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International Arbitration Case Law

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RAILROAD DEVELOPMENT CORPORATION (RDC) V. REPUBLIC OF GUATEMALA

Case Report by Dmytro Galagan**
Edited by Ignacio Torterola***

An Award rendered on June 29, 2012, under the Dominican Republic – Central America – United States of America Free Trade Agreement ("CAFTA").

Tribunal:	Dr. Andrés Rigo Sureda (President), Honorable Stuart E. Eizenstat, Professor James Crawford
Claimant's Counsel:	Mr. C. Allen Foster, Mr. Kevin E. Stern, Ms. Ruth Espey-Romero, Greenberg Traurig, LLP; Mr. Juan Pablo Carrasco de Groote, Díaz-Durán & Asociados Central-Law; Ms. Regina K. Vargo, Greenberg Traurig, Llp
Defendant's Counsel:	Hon. Larry Mark Robles Guibert, Attorney General of the Republic of Guatemala; Hon. Sergio de la Torre, Minister of Economy of the Republic of Guatemala; Hon. Marvin Gustavo Lau López, Under Secretary General of the Office of the President; Lic. Carlos Samayoa Flores, Administrator of Ferrocarriles De Guatemala; Mr. David Orta, Mr. Whitney Debevoise, Mr. Daniel Salinas Serrano, Ms. Margarita R. Sánchez, Ms. Giselle Fuentes, Ms. Dawn Yamane-Hewett, Ms. Mallory Silberman, Arnold & Porter LLP

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Digest

1. Facts of the Case (¶¶ 30-37)

Railroad Development Corporation ("RDC" or "Claimant") is a privately-owned railway investment and management company. Compañía Desarrolladora Ferroviaria, S.A., is a company which does business in Republic of Guatemala ("Guatemala" or "Respondent") as Ferrovías Guatemala ("FVG") and is majority-owned and controlled by RDC. In 1997 RDC won, through public bidding, the 50-year right to use of the infrastructure and other rail assets, which did not include rolling stock required for the operation of the railroad, to rebuild and operate the Guatemalan rail system (the "Usufruct"). Guatemalan railway system had been closed since March 1996.[1]

On November 25, 1997, FVG signed the Usufruct Contract of Right of Way ("Contract 402") with Ferrocarriles de Guatemala ("FEGUA"), a state-owned company responsible for providing certain railway transport services and managing the rail equipment and real estate assets. The Usufruct and Contract 402 were ratified by the Congress of Guatemala and came into force on May 23, 1998.[2] The Usufruct covered a narrow gauge railroad and included the right to develop alternative uses for the right of way (e.g., pipelines, commercial and institutional development); in return, RDC (through FVG) agreed to make payments to FEGUA[3].

In November 1997 Guatemala invited bids for the use of the FEGUA rail equipment, and FVG won the usufruct. On March 23, 1999, FEGUA and FVG signed Usufruct Contract No. 41 ("Contract No. 41"), which did not enter into force because of lack of approval by *acuerdo gubernativo*, such approval being necessary under Guatemalan law.[4] Since Contract No. 41 had not entered into force, FVG and FEGUA entered into Contract No.143 on August 28, 2003, and modified it in October 2003 by deed No. 158 ("Contract 143/158").[5]

FVG restored railway service between El Chile and Guatemala City in April 1999, and between Guatemala City and Puerto Barrios and Puerto Santo Tomás

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[1] Award, ¶ 30.
[2] *Id.*
[3] *Id.*, ¶ 31.
[4] *Id.*, ¶ 32.
[5] *Id.*, ¶ 33.

in December 1999[6]. However, on June 26, 2005, FVG initiated two arbitration cases against FEGUA, alleging that Guatemala (through FEGUA) breached the contract in particular, by failing to remove squatters from the rail right of way[7].

On August 1, 2005, the Attorney General of Guatemala issued Opinion No. 205-2005 ("Lesivo Opinion") and recommended that Guatemala declare Contract 143/158 void as not in the interest of the country[8]. Subsequently, on January 13, 2006, FEGUA issued Opinion 05-2006 that Contract 143/158 was not awarded as a result of a public bid[9]. On March 7, 2006, Claimant met with the President of Guatemala, who set up a commission to work with RDC and FVG. However, Guatemala also prepared a resolution declaring the usufruct of the rolling stock injurious to the interests of the State ("*Lesivo* Resolution"), which was adopted on August 11, 2006 and published on August 25, 2006.[10]

On June 14, 2007 RDC filed a Request for Arbitration before the International Centre for Settlement of Investment Disputes ("ICSID") against Guatemala on its own behalf and on behalf of FVG[11]. Respondent raised an objection to the jurisdiction of the Tribunal, and the Tribunal issued on November 17, 2008 its Decision on Objection to Jurisdiction under CAFTA Article 10.20.5 ("First Objection to Jurisdiction") and on May 28, 2010 its Second Decision on Objections to Jurisdiction pursuant to Article 10.20.4 and Article 25 of the ICSID Convention ("Second Decision on Jurisdiction"). In the later Decision the Tribunal rejected Respondent's objections *ratione temporis* and *ratione materiae* to its jurisdiction, but confirmed that its jurisdiction was limited to the *Lesivo* Resolution and the conduct subsequent to the *Lesivo* Resolution[12].

2. Legal Issues Discussed in the Decision

2.1. Indirect Expropriation (¶¶ 79-152)

Claimant alleged that Respondent indirectly expropriated Claimant's investment, since the *Lesivo* Resolution did not meet the requirements of Article 10.7.1 of CAFTA for a lawful expropriation[13]. The Tribunal chose to consider whether FVG had owned usufruct rights, and to proceed with the analysis of the

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[6] *Id.*, ¶ 34.
[7] *Id.*, ¶ 35.
[8] *Id.*
[9] *Id.*, ¶ 36.
[10] *Id.*, ¶ 37.
[11] *Id.*, ¶ 30.
[12] *Id.*, ¶ 20.
[13] *Id.*, ¶ 41.

nature of the *Lesivo Resolution*, its public purpose, Claimant's reasonable investment-backed expectations, and their economic impact on Claimant's investment[14].

(a) FVG's Usufruct Rights under Contract 143/158 (¶¶ 82-84)

In response to Respondent's assertions that Claimant could not claim expropriation of usufruct rights that FVG had not owned, the Tribunal recalled its reasoning in the Second Decision on Jurisdiction: even though Contract 41 had been never approved by *Acuerdo Gubernativo* and Congress, FEGUA authorized FVG by letters to use the equipment requested by FVG, and both parties to Contract 41 had acted as if Contract 41 would had been in effect[15]. Therefore, even if FEGUA's actions were *ultra vires*, principles of fairness prevent Guatemala from raising violations of its own law as a defense when it (through FEGUA) knowingly overlooked them and effectively approved an investment made in contradiction to its law[16]. The Tribunal also noted that, by authorizing the Attorney General by the *Lesivo Resolution* to undertake all necessary legal measures to "cease the binding force of the contract", Respondent had shown that it considered Contract 143/158 to be binding[17].

Thus, the Tribunal concluded that rights of FVG under Contract 143/158 were in effect and could have been expropriated by Respondent[18].

(b) The Character of the Government's Action (¶¶ 85-92)

The Tribunal noted that the *Lesivo Resolution* was a measure adopted by the executive branch, where Guatemala declared Contract 143/158 *lesivo* since it was harmful to the State, and instructed and authorized the Attorney General to take appropriate measures; accordingly, the Attorney General filed a *lesivo* claim with the Administrative Tribunal[19].

The Tribunal concluded that "(a) *lesivo* is unrelated to the performance of either party under the contract declared *lesivo*; (b) it leaves the rights of the parties unaffected; (c) it is a process that applies only to contracts with the State and its agencies; (d) a declaration of *lesivo* may or may not be accepted by the

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[14] *Id.*, ¶ 81.
[15] *Id.*, ¶ 82, citing the Second Decision on Jurisdiction, ¶¶ 141-144.
[16] *Id.*, ¶ 82, citing the Second Decision on Jurisdiction at ¶146; see also Award, ¶ 234.
[17] *Id.*, ¶ 83.
[18] *Id.*, ¶ 84.
[19] *Id.*, ¶ 85.

Administrative Tribunal; (e) if the declaration is accepted, the defendant would have the possibility to appeal the decision to the Supreme Court; and (f) if the *lesivo* declaration is confirmed, a *lesivo* contract is void *ab initio*."[20]

(c) The Purpose of the Measure (¶¶ 93-111)

Claimant made an allegation that the intent of Respondent was not to expropriate for a public purpose, but to transfer Claimant's usufruct rights to Mr. Ramón Campollo or other investors[21]. The Tribunal found that, although certain evidence shows interest of Mr. Héctor Pinto in the Southern Corridor, whether he was acting on behalf of himself or of Mr. Campollo, in April 2005 he desisted from pursuing this matter further, the Usufruct Contracts remained in effect for more than five years after the *Lesivo* Resolution, and Respondent did not make any attempt to transfer the railway concession from Claimant to Mr. Campollo[22].

Thus, the Tribunal concluded that Claimant had failed to prove that the purpose of the *Lesivo* Resolution was to deprive Claimant of its usufruct rights for the benefit of Mr. Campollo[23]. However, the Tribunal noted that Respondent used the *Lesivo* Resolution to put pressure on Claimant to invest more, irrespective of its obligations under Contract 402, or forfeit the railway concession in favor of other investors, and this matter is to be addressed when considering the alleged breach of the minimum standard of treatment[24].

(d) Investment-backed Expectations (¶¶ 112-123)

Claimant asserted that *Lesivo* Resolution had undermined its investment-backed expectations[25]. The Tribunal noted that an investor "may not have legitimate expectations that a government would not make mistakes in assessing one's legal rights", but the real issue is whether "if mistakes are made, other parties who had acted on such mistakes in good faith … should have the right to expect that the party who made the mistake would bear the consequences"[26].

In the present case, Claimant won three contracts through a bidding process. Whereas first two were approved by *acuerdo gubernativo*, the third, Contract 41,

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[20] *Id.*, ¶ 91.
[21] *Id.*, ¶ 93.
[22] *Id.*, ¶ 109.
[23] *Id.*, ¶ 110.
[24] *Id.*, ¶ 111.
[25] *Id.*, ¶ 112.
[26] *Id.*, ¶ 116.

has never been approved[27], and no explanation for this has been provided[28]. Under such circumstances an investor could reasonably expect that the third contract would also be ratified, especially taken into account that both FEGUA and FVG started to implement contracts after they were awarded and signed, prior to ratification by *acuerdo gubernativo*[29]. Although Respondent has not ratified Contract 41, it benefited from the re-opening of the railway, and FEGUA accepted payments for the use of its equipment without any objection[30].

The Tribunal took the view that it was legitimate for Claimant to believe that its actions were not harmful to the interest of the State, since it was providing a service that Guatemala had decided to privatize (and which "in state hands had already irretrievably broken down"), and the Usufruct Contracts had been secured through competitive bidding under conditions stipulated by Respondent[31]. Thus, the Tribunal concluded that actions of Respondent and its agency, FEGUA, created the expectation of Claimant to have a legally valid contract[32].

(e) The Economic Impact of the Government's Action (¶¶ 124-152)

The Tribunal addressed the link between the availability of the equipment and Contract 402; the extent to which Respondent linked the issues of Contract 143/158 to the overall investment; and the effect of the *Lesivo* Resolution on Claimant's investment[33].

Although contracts for the right-of-way and for the use of railway equipment were bid separately[34], Contract 402 empowered Claimant to terminate it if Claimant could not obtain necessary railway equipment of FEGUA[35], and Respondent itself considered railway equipment of FEGUA to be an important issue in the negotiations regarding alleged illegalities of Contract 143/158[36].

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[27] *Id.*, ¶ 117.
[28] *Id.*, ¶ 120.
[29] *Id.*
[30] *Id.*, ¶ 122.
[31] *Id.*
[32] *Id.*, ¶ 123.
[33] *Id.*, ¶ 139.
[34] *Id.*, ¶ 140.
[35] *Id.*, ¶ 141.
[36] *Id.*, ¶ 143.

Also, the Tribunal found that statements made by the President of Guatemala were "clear and consistent in linking *lesividad* to the overall investment of Claimant"[37] and "the President's declaration that a contract which is an integral part of an investment is harmful to the interests of the State is a powerful tool that creates at least uncertainty in the minds of users"[38].

The Tribunal stated that an expropriation takes place if "an effect of the measures is that the claimant is deprived substantially of the use and benefits of the investment"[39]. Since Contract 143/158 and Contract 402 remained in effect more than five years after the *Lesivo* Resolution; Claimant had continued to be in possession of the railway equipment and to receive rents associated with its real estate rights under Contract 402, which amounted to 92% of FVG's revenues, – the Tribunal concluded that the effect of Respondent's measures on Claimant's investment does not rise to the level of an indirect expropriation[40].

2.2. National Treatment (¶¶ 153-155)

Claimant alleged that Respondent breached the national treatment standard of CAFTA Article 10.3[41]. However, the Tribunal rejected Claimant's allegations that RDC and Ramón Campollo are, respectively, foreign and domestic investors in "like circumstances" and Respondent treated Claimant differently from Mr. Campollo, since Claimant had not shown that the purpose of the *Lesivo* Resolution was to favor Mr. Campollo; Claimant had continued to have its contractual rights to the right-of-way and had remained in possession of the railway equipment for more than five years after the *Lesivo* Resolution; and there is a difference in scale between the railroad for the exclusive exploitation of the sugar plantation of Mr. Campollo in the Dominican Republic and the railway operation of Claimant in Guatemala[42].

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[37] *Id.*, ¶ 146.

[38] *Id.*, ¶ 147.

[39] *Id.*, ¶ 151, referring to *Metalclad Corporation v United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of August 30, 2000, ¶ 103; *Pope and Talbot, Inc v Canada*, NAFTA (UNCITRAL), Partial Award of June 26, 2000, ¶ 102; *Técnicas Medioambientales Tecmed SA v United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award of May 20, 2003; *CMS Gas Transmission v Argentina*, ICSID Case No. ARB/01/8, Award of May 12, 2005, ¶ 262; *Telenor Mobile Communications SA v Republic of Hungary*, ICSID Case No ARB/04/15, Award of September 13, 2006, ¶ 65; *Fireman's Fund Insurance Company v United Mexican States*, ICSID Case No ARB(AF)/02/1, Award of July 14, 2006, ¶ 176(c).

[40] *Id.*, ¶ 152.

[41] *Id.*, ¶ 52.

[42] *Id.*, ¶ 153.

With respect to the allegation of Claimant that Guatemala discriminated against RDC when it attempted to coerce RDC to surrender a part of the railway in favor of "other investors" in exchange for abandoning the *Lesivo* Resolution, the Tribunal chose to review it under the minimum standard of treatment[43].

Thus, the Tribunal found that the allegation of breach by Respondent of national treatment standard was without merit[44].

2.3. Minimum Standard of Treatment (¶¶ 156-236)

Claimant argued that Respondent did not treat it fairly and equitably[45].

(a) The Applicable Standard (¶¶ 212-219)

The Tribunal recalled that Article 10.5.1 of CAFTA requires each Party to "accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security", Article 10.5.2 of CAFTA stipulates that "…paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments", and Annex 10-B clarifies that " 'customary international law' … results from a general and consistent practice of States that they follow from a sense of legal obligation"[46].

Further, the Tribunal rejected the suggestion that *Neer* case formulated the minimum standard of treatment after the analysis of state practice[47]. It noted that although arbitral awards, as such, do not constitute State practice, to use them is "an efficient manner for a party in a judicial process to show what it believes to be the law"[48]. Furthermore, the Tribunal recalled that "the customary international law … is not 'frozen in time' and that the minimum standard of treatment evolves. … what customary international law projects is not a static photograph of the minimum standard … as it stood in 1927 when the Award in

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[43] *Id.*, ¶ 154.

[44] *Id.*, ¶ 155.

[45] *Id.*, ¶ 156.

[46] *Id.*, ¶ 212.

[47] *Id.*, ¶ 216, citing *L.F.H. Neer and Pauline Neer (U.S.A.) v. United Mexican States* (1926) 4 R.I.A.A, p. 61, ¶ 4: "… the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency".

[48] *Id.*, ¶ 217.

the *Neer* case was rendered."[49] Accordingly, the Tribunal stated that *Waste Management II* integrates the analysis of previous NAFTA Tribunals, and chose to apply its "arbitrary, grossly unfair, and unjust" standard to the present case[50].

(b) The Application of the Minimum Standard of Treatment (¶¶ 220-236)

The Tribunal noted *lesivo* power of Guatemala to invalidate its own acts within three years since their occurrence is an extraordinary remedy[51], is characterized by inherent legal uncertainty[52], may be easily abused[53], and, if used outside of truly exceptional circumstances (*e.g.*, cases of corruption), may violate the minimum standard of treatment[54].

The Tribunal held that the manner of and grounds for application of the *lesivo* power by Respondent had constituted a breach of the minimum standard of treatment under Article 10.5 of CAFTA by being arbitrary, grossly unfair, and unjust[55]. Respondent declared *lesivo* Contract 143/158 for the use of railway equipment for which FEGUA received payments without any objection[56]. Contract 143/158 was concluded at the initiative of FEGUA after Respondent had failed, for unknown reasons, to secure approval of Contract 41, which FVG won through public bidding, by *acuerdo gubernativo*[57]. *Lesivo* Resolution was justified, in part, by the failure of ratification and lack of public bidding for Contract 143/158 for the use of the same equipment as under Contract 41, both matters

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[49] *Id.*, ¶ 218, citing *ADF Group Inc. v. United States*, ICSID Case No. ARB (AF)/00/1 (NAFTA), Award of January 9, 2003, *Id.*, ¶ 179.

[50] *Id.*, ¶ 219, citing *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of April 30, 2004, (Waste Management II), ¶ 98: "… the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."

[51] *Id.*, ¶ 222.

[52] *Id.*, ¶ 229.

[53] *Id.*, ¶¶ 222, 233.

[54] *Id.*, ¶ 233: "alleged inevitability of the process together with 'illegality' having equal status with *lesividad* mean that an extraordinary remedy may become routine once any 'illegality' of a Government act has been identified by the Government itself".

[55] *Id.*, ¶ 235.

[56] *Id.*, ¶¶ 225, 235.

[57] *Id.*, ¶¶ 226, 235.

being under control of Respondent[58]. Grounds for *lesivo* referred to the terms of Contract 41 which Respondent itself proposed, and FVG and FEGUA had inserted into Contract 143/158[59]. Respondent had been fully aware of the use of the railway equipment at issue by FVG since 1998, and without said equipment could not have performed its obligations under Contract 402[60]. FEGUA acknowledged that FVG's obligations under Phase I and II of the railway rehabilitation had been performed satisfactory, while FVG had used the same railway equipment first under the exchange of letters with FEGUA and later under Contract 143/158[61]. Respondent's proposals, as conditions for not proceeding further with *lesivo*, were mostly unrelated to the curing of *lesivo*; Respondent used *Lesivo* Resolution as a tactic to coerce Claimant to invest more, irrespective of its obligations under Contract 402, or forfeit the railway concession in favor of other investors[62].

2.4. Full Protection and Security (¶¶ 237-238)

Claimant alleged that Respondent had failed to afford Claimant's investment full protection and security under CAFTA Article 10.5, mainly by failing to protect FVG's right-of-way from squatters[63]. For the reasons of procedural economy, the Tribunal chose not to consider this allegation, since, first, the jurisdiction of the Tribunal extended only to "acts or omissions of Respondent related to squatters, but only to the extent that these result from the *Lesivo* Resolution[64]", whereas the problem with squatters had been continuous and it would be hard to isolate those aspects of it over which the Tribunal had jurisdiction, and, second, breach of full protection and security would not have entitled Claimant to greater relief than the relief already established for the breach of minimum standard of treatment by Respondent[65].

2.5. Damages (¶¶ 239-277)

Although CAFTA's provisions on compensation refer only to the case of expropriation[66], the Tribunal found that in accordance with customary international law, as reflected in the ILC Articles, the State "is under an

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[58] *Id.*, ¶¶ 228, 234, 235.
[59] *Id.*, ¶¶ 229, 235.
[60] *Id.*, ¶¶ 226, 235.
[61] *Id.*, ¶¶ 226, 235.
[62] *Id.*, ¶¶ 227, 230; see also Award at ¶ 111.
[63] *Id.*, ¶ 237.
[64] *Id.*, ¶ 237, citing the Second Decision on Objections to Jurisdiction, ¶ 155.
[65] *Id.*, ¶ 238.
[66] *Id.*, ¶ 259.

obligation to make full reparation for the injury caused by the internationally wrongful act."[67]

In addition, the Tribunal expressed its concern regarding the possibility of double recovery, and noted that the return of investment assets to host State as a condition for payment under an award is "not uncommon" in indirect expropriation cases and "not unknown" in cases involving breach of the fair and equitable treatment standard[68].

Thus, the Tribunal concluded that Claimant should be compensated fully for the injury it had suffered, and the payment of the awarded amount is conditioned upon the transfer of Claimant's shares in FVG to Respondent[69].

3. Decision (¶ 283)

The Tribunal held that Respondent breached the minimum standard of treatment under Article 10.5 of CAFTA in respect of Claimant's investment. Therefore, it decided that Respondent should pay Claimant: a) $6,576,861 on account of its investment in Phases I and II; b) $1,350,429 for operating the railroad for another year after the *Lesivo* Resolution which permitted an orderly closure of the railroad service; and c) $3,379,450.93 – the NPV of the existing real estate leases measured over their remaining life as of the date of *Lesivo* – minus rents paid to FVG under such leases post-*lesivo*; the awarded amount of compensation should be subject to compound interest at a rate equivalent to six-month LIBOR plus two percentage points as from the date of the *Lesivo* Resolution to the date of payment. On payment of the awarded compensation, Claimant should forfeit and renounce all its rights under the Usufruct Contracts and transfer to Respondent Claimant's shares in FVG. Respondent should be responsible for the administrative expenses of ICSID and fees and expenses of the Tribunal related to the two jurisdictional phases, and each party should be responsible for 50% of the remainder of administrative expenses of ICSID and of the fees and expenses of the Tribunal, as well as for its own counsel fees and expenses.

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[67] *Id.*, ¶ 260, citing the ILC Articles, Article 31.1.

[68] *Id.*, ¶¶ 263, 265, referring to *ADC v. Hungary*, ICSID Case No. ARB/03/16, Award of October 2, 2006, ¶ 543.4; *Técnicas Medioambientales S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award of May 20, 2003, ¶ 199; *CMS Gas Transmission Company v. The Argentine Republic*, Award of 12 May 2005.

[69] *Id.*, ¶¶ 265, 267.