribunal acknowledged that "a failure to prosecute something of the order of a violation of the ADL" could cause an investor to "reasonably infer" that it was acting lawfully and "obviate" an objection to jurisdiction. But Fraport, the Tribunal found, "consciously concealed" its violation of the ADL and thus "actions that might otherwise have been viewed by an investor in good faith as endorsements of the Philippine government cannot be deemed to have cured the violation or estopped the Government." (¶387).

In a dissenting opinion, Dr. Cremades maintained that no violation of the ADL had been established. Given the Philippine Supreme Court's finding that the Terminal 3 concession contracts were null and void, Dr. Cremades concluded that the concession "was never valid and had no effect" and thus "PIATCO never held a public utility franchise and so the Anti-Dummy Law could not apply." (§1).

Dr. Cremades further maintained that even if Fraport's asset (PIATCO) had violated the ADL, Fraport's shareholdings in PIATCO nevertheless constituted "an asset accepted in accordance with Philippine law." (§13). Dr. Cremades also found that "good faith applies to both the investor and the State Party" in international arbitration, (§1), and that the Philippines had engaged in "procedural bad faith" when "escap[ing]" from its agreement to arbitrate by pointing to "the criminal control of a franchise that for four years it has insisted does not exist."(§31).

3. *Decision*

The Tribunal found that it did not have jurisdiction over Fraport's claim because "Fraport's ostensible purchase of shares in the Terminal 3 project, which concealed a different type of unlawful investment, is not an 'investment' which is covered by the BIT." (¶404). Finding that there was "no successful party on the merits in the traditional sense," the Tribunal ruled that each party would bear its own costs. (¶405).