

# International Arbitration Case Law

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**SGS SOCIÉTÉ GÉNÉRALE DE SURVEILLANCE S.A.  
AND  
THE REPUBLIC OF PARAGUAY  
ICSID CASE NO. ARB/07/29**

Case Report by Kate Nadeau \*\*  
Edited by Ignacio Torterola \*\*\*

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In a decision rendered on 10 February 2012, under the Agreement on the Promotion and Reciprocal Protection of Investments between Switzerland and Paraguay and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, the Tribunal found that Respondent breached its obligations under Article 11 of the bilateral investment treaty.

**Members of the Tribunal**

Dr. Stanimir A. Alexandrov, President; Mr. Donald Francis Donovan; Dr. Pablo García Mexía and Mrs. Mercedes Cordido-Freytes de Kurowski Secretary of the Tribunal

**Claimant's Counsel**

Mr. Olivier Merkt and Mr. Nicolas Grégoire, Société Générale de Surveillance S.A., Geneva, Switzerland and Mr. Paul Friedland and Mr. Damien Nyer, White & Case LLP, New York

**Respondent's Counsel**

Dr. José Enrique García Ávalos, Procurador General de la República del Paraguay, Asunción, Paraguay and Mr. Brian C. Dunning, Ms. Irene Ribeiro Gee, and Mr. David Cinotti, Venable LLP, New York

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On 19 October 2007, the International Centre for Settlement of Investment Disputes (“ICSID” or the “Centre”) received a request for arbitration (the “Request”) dated 16 October 2007 from SGS Société Générale de Surveillance S.A. (“SGS” or “Claimant”) against the Republic of Paraguay (“Paraguay” or “Respondent”) (collectively, the “parties”). The Request was made under the Agreement on the Promotion and Reciprocal Protection of Investments between Switzerland and Paraguay signed 31 January 1992 and entered into force 28 September 1992 (the “BIT” or the “Treaty”), and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“ICSID Convention” or “Convention”). Claimant is a Swiss company.

## 1. FACTS OF THE CASE

### 1.1 The Contract

In 1995, the Ministry of Finance of Paraguay invited five companies including SGS and the Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. (“BIVAC”) to submit bids to provide “pre-shipment” inspection services, *i.e.*, services involving the inspection of imported goods prior to shipment to ensure the accurate collection of import information and facilitate collection of customs duties. SGS and BIVAC were selected. On 6 May 1996, the Ministry of Finance and SGS signed an Agreement on the Rendering of Technical Services for Import Pre-Shipment Inspection (the “Contract”). The Contract was to remain in effect for three years, starting on 15 July 1996.<sup>1</sup>

The Contract required SGS to provide three categories of “technical services”: (1) pre-shipment inspection and related services, which would include the issuance of Inspection Certificates or Discrepancy Reports; (2) training to Paraguayan Customs officials with the purpose of reaching an efficient and effective execution and protection of tax revenues and to make up a body of officials specialized in customs valuation; and (3) create a Customs database for organizing the information in the Inspection Certificates and train Paraguayan officials to use the database.<sup>2</sup>

Under the Contract, SGS carried out physical inspections of goods being imported and provided Customs with its opinion on the appropriate customs value and tariff classification of the shipment and verified the country of origin.<sup>3</sup> After the inspection, SGS would provide Customs with a copy of either an Inspection Certificate or, if SGS disagreed with the importer’s shipment documentation, a Discrepancy Report. SGS would also provide Customs with a monthly report that would include, among other things, the details of the inspections conducted during the month. SGS and Customs met on a weekly basis, and sometimes twice weekly, to discuss the inspections.<sup>4</sup>

Paraguay agreed to pay SGS the larger of (a) a fee equal to 1.3% of the FOB value of the goods shown in the Inspection Certificate or the Discrepancy Report or (b) US\$ 280. SGS would send the Ministry a monthly invoice denominated in U.S. dollars, and the invoices were to be paid within 20 days after receipt. If the Ministry of Finance disputed an invoice, the Ministry was required to pay any undisputed amounts.<sup>5</sup>

SGS posted a US\$ 250,000 performance bond and the Contract contained a forum selection clause that stated that any conflict deriving from the Contract should be submitted to the City of Asunción

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<sup>1</sup>SGS Societe General de Surveillance S.A. v. The Republic of Paraguay, ICSID Case No. ARB/07/29., ¶5.

<sup>2</sup>*Id.*, ¶ 28, 29, 30, 31.

<sup>3</sup>*Id.*, 32.

<sup>4</sup>*Id.*, 33.

<sup>5</sup>*Id.*, 34.

under the Law of Paraguay.<sup>6</sup> The Contract also included a termination clause.<sup>7</sup>

Paraguay issued several regulations governing the provision of services including: (1) Resolution 1171 that required inspections for small shipments valued at less than US\$3,000 when such shipments were part of a larger order or a consolidated bill of lading that exceeded US\$ 3,000 and (2) Resolution 1579 that exempted certain shipments from pre-shipment inspection.<sup>8</sup>

In June 1999, the end of the Contract's three-year term, the parties terminated the Contract by mutual agreement.<sup>9</sup>

## 1.2 Unpaid Invoices

During the term of the Contract, SGS conducted approximately 100,000 inspections and issued 35 monthly invoices to the Customs of Paraguay. The Ministry of Finance paid only ten of those invoices; 25 of SGS's 35 invoices were not paid, totaling (in principal, not including interest) US\$ 39,025,950.86.<sup>10</sup>

Between July 1996 and the time when the Contract was terminated in June 1999, officials from SGS and the Government of Paraguay engaged in an ongoing dialogue regarding the unpaid invoices and the terms of the Contract.<sup>11</sup> In July 1998, the Ministry of Finance sent a letter to SGS acknowledging receipt of SGS's invoices for pre-shipment inspection services rendered to the government of the Republic of Paraguay, totaling, at that time, approximately US\$ 24 million.<sup>12</sup> The Ministry of Finance did not disburse national budget monies to pay SGS.<sup>13</sup>

Government officials repeatedly promised to pay SGS. SGS also agreed to reduce its minimum fee, and for oil products to retroactively reduce the service fee for the period January-August 1997 and cease inspections of oil products from September 1, 1997.<sup>14</sup>

During the life of the Contract, Paraguay never informed SGS of any problems with the performance of the pre-shipment inspection services, training, or database.<sup>15</sup> From the time of the first non-payment, SGS persistently sought payment for the 25 unpaid invoices.<sup>16</sup> From September 1998 through 2006, SGS was subject to Government examinations and investigations relating to the performance of the Contract and SGS's business conduct within Paraguay (evading taxes).<sup>17</sup>

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<sup>6</sup>*Id.*, 35, 36.

<sup>7</sup>*Id.*, 37.

<sup>8</sup>*Id.*, 38.

<sup>9</sup>*Id.*, 39.

<sup>10</sup>*Id.*

<sup>11</sup>*Id.*, 40.

<sup>12</sup>*Id.*, 44.

<sup>13</sup>*Id.*, 42,46.

<sup>14</sup>*Id.*, 42, 43.

<sup>15</sup>*Id.*, 154.

<sup>16</sup>*Id.*, 165.

<sup>17</sup> *Id.*, 48-61.

## 2. LEGAL ISSUES DISCUSSED

In February 2010, the tribunal in its Decision on Jurisdiction found that it had jurisdiction over the claims, that the claims were admissible, and that the Tribunal was required to provide a decision on the claims.<sup>18</sup>

### 2.1 Assessment of Claims Under Article 11 of the BIT

The Tribunal decided whether Paraguay breached its obligations under Article 11 of the BIT to observe commitments it entered into with SGS. The Tribunal also determined whether Paraguay impaired SGS's investment by undue and discriminatory measures in violation of Article 4(1) of the BIT and denied SGS fair and equitable treatment in violation of Article 4(2) of the BIT.<sup>19</sup>

The Tribunal concludes that Paraguay breached its obligations under Article 11 of the BIT and therefore, did not address claims under Article 4(1) and 4(2) of the BIT, as they arise out of identical facts and would not, even if the Tribunal were to find a violation, result in increasing the damages owed to SGS.<sup>20</sup>

#### (a) Abuse of Sovereign Powers is Not Required to Breach Article 11 of the BIT

The Tribunal does not accept that an abuse of sovereign authority is necessary to prove a violation of Article 11. Article 11 of the BIT states, "Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party."<sup>21</sup> Article 11 does not state or imply that a government will only fail to observe its commitments if it abuses its sovereign authority. In standard principles of treaty interpretation, a breach of contract by Paraguay with respect to an investment of a Swiss investor is a breach of Article 11.<sup>22</sup>

The Tribunal found that most case law cited by the Respondent was inapposite not standing for the proposition that an abuse of sovereign authority is necessary in order to establish a breach of an umbrella clause – Article 11 of the BIT. The Tribunal parted ways with *SGS v. Pakistan* for the proposition that the "commitment" protected by an umbrella clause does not include mere contracts. The Tribunal found that Article 11 of the BIT provides no basis for excluding contracts from the scope of "commitments" covered in the Article. Similarly, the Tribunal disagrees with the *Siemens* award to the extent that it concluded that an abuse of sovereign power was necessary to establish a breach of an umbrella clause. The Tribunal followed the reasoning of other ICSID tribunals that have concluded that the umbrella clause may apply whether or not the exercise of sovereign power is involved.<sup>23</sup>

Paraguay failed to observe its contractual commitments, and as such, breached Article 11.<sup>24</sup>

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<sup>18</sup> *Id.*, 71.

<sup>19</sup> *Id.*, 66.

<sup>20</sup> *Id.*, 67.

<sup>21</sup> *Id.*, 89, 90.

<sup>22</sup> *Id.*, 91.

<sup>23</sup> *Id.*, 93.

<sup>24</sup> *Id.*, 95.

### **(b) A Forum Selection Clause Does Not Preclude a Finding of Liability**

The Tribunal rejected the defense that the Contract was not breached because the claims were required to be resolved in the local courts based on a forum selection clause.

First, no legal authority had been cited in support of Respondent's position.<sup>25</sup>

Second, the payment and dispute resolution provisions in the Contract were two separate obligations. If Respondent failed to comply with its payment obligations and if it frustrated attempts to submit disputes to local courts in accordance with the forum selection clause, then, Respondent failed to comply with two commitments under the Contract.<sup>26</sup>

Third, the Contract could not be negotiated in the expectation that the forum selection clause would negate responsibility under the BIT. The Respondent separately agreed to arbitration in accordance with the BIT, and by doing so, offered to Swiss investors an alternative forum for dispute settlement. The BIT arbitration mechanism formed part of the applicable legal framework and became an irrevocable part of the bargain.<sup>27</sup>

### **(c) Claimant Did Not Breach the Contract**

The Tribunal determined whether the Claimant breached the Contract by: (i) failing to train Customs officials and establish a usable database; (ii) issuing multiple invoices for certain Certificates of Inspection; (iii) improperly conducting inspections and issuing invoices for imports from the Mercosur region; and (iv) improperly conducting inspections and issuing invoices for imports of petroleum products.

#### **(i) Burden of Proof Not Met with Respect to Claim that Claimant Failed to Train Customs Officials and Establish a Database**

The Tribunal rejected letters from Customs (March 1999) and the Ministry of Finance's internal auditor (January 2003) stating that neither report provided evidence for its conclusions that Claimant failed to provide training and establish a database.<sup>28</sup> The Tribunal found that Claimant provided contemporaneous documentation (in the form of its 1998 letter to Customs) as well as testimony from Mr. Musalem, a knowledgeable and credible witness, regarding the services that it provided. Such services included training, the provision of hardware and software, and the provision of data for the database. No evidence was provided that Respondent contested the information in SGS's 1998 letter.<sup>29</sup>

The Respondent relied on three Customs reports stating that the training requirement of the Contract had not been met. In fact, the author of the first letter, a document invoked by Respondent, a Customs Report from March 1999, expressly admits that he is "totally ignorant" ("cabemanifestar el totaldesconocimiento") of most of the issues referred to in Claimant's 1998 letter and in the Contract. The 1999 Customs Report simply stated that the training "has not been done" but does not provide any further justification. The other two documents that Respondent

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<sup>25</sup> *Id.*, 104.

<sup>26</sup> *Id.*, 104, 105.

<sup>27</sup> *Id.*, 107.

<sup>28</sup> *Id.*, 117.

<sup>29</sup> *Id.*, 119.

relied upon were conclusory and failed to identify deficiencies in the services SGS provided with any meaningful specificity.<sup>30</sup> In addition, the Tribunal found that Respondent never provided the Reports to Claimant. There was no evidence that any problem was ever raised during the life of the Contract.<sup>31</sup>

The Respondent provided no legal authority supporting its position that it would therefore be relieved of any obligation to make payments under the Contract even while continuing to accept SGS's inspection services. No provision in the Contract provides such authority. The Contract does not allow the allegedly aggrieved party to continue to demand performance while simply ceasing to meet its own contractual obligations.<sup>32</sup>

## **(ii) Burden of Proof Not Met with Respect to Claim that Claimant's Invoicing Practices were Impermissible**

The Tribunal finds that Respondent has not carried its burden of proof that Claimant's invoicing practices were impermissible. The question was whether Claimant, when inspecting a larger shipment exceeding the value threshold stated in the Contract, should be allowed to file an invoice for each individual shipment within the larger shipment inspected and how should it be priced by Claimant.<sup>33</sup>

The only apparent way Claimant could provide a pre-inspection, as required by the Contract, was to inspect the small shipments associated with the larger invoice. Resolution 1171 under the Contract is not clear how such inspections should be charged, and neither party provided legal authority to assist the Tribunal in understanding how Resolution 1171 should be interpreted. The Tribunal's declared that it would not be reasonable to conclude that the parties intended that Claimant charge nothing for the inspections.<sup>34</sup>

With respect to pricing, Claimant could charge either a minimum fee or percentage when that was greater. The question was whether, when charging for smaller shipments associated with a larger invoice, should Claimant have charged the minimum fee for each inspection or the percentage of the shipment as a whole. The Claimant had charged the minimum amount. In the Tribunal's view, this was a reasonable approach, as there is no evidence to show that the cost of any individual inspection would be lower if the component shipments were of lower value. Furthermore, this was SGS's uniform practice throughout the performance of the Contract to charge the minimum fee in these circumstances. Respondent provided no evidence that it told Claimant that it objected to this approach.<sup>35</sup>

Lastly, Respondent's March 1999 Report concluded that Claimant's methodology was inappropriate; however, that the report was not communicated to Claimant.<sup>36</sup>

The Tribunal therefore concludes that Claimant's invoicing methodology did not violate its contractual obligations.<sup>37</sup>

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<sup>30</sup> *Id.*

<sup>31</sup> *Id.*, 120.

<sup>32</sup> *Id.*, 121.

<sup>33</sup> *Id.*, 129.

<sup>34</sup> *Id.*, 130, 131.

<sup>35</sup> *Id.*, 132.

<sup>36</sup> *Id.*, 132.

<sup>37</sup> *Id.*

### **(iii) Claimant did not Improperly Inspect Goods Originating from the Mercosur Region**

The Tribunal finds that Respondent has not carried its burden of proof in establishing that Claimant improperly inspected shipments from the Mercosur region.

Respondent provided no legal authority for its position apart from the language of Resolution 1579. Resolution 1579 exempts from inspection those goods that are exempted from customs duties and internal taxes. Respondent argues that the phrase should be interpreted to exempt goods from inspection if they were exempt from either customs duties or internal taxes. The Tribunal interpreted the relevant provision, as written and in context, as exempting a single class of goods. The preamble to Resolution 1579 states that the purpose of the Resolution is to ensure that merchandise is not subject to pre-shipment inspection if the merchandise is exempt from “all customs duties and non-customs taxes” (“todotributo, aduanero y no aduanero”) (emphasis added).

Furthermore, as Claimant argues and Respondent does not dispute, imports from the Mercosur region were subject to VAT and sales tax, and such taxes were assessed based on the price referenced in the Inspection Certificate. Respondent argued that the Treaty of Asunción requires Paraguay to accept, for duty assessment purposes, the declared customs value without the need for an inspection. The Tribunal found that the portions of the Treaty of Asunción on which Respondent relies do not require Paraguay to accept the declared value for purposes of assessing internal taxes. Therefore, it was necessary for SGS to conduct the inspections for tax assessment purposes. The Tribunal found that the Claimant should be able to invoice the inspections, particularly if such imports accounted for 50 to 70 percent of the total imports into Paraguay.

The Tribunal is also persuaded that it would be unlikely for an importer to request an inspection for an import from the Mercosur region that was exempt from both customs duties and internal taxes.

For these reasons, the Tribunal concludes that Respondent has not carried its burden in proving that Claimant breached its contractual commitments.

### **(iv) Claimant did not improperly invoice Paraguay for the inspection of petroleum imports after September 1, 1997**

The Tribunal concludes that Respondent has not carried its burden in proving that Claimant improperly invoiced Paraguay for the inspection of petroleum imports after September 1, 1997. The Tribunal noted that the Respondent provided no evidence that the imports were for petroleum products rather than equipment. Furthermore, Claimant declared that it credited Paraguay for any invoices associated with petroleum product shipments in September 1997; Respondent did not dispute this declaration. As such, Claimant is entitled to damages for unpaid invoices associated with those inspections.<sup>38</sup>

## **2.2 Whether Respondent Has Failed to Guarantee the Observance of Its Contractual Commitments**

Claimant’s invoices were not paid. Under the Contract, if there were any disagreement between the parties regarding the invoices, Respondent could have paid the uncontested portions of the invoices

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<sup>38</sup> *Id.*, 150, 152.

and contested the remainder. However, Respondent ceased payment without contesting certain invoices and did not pay uncontested invoices.<sup>39</sup>

Accordingly, the Tribunal finds that Respondent failed to observe its contractual commitments in breach of Article 11 of the BIT.<sup>40</sup>

### **2.3 Article 11 Claims Based on Alleged Extra-Contractual Commitments**

The Tribunal was questioned whether “extra-contractual” statements made by Paraguayan officials promising to pay SGS’s invoices created additional enforceable commitments under Article 11 of the BIT or were outside the contract and inadmissible as they related to settlement discussions between the parties. The Tribunal decided that it need not resolve these matters because the resolution would not result in additional liability on behalf of Respondent.<sup>41</sup>

### **2.4 Claimant’s Remaining Claims**

The question was whether Respondent’s actions impaired Claimant’s investment by undue and discriminatory measures in violation of Article 4(1) of the BIT and amounted to a denial of fair and equitable treatment under Article 4(2) of the BIT.<sup>42</sup>

In light of the Tribunal’s conclusion that Respondent breached Article 11 of the BIT by failing to meet its payment obligations under the Contract, the Tribunal found it unnecessary to resolve these claims as they arose out of the same facts and it would not result in additional liability on behalf of Respondent.<sup>43</sup>

### **2.5 Respondent’s Claim of Prejudice**

The Tribunal found that Respondent was not unduly prejudiced.

The fact that Claimant waited several years after the termination of the Contract to initiate dispute settlement proceedings did not prejudice Respondent. The facts are the same and Respondent was obligated to pay properly issued invoices.<sup>44</sup> Also, the fact that Respondent failed to preserve its own records did not prejudice Respondent as it was the responsibility of the Respondent.<sup>45</sup> Finally, Claimant continued to seek payment of its invoices even following the termination of the contract. Claimant delayed initiating the arbitration because the parties were continuing to discuss a resolution.<sup>46</sup> Accordingly, Respondent was not unduly prejudiced.

The Tribunal noted that the BIT at issue does not contain a period of limitation that would prevent Claimant’s claims.<sup>47</sup>

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<sup>39</sup> *Id.*, 154.

<sup>40</sup> *Id.*, 155.

<sup>41</sup> *Id.*, 157, 158.

<sup>42</sup> *Id.*, 160.

<sup>43</sup> *Id.*, 161.

<sup>44</sup> *Id.*, 163.

<sup>45</sup> *Id.*, 164.

<sup>46</sup> *Id.*, 165.

<sup>47</sup> *Id.*, 166.

### 3. DECISION

The Tribunal found that Respondent breached its obligations under Article 11 of the BIT by failing to guarantee the observance of the commitments it has entered into with respect to Claimant's investment.<sup>48</sup>

The Tribunal found that it does not need to resolve Claimant's claim that Respondent's failure to fulfill its alleged extra-contractual promises of payment constituted an additional breach of Article 11 of the BIT because (i) those claims ultimately derive from the same set of facts and commitments that gave rise to the Tribunal's conclusion that Respondent breached Article 11 of the BIT by failing to guarantee the observance of the contractual commitments it has entered into with respect to Claimant and (ii) even if the Tribunal were to find an additional breach of the BIT due to Respondent's alleged failure to fulfill its extra-contractual promises, the finding would not affect the quantum of damages.<sup>49</sup>

The tribunal found that it does not need to resolve Claimant's claims that Respondent breached Articles 4(1) and 4(2) of the BIT because (i) such claims ultimately derive from the same set of facts and contractual commitments that gave rise to the Tribunal's conclusion that Respondent breached Article 11 of the BIT by failing to guarantee the observance of the contractual commitments it entered into with respect to Claimant's investment and (ii) even if the Tribunal were to find an additional breach of Articles 4(1) and 4(2) of the BIT, the finding would not affect the quantum of damages.<sup>50</sup>

The Tribunal concludes that Claimant is entitled to damages equal to the amount of the unpaid invoices plus interest accruing from July 1999, the first month after the Contract was terminated, is consistent with Article 38(2) of the International Law Commission's (ILC) Articles on State Responsibility and the UNIDROIT Principles of International Commercial Contracts.<sup>51</sup>

With respect to principal, the Tribunal found that Claimant is entitled to the entire amount of the unpaid invoices totaling US\$ 39,025,950.86. For interest, the Tribunal has concluded that it would be appropriate to apply the LIBOR rate plus one percentage point.<sup>52</sup>

Lastly, the Tribunal awarded Claimant one-half of the amount of US\$ 673,923.28, which is the total amount of the costs of the arbitration.<sup>53</sup>

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<sup>48</sup> *Id.*, 194.

<sup>49</sup> *Id.*, 195.

<sup>50</sup> *Id.*, 196.

<sup>51</sup> *Id.*, 171.

<sup>52</sup> *Id.*, 167-188.

<sup>53</sup> *Id.*, 189-192.