INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

In the Matter of the Arbitration between

RAILROAD DEVELOPMENT CORPORATION (RDC)
Claimant

and

REPUBLIC OF GUATEMALA
Respondent

ICSID CASE NO. ARB/07/23

AWARD

MEMBERS OF THE TRIBUNAL
Dr. Andrés Rigo Sureda, President
Honorable Stuart E. Eizenstat, Arbitrator
Professor James Crawford, Arbitrator

SECRETARY OF THE TRIBUNAL
Natalí Sequeira

REPRESENTING THE CLAIMANT:

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

REPRESENTING THE RESPONDENT:

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 *(until April 26, 2012)*
Mr. Whitney Debevoise
Mr. Daniel Salinas Serrano *(until May 7, 2012)*
Ms. Margarita R. Sánchez, Ms. Giselle Fuentes
Ms. Dawn Yamane-Hewett, Ms. Mallory Silberman
Arnold & Porter LLP

DATE OF DISPATCH: June 29, 2012

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AWARD

I. PROCEDURE

1. On June 14, 2007, Railroad Development Corporation ("RDC" or "Claimant") filed before the International Centre for Settlement of Investment Disputes ("ICSID" or the "Centre") a Request for Arbitration against the Republic of Guatemala ("Respondent', "Guatemala" or the "Government") on its own behalf and on behalf of Compañía Desarrolladora Ferroviaria, S.A., a Guatemalan company which does business as Ferrovías Guatemala ("FVG") and is majority-owned and controlled by RDC. The Request was brought under the Dominican Republic – Central America – United States of America ("United States") Free Trade Agreement[1] ("CAFTA" or the "Treaty"). ICSID registered the Request for Arbitration on August 20, 2007.

2. Pursuant to CAFTA Article 10.19.1, Claimant appointed the Honorable Stuart E. Eizenstat (United States of America); Respondent appointed Professor James Crawford (Australia). Pursuant to Article 10.19.3, the Acting Secretary-General of ICSID appointed Dr. Andrés Rigo Sureda (Spain), as President of the Tribunal. The Arbitral Tribunal was constituted on April 14, 2008.

3. On May 29, 2008, Respondent requested that the Tribunal consider, on an expedited basis, an objection to the jurisdiction of the Tribunal pursuant to CAFTA Article 10.20.5. As required by Article 10.20.5, the Tribunal suspended the proceedings on the merits. The parties exchanged written submissions and a hearing on jurisdiction was held on October 10, 2008 in Washington D.C. The parties were represented by their counsel. Pursuant to CAFTA Article 10.21 the hearing was open to the public.

4. On November 17, 2008, the Tribunal issued its Decision on Objection to Jurisdiction under CAFTA Article 10.20.5 ("First Decision on Jurisdiction"). In that decision the Tribunal held:

[1] Signed in August 5, 2004. CAFTA entered into force between the United States of America and Guatemala on July 1, 2006.

> "(a) That the reservation included in the waivers submitted by the Claimant pursuant to Article 10.18.2 is of no consequence for purposes of their validity. [and] (b) [t]hat the waivers submitted by the Claimant pursuant to Article 10.18.2 are valid in respect of the claim arising from the *Lesivo* Resolution and from subsequent conduct of the Respondent pursuant to the *Lesivo* Resolution and, therefore, fulfill the Respondent's consent to arbitration conditions under Article 10.18 in respect of that claim."

5. On December 12, 2008, Respondent filed a request for clarification of the First Decision on Jurisdiction. Claimant filed comments on December 19, 2008. On January 13, 2009, the Tribunal issued a Decision on Clarification of the First Decision on Jurisdiction.

6. On January 6, 2009, the Tribunal issued a procedural order establishing the procedural calendar on the merits phase of the proceedings, fixing May 24, 2009 as the deadline for the submission of the Memorial on the Merits, and a two-week deadline after the date of submission of the Memorial on the Merits for "Respondent [to] inform the Tribunal and Claimant of any intention to raise preliminary objections."

7. By Claimant's letter of May 5, 2009 and Respondent's letter of May 7, 2009, the parties informed the Tribunal of their agreement to modify the schedule for the submissions of pleadings set forth in Procedural Order No. 2 and sought the Tribunal's approval of the agreed procedural schedule. By letter of May 8, 2009, the Tribunal approved the parties' proposal. According to the new calendar, Claimant's Memorial was to be submitted on June 26, 2008 while Respondent's notice of any jurisdictional objections was scheduled for July 25, 2009. Accordingly, Claimant filed its Memorial on the Merits on June 26, 2009.

8. On July 24, 2009, Guatemala filed a notice of intent to raise preliminary objections, as it had reserved the right to do under CAFTA, Article 10.20.4. Claimant objected on August 4, 2009.

9. On August 24, 2009, Tribunal issued a procedural order suspending the proceeding on the merits.

10. On September 24, 2009, Guatemala filed its Memorial on Objections to Jurisdiction under Article 10.20.4 of CAFTA and Article 25 of the ICSID Convention. Claimant filed its Counter-Memorial on Jurisdiction on October 26, 2009.

11. On November 3, 2009, the Tribunal informed the parties that a second round of pleadings was not necessary.

12. The second hearing on jurisdiction was held from March 1 to March 3, 2010 at the seat of the Centre in Washington, D.C. Pursuant to CAFTA Article 10.21 the hearing was open to the public. Representatives of the United States and the Republic of El Salvador ("El Salvador") attended the hearing as CAFTA non-disputing parties. The parties were represented by their respective counsel who made presentations to the Tribunal.

13. During the hearing, on March 3, 2010, the representatives of the United States and El Salvador made oral statements reserving their right to make written submissions as non-disputing parties under CAFTA Article 10.20.2 and requesting the Tribunal to fix a dateline for filing them.

14. On March 5, 2010, the Tribunal sent a communication to all non-disputing parties fixing March 19, 2010 as the time limit to file submissions under CAFTA Article 10.20.2.

15. On March 10, 2010, the Tribunal requested the parties to file post-hearing briefs on specific questions not later than March 31, 2010.

16. On March 18, 2010, the United States informed the Tribunal that it would not file a non-disputing party submission pursuant to CAFTA Article 10.20.2.

17. On March 19, 2010, El Salvador filed a submission as a non-disputing Party under CAFTA Article 10.20.2.

18. On March 23, 2010, the Tribunal invited the views of the parties on the submission of El Salvador.

19. On March 31, 2010, the parties filed their replies to the Tribunal's questions and their observations on El Salvador's submission.

20. On May 18, 2010, the Tribunal issued its Second Decision on Objections to Jurisdiction pursuant to CAFTA Article 10.20.4 and Article 25 of the ICSID Convention ("Second Decision on Jurisdiction"). In this Decision the Tribunal: (i) rejected Respondent's objections *ratione temporis* and *ratione materiae* to its jurisdiction; and (ii) confirmed that its jurisdiction was limited to the *Lesivo* Resolution and the conduct subsequent to this Resolution, which may include acts or omissions by Respondent related to squatters, but only to the extent that these result from the *Lesivo* Resolution.

21. On June 7, 2010, after consultation with the parties, the Tribunal issued a procedural order fixing the time limits for the proceedings on the merits.

22. On October 5, 2010, Respondent filed its counter-memorial on the merits. Claimant filed its reply on the merits on March 24, 2011. Respondent filed a rejoinder on the merits on October 21, 2011.

23. The hearing on the merits was held from December 8 to December 16, 2011 at the seat of the Centre in Washington, D.C. Pursuant to CAFTA Article 10.21.2 the hearing was open to the public and, with the consent of the parties, was transmitted via live internet feed. Representatives of the United States and El Salvador attended the hearing as CAFTA non-disputing parties. The parties were represented by their respective counsel who made presentations to the Tribunal.

24. Present at the hearing were:

Tribunal

Dr. Andrés Rigo Sureda, President

Prof. James Crawford, SC, Arbitrator

Hon. Stuart E. Eizenstat, Arbitrator

ICSID Secretariat

Ms. Natalí Sequeira

Assistant to Hon. Stuart E. Eizenstat

Mr. Alex Berengaut

Claimant

Mr. C. Allen Foster, *Greenberg Traurig, LLP*

Mr. Kevin Stern, *Greenberg Traurig, LLP*

Ms. Ruth Espey-Romero, *Greenberg Traurig, LLP*

Ms. Regina Vargo, *Greenberg Traurig, LLP*

Mr. P. Nicholas Caldwell, *Greenberg Traurig, LLP*

Ms. Precious Murchinson, *Greenberg Traurig, LLP*

Mr. Juan Pablo Carrasco, *Díaz-Durán & Asociados*

Mr. Adrian F. Snead, *Greenberg Traurig, LLP*

Ms. Verónica Sofía González, *Díaz-Durán & Asociados*

Ms. Lisa Aldana, *Díaz-Durán & Asociados*

Mr. Robert Pietrandrea, *Railroad Development Corporation*

Mr. Andrew Biller, *Railroad Development Corporation*

Mr. Agustin M. Posner, *Railroad Development Corporation*

Mr. Pablo Alonzo, *Ferrovías Guatemala*

Ms. Kimberly L.A. Linebarger, *Dr. Shannon Pratt´s Assistant*

Mr. Daniel Carey, *Courtroom technician*

Witnesses for the Claimant:

Mr. Henry Posner III

Mr. Jorge Senn

Mr. William J. Duggan

Mr. Carlos Franco

Ms. Mabel Hernández

Mr. Máximo Jiménez

Mr. Inngmar Iten

Mr. Ricardo Spiegeler

Mr. Héctor Valenzuela

Mr. Mario Fuentes

Ms. Olga de Valdez

Experts for the Claimant:

Dr. Eduardo Mayora

Mr. Louis Thompson

Mr. Robert MacSwain

Dr. Shannon Pratt

Respondent

Mr. Larry Robles, *Attorney General of the Republic of Guatemala*

Mr. Carlos Samayoa, *Overseer, Ferrocarriles de Guatemala (FEGUA)*

Mr. Aníbal Samayoa Salazar, *Deputy Secretary General of the Presidency*

Mr. Fernando de la Cerda, *Embassy of Guatemala, Washington, D.C.*

Mr. José Lambour, *Embassy of Guatemala, Washington, D.C.*

Mr. Mynor René Castillo, *Ministry of Economy*

Mr. Joaquín Romeo López Gutiérrez, *Ministry of Economy*

Mr. Saúl Oliva, *Office of the Attorney General of Guatemala*

Ms. Silvia Cabrera Estrada, *Office of the Attorney General of Guatemala*

Mr. David M. Orta, *Arnold & Porter, LLP*

Mr. Whitney Debevoise, *Arnold & Porter, LLP*

Mr. Daniel Salinas Serrano, *Arnold & Porter, LLP*

Ms. Margarita R. Sánchez, *Arnold & Porter, LLP*

Ms. Giselle K. Fuentes, *Arnold & Porter, LLP*

Ms. Dawn Y. Yamane Hewett, *Arnold & Porter, LLP*

Ms. Mallory B. Silberman, *Arnold & Porter, LLP*

Mr. José Antonio Rivas, *Arnold & Porter, LLP*

Mr. José Bernard Pallais, *Arnold & Porter, LLP*

Ms. Camila Valenzuela, *Arnold & Porter, LLP*

Mr. Hans H. Hartell, *Arnold & Porter, LLP*

Mr. Kelby Ballena, *Arnold & Porter, LLP*

Mr. César Payés, *FEGUA Legal Advisor*

Mr. Patrick J. O'Connor, *Harper Meyer Perez Hagen O'Connor Albert & Dribin LLP (counsel for Mr. Ramón Campollo)*

Ms. Amy Endicott, *Arnold & Porter, LLP*

Mr. Pedro Soto, *Arnold & Porter, LLP*

Ms. Nicole Ann Aaronson, *Arnold & Porter, LLP*

Witnesses for the Respondent

Mr. Arturo Gramajo Mondal

Mr. Richard Aitkenhead

Mr. Juan Esteban Berger Widmann

Mr. Ramón Campollo

Mr. José Miguel Carrillo

Mr. Miguel Ángel Samayoa

Mr. Andrés Porras Castillo

Mr. Mario Marroquín

Experts for the Respondent

Mr. Juan Luis Aguilar

Mr. Pablo Spiller

CAFTA non-disputing Parties:

On behalf of El Salvador:

Mr. Enilson Solano, Embassy of the Republic of El Salvador

Mr. Luis Parada, Dewey & LeBoeuf

Mr. Tomás Solís, Dewey & LeBoeuf

Ms. Erin Argueta, Dewey & LeBoeuf

On behalf of the United States:

Mr. Neale Bergman, Attorney- Adviser, U.S Department of State

Mr. David Bigge, Attorney- Adviser, U.S Department of State

Ms. Alicia Cate, Attorney- Adviser, U.S Department of State

Ms. Kimberley Claman, Senior Director, U.S Trade Representative

Ms. Lisa Grosh, Deputy Assistant Legal Advisor, U.S Department of State

Ms. Karin Kizer, Attorney- Adviser, U.S Department of State

Mr. Jeffrey Kovar, Assistant Legal Advisor, U.S Department of State

Mr. Patrick Pearsall, Attorney- Adviser, U.S Department of State

Mr. Jeremy Sharpe, Attorney- Adviser, U.S Department of State

25. During the hearing, the representatives of the United States and El Salvador reserved their right to make submissions under CAFTA Article 10.20.2 and requested the Tribunal to fix a calendar for the submissions of non-disputing Parties.

26. On December 21, 2011, the Tribunal sent a communication to all non-disputing Parties fixing January 31, 2012 as the deadline to file submissions under CAFTA Article 10.20.2.

27. On January 31, 2012, El Salvador and the United States filed written submissions on the interpretation of CAFTA pursuant to Article 10.20.2. On that date, the Republic of Honduras ("Honduras") expressed its intention to file a submission as a non-disputing party and requested an extension of the time limit. The Tribunal granted a ten-day extension and Honduras filed its submission on February 10, 2012.

28. At the invitation of the Tribunal, the parties filed observations on the CAFTA non-disputing Parties' submissions on February 24, 2012.

29. On April 25, 2012, the Tribunal ordered the closure of the proceeding.

II. SUMMARY STATEMENT OF FACTS

30. It will be useful to recount here the basic facts as they were stated in the Second Decision on Jurisdiction. RDC is a privately-owned railway investment and management company which in 1997 won, through international public bidding, the use of the infrastructure and other rail assets to provide railway services in Guatemala (the "Usufruct"). Only two bids were submitted and RDC's bid was the only one considered responsive by Respondent. RDC's bid consisted of a staged plan to rebuild the rail system, which had been closed since March 1996, with an investment program of about ten million U.S. dollars. Although the bidding conditions did not include rolling stock, RDC included in its bid a rehabilitation plan for the rolling stock that would be required for the operation of the railroad (Section 4.2, "Rehabilitation Plan for Locomotives and Freight Cars"). The Usufruct that was awarded to RDC consisted of a 50-year right to rebuild and operate the Guatemalan rail system and did not include rolling stock. On November 25, 1997, FVG signed the Usufruct Contract of Right of Way (the "Usufruct Contract", "Contract 402" or "Deed 402") with Ferrocarriles de Guatemala ("FEGUA"), a state-owned company established in 1969 which is responsible for providing certain railway transport services and managing the rail equipment and real estate assets. The Usufruct and the Usufruct Contract were ratified by the Congress of Guatemala by Decree 27-98, published in the Official Gazette on April 23, 1998, and came into force on May 23, 1998.

31. The Usufruct covers a 497-mile narrow gauge railroad and includes the right to develop alternative uses for the right of way, such as pipelines, electricity transmission, fiber optics and commercial and institutional development. In return for the right-of-way Usufruct, RDC (through FVG) agreed to make certain payments to FEGUA.

32. In November 1997 Guatemala invited bids for the use of the FEGUA rail equipment in onerous usufruct. On December 11, 1997, FVG submitted its bid and won the rail usufruct on December 16, 1997. FEGUA and FVG signed Usufruct Contract No. 41, dated March 23, 1999 ("Contract No. 41"), which granted FVG "the use, enjoyment, repair and maintenance of railway equipment owned by FEGUA for the purposes of rendering railway transportation services." This contract never went into force because it was never approved by *acuerdo gubernativo*. Such approval is required under Guatemalan Administrative Law and Clause 6.4 of the bidding conditions for Contract No. 41. No explanation was offered to the Tribunal of why the government approval was not given.

33. Since Contract No. 41 had not entered into force, FVG and FEGUA entered into Contract No.143 on August 28, 2003. The circumstances and effect of Contract No. 143 are a matter of controversy between the parties and the Tribunal simply registers the fact that FVG and FEGUA signed this contract and modified it in October 2003 by deed No. 158 ("Contract 143/158").

34. FVG restored commercial service between El Chile and Guatemala City on April 15, 1999. In December 1999, commercial service was restored between Guatemala City and the Atlantic ports of Puerto Barrios and Puerto Santo Tomás. Tonnage gradually increased until 2005 but declined in 2006.

35. On June 26, 2005, FVG initiated two domestic arbitration cases against FEGUA for breach of contract. The Claimant alleged that Guatemala through FEGUA failed to remove squatters from the rail right of way and to make agreed payments to the Trust Fund. The Claimant further alleged that, in anticipation of FVG's filings, FEGUA requested the Attorney General to investigate the circumstances surrounding the award of the Usufruct and to issue an opinion on the validity of Deed 143 and

Deed 158. The Attorney General issued Opinion No. 205-2005 on August 1, 2005 ("*Lesivo* Opinion"), and recommended that Guatemala declare Contract 143/158 void as not in the interest of the country. As translated by the Claimant, the *Lesivo* Opinion stated:

> "Lesion was caused in this case because there is a violation to rules and procedures that should have been applied in order to execute the agreement in due form and with legal validity. The relevant contract breaks the Government Contracting Law and other laws that govern the process to grant FEGUA's property in usufruct.
>
> There is pecuniary lesion by executing an Onerous Usufruct Contract to grant the State's property in usufruct to be exploited by a private entity, in exchange of one point twenty-five percent (1.25%) of the gross income as a result of rendering transportation services."

36. On January 13, 2006, FEGUA issued Opinion 05-2006, in agreement with the Attorney General's opinion, arguing that Contract 143/158 was not awarded as a result of a public bid.

37. Claimant and FVG made numerous attempts to reach an understanding. Claimant met the President of the Republic, Mr. Oscar Berger, on March 7, 2006. The President set up a high level commission to work with RDC and FVG, on which FEGUA was represented. This commission met a number of times but after about three months the meetings were suspended. It is the contention of the Claimant that, in parallel, the Government was preparing a resolution to declare the usufruct of the rolling stock injurious to the interests of the State. Such a resolution ("*Lesivo* Resolution" or "*Lesivo* Declaration") was adopted by the Government on August 11, 2006 and published on August 25, 2006.

III. JURISDICTION OF THE TRIBUNAL

38. In its First Decision on Jurisdiction, the Tribunal decided:

"(a) That the reservation included in the waivers submitted by the Claimant pursuant to Article 10.18.2 is of no consequence for purposes of their validity.

(b) That the waivers submitted by the Claimant pursuant to Article 10.18.2 are valid in respect of the claim arising from the *Lesivo* Resolution and from subsequent conduct of the Respondent pursuant to the *Lesivo* Resolution and, therefore, fulfill the Respondent's consent to arbitration conditions under Article 10.18 in respect of that claim." (para. 76)

39. In its Second Decision on Jurisdiction the Tribunal decided to reject Respondent's objections *ratione temporis* and *ratione materiae*, and to confirm that its jurisdiction is limited to the *Lesivo* Resolution and conduct subsequent to this Resolution, which may include acts or omissions of Respondent related to squatters, but only to the extent that these result from the *Lesivo* Resolution.

40. In the reasoning leading to its decision, the Tribunal concluded that: "there is a dispute between Claimant and Respondent which began on the date the *Lesivo* Resolution was published in the Official Gazette. Having reached this conclusion, the Tribunal does not need to determine whether a tribunal under CAFTA has jurisdiction over disputes which began before the date the Treaty entered into force and which continued after such date. It merely notes that CAFTA is expressed to apply 'to measures adopted or maintained by a Party' (Article 10.1.1), and that it was not until the *Lesivo* Resolution was finally published that it could be considered a 'measure'". (para.136)

IV. SUMMARY OF THE PARTIES' ARGUMENTS

1. Memorial

41. It is the contention of Claimant that Respondent indirectly expropriated Claimant's investment. Claimant analyzes the *Lesivo* Resolution against the requirements of Article 10.7.1 of CAFTA for a lawful expropriation and argues that the *Lesivo* Resolution does not meet them.

42. Claimant denies that the expropriation was for a public purpose. It rebuts the suggestion that its purpose could be to protect the cultural and historical patrimony, since no rolling stock was ever designated as such. The argument that the canon fee was too low ignores the fact that the effective rate in the Usufruct Contracts was 11.25%. Further, the integrated character of the Usufruct Contracts "makes ridiculous the contention that another round of public bidding on the rolling stock would have produced a serious competing bid or made any difference in the 'award' of Deed 143." (para. 108). Claimant denies that *lesivo* was a non-discriminatory measure since the Government had the intention to act against Claimant in favor of Mr. Ramón Campollo or other nationals. Claimant contends that the *lesivo* procedure lacked due process, basing itself on Professor Riesman's opinion that:

> "In this idiosyncratic Guatemalan *lesivo* regime, the President of the Republic in Cabinet Council can freely decide what such interests of the State are, and, due to the lack of standards for review, the administrative court which is then asked to confirm his decision will have a hard time articulating any reasons to counteract the President's judgment. In particular, the interests of the State which are adduced may not even amount to illegalities of contract formation and content. The private party to whom the resolution is directed has no opportunity to be heard – to be informed of and respond to the charges prior to the issuance of the decree. Under Article 584 of the Procedural Code, the Government is even prohibited from desisting from a *lesivo* claim once it has been filed." (para. 111)

43. Claimant then refers to the indirect expropriation factors in Annex 10-C of CAFTA. In Claimant's view, the *Lesivo* Resolution had a devastating effect:

> (i) It caused a critical number of FVG's railway customers to refuse to continue to do business with FVG;
>
> (ii) It caused FVG's principal suppliers of goods, services and short-term financing to significantly reduce or eliminate their credit terms and/or services to FVG;
>
> (iii) Potential new customers, lenders, investors and joint venture partners immediately backed away from negotiations and discussions with FVG after having previously expressed interest in doing business with FVG; and
>
> (iv) Local courts, police and municipalities consistently relied upon the Lesivo Resolution as a basis to deny protection to, issue rulings against and allow theft of and vandalism against FVG's Usufruct property." (para. 133)

44. According to Claimant, the *Lesivo* Resolution interfered with Claimant's reasonable investment-backed expectations: the rolling stock was an express component of the award of the 50-year Usufruct to operate the railroad, and RDC had the expectation that each of the Usufruct Contracts would be awarded, executed and approved in accordance with Guatemalan law.

45. Claimant contends that for nine years prior to the *Lesivo* Resolution RDC had a reasonable investment-backed expectation that the financial terms of Contract 143/158 were sufficient, adequate and not harmful to the interests of Guatemala and that Respondent represented them as legal and proper, Deed 143 included. (para 119)

46. Prior to the *Lesivo* Resolution, RDC had no reason to believe that it was not adequately protecting Guatemala's "historical and cultural patrimony" interest in certain rolling stock and rail equipment. FVG had no notice of what specific rolling stock the Government had designated as cultural patrimony because the Government never officially declared or designated under its Cultural Patrimony Law any of the FEGUA rolling stock. Claimant refers (i) to Guatemala's own description of the condition of the railway operation as "in a state of obsolescence" and in a "terrible state", (ii) to the fact that, by 2003, Guatemala was so pleased with FVG's rehabilitation and restoration of the railroad equipment that it entered into an agreement with FVG to display several FVG-restored historical locomotives and rail cars at the national railroad museum, and (iii) to an award that in 2005, approximately a year and a half prior to the *Lesivo* Resolution, was presented by FEGUA's Overseer to FVG's Chairman on behalf of the FEGUA-affiliated Railroad Museum for "*the rescue and restoration of the Historic Railway Patrimony of Guatemala*." (para. 120. Emphasis added by Claimant)

47. According to Claimant, an indirect expropriation can occur even though the investor still retains nominal or legal ownership of the investment or investment assets. Furthermore, a State's actions can constitute an indirect expropriation under international law even where such actions are determined to be legitimate or in compliance with the host State's domestic laws. Whether or not it was lawful under Guatemalan law, the *Lesivo* Resolution was completely disproportionate to its stated

aim. In Claimant's opinion Guatemala could have taken less extreme actions that would not have destroyed RDC's investment if it had been truly interested in protecting the public interests upon which it purports to rely to justify the *Lesivo* Resolution.

48. Claimant also alleges that Respondent is in breach of the minimum standard of treatment under Article 10.5 of CAFTA. According to Claimant, when applied against a foreign investor the *lesivo* procedure does not conform with this obligation because it is a procedure that lacks foundation under substantive Guatemalan law, affords no due process to the investor; in practice, as was the case here, Respondent may use its *lesivo* power in order to avoid or force the renegotiation of valid administrative contracts without compensating the investor. According to Claimant: "The Government here specifically demanded that, in order to avoid a declaration of *lesivo*, FVG had to agree, for no consideration, to modify significantly the economic terms of the Usufruct Contracts, drop its local arbitrations for breach of contract, and release undeveloped railway segments to other interested parties (*i.e.*, Ramon Campollo). The Government did this because it knew and understood that, once a *lesivo* resolution is issued against an administrative contract, that contract is, as a practical matter, rendered worthless even if the resolution has no legal or factual basis." (para. 145)

49. Claimant alleges that Respondent acted maliciously because it issued the *Lesivo* Resolution to accomplish improper and discriminatory goals. It points to the following specific grounds: "(i) Basing the *Lesivo* Resolution on grounds that are directly contrary to the facts and prior actions, representations and agreements of the Government; (ii) Basing the *Lesivo* Resolution on grounds that were entirely the fault of the Government and easily within the Government's control to address and correct (if even necessary) through less extreme measures; (iii) Issuing the *Lesivo* Resolution just prior to the expiration of the three-year limitation period after FVG refused the Government's demands that it agree, for no consideration (other than the Government abandoning the *Lesivo* Resolution), to modify the economic terms of the Usufruct Contracts to the Government's benefit and surrender substantial rights under the Contracts; (iv) Declaring Deeds 143/158 detrimental or injurious to the interests of the State when no demonstrable injury to the State existed; (v) Failing to provide FVG with

any due process to challenge or contest the *Lesivo* Resolution before an independent and neutral decision maker prior to or even shortly after its issuance; and (vi) failing to act in good faith towards RDC and its investment by implementing a measure with intent to discriminate and knowledge of the unlawfulness of such implementation." (para. 149)

50. Claimant argues that the minimum standard of treatment includes the concept of transparency; Respondent failed to ensure a transparent and predictable framework and with the *Lesivo* Resolution undermined legitimate investment-backed expectations of Claimant based on representations, promises and actions of Respondent over more than nine years.

51. Claimant also alleges breach of Respondent's obligation to provide full protection and security to its investment under Article 10.5.1 of CAFTA. Claimant bases this allegation on the fact that, after the *Lesivo* Resolution was issued, the local authorities determined that there was no need to protect an investment declared harmful to the State's interests. Consequently, local people stole 65 kilometers of rails, track materials, cross-members of three major bridges and set up living quarters along the tracks and in station yards. Claimant also alleges that these actions, in some instances, were done by or in collaboration with local authorities who also intervened in legal actions brought by FVG, to argue that FVG no longer had any enforceable contract rights and no legal standing. Claimant explains that FVG reported to the Public Ministry every theft, act of vandalism or squatter invasion but is not aware of any action taken in response to FVG's reports.

52. Claimant further alleges breach of the national treatment standard of CAFTA Article 10.3. According to Claimant, RDC and Ramón Campollo are foreign and domestic investors in "like circumstances": both are competitors in the same economic sector since they have been competing to invest and operate the railroad and in leasing and developing the railroad's assets. Claimant refers to offers directly or indirectly made to RDC by Mr. Campollo. According to Claimant: "In these proposals, Campollo demanded that he be allowed, without compensating FVG, to take over the Usufruct in whole or in part and be granted the exclusive right to use, develop and

exploit the Usufruct assets, particularly along the South Coast corridor where Campollo's sugar business and other business interests and investments are concentrated. Direct competition could hardly be clearer." (para. 162)

53. Claimant contends that the discriminatory measure of Respondent was the *Lesivo* Resolution because direct and circumstantial evidence demonstrates that one of the principal motivations of Respondent in issuing the resolution was to help facilitate the takeover of the FVG's usufruct by Mr. Campollo. Claimant also contends that in any case "even absent the complicity between the Government and Mr. Campollo, Guatemala discriminated against RDC when it sought to coerce RDC into surrendering unrestored rail segments in favor of 'other [interested] investors' in exchange for the Government abandoning the *Lesivo* Resolution." (para. 165)

54. As to damages, Claimant argues that the damages that RDC should recover must be determined by international law and must be the fair market value of its investment including: "(i) the adjusted amount of the investment as of the date of expropriation and other substantive violations of CAFTA – in this case as of 2006; (ii) consequential damages of lost profits from that date to the terminal date of the Usufruct; and (iii) compound pre-award interest at a commercially reasonable rate." (para. 172) As calculated by Claimant the aggregate of these three items comes to $64,035,859.

55. Claimant requests that the Tribunal determine:

> "a. That Claimant is an "investor of a Party" protected by CAFTA;
>
> b. That Claimant's "covered investments" under CAFTA include (i) income generated under the Usufruct, (ii) investment capital and loans committed by RDC to FVG under the Usufruct, and (iii) the value of FVG as the business enterprise operating the Usufruct;
>
> c. That the *Lesivo* Resolution and subsequent conduct of the Republic of Guatemala pursuant to the Resolution described herein constitute an indirect expropriation of Claimant's rights in the Usufruct, in violation of CAFTA Article 10.7.1;
>
> d. That through these measures, the Republic of Guatemala violated the minimum standard of treatment of CAFTA Article 10.5 by failing to provide, in accordance with customary international law, fair and equitable

treatment and full protection and security to Claimant's covered investments;

e. That the Republic of Guatemala has violated the national treatment standard of CAFTA Article 10.3;

f. That the Republic of Guatemala shall pay Claimant $64,035,859 in damages plus compound pre-award interest at the average interest rate paid by Guatemala on its private commercial debt; and

g. That that the Tribunal, pursuant to its power under CAFTA Article 10.26, award Claimant its costs and attorneys' fees incurred in prosecuting its CAFTA claims." (para. 248)

2. Counter-Memorial

56. According to Respondent, Claimant promised to rehabilitate Guatemala's entire railway system and deliver a modernized state-of-the-art railway, but did not deliver. It ran its investment through FVG, but had losses every year since its inception because it did not invest the funds necessary to give the railway project a fair opportunity to succeed. It rehabilitated the first phase very poorly and realized that the only investment that could be profitable would be the rehabilitation and successful operation of the railway on the Southern Coast.

57. Respondent explains that this part of the rehabilitation would cost approximately $100 million and Claimant was not able to raise the funds or provide them itself. By that time, FVG already was on notice that Contract 143/158 had been questioned by FEGUA and it was negotiating with that agency over the terms of a new equipment contract that would cure the defects in the existing one, as well as a number of other contractual disputes. Respondent affirms that these negotiations faltered at about the same time that FVG realized that it could not raise the funds to build the railway in the Southern Coast.

58. Respondent presents the current arbitration as part of a strategy undertaken when Claimant realized that its investment was in a shambles. According to Respondent: "Claimant's first step, initiating two local arbitrations against FEGUA – one of which sought to blame the Government for failing to remove squatters from the right of way notwithstanding that FVG had a long-standing practice of charging rent to these very same squatters, thereby perpetuating the problem of which it complained and despite that the Government was cooperating with the eviction of the squatters

including designing a detailed plan to evict squatters along the portion of the right of way that encompassed the Southern Coast." (para. 6)

59. Respondent refers to a round of negotiations in 2006 after a meeting of Claimant with President Berger. According to Respondent, Claimant and FVG were not prepared or willing to negotiate in good faith because they had no real solution to their failed business venture, and when "they caught wind from an internal government source that the Government was going to declare their equipment contract *lesivo* to the interests of Guatemala, they initiated their planning for this exit strategy; *i.e.*, this arbitration." (para. 7)

60. Respondent points out that the very first business day after the publication of the *Lesivo* Declaration, Claimant and FVG took out a paid advertisement in all of the principal Guatemalan newspapers read by the general public, branding FVG as a "dead man walking" and manufacturing the harm they allege in this case. Furthermore, according to Respondent, Claimant unilaterally abandoned Guatemala and repudiated its obligations under the Usufruct Contracts when it announced on July 6, 2007 that it was discontinuing rail service as of October 1, 2007 and withdrawing financial support from FVG. (Respondent claims that Guatemala had legitimate reasons for initiating the *lesividad* process, that this process was not the cause of Claimant's alleged damages, that the *lesividad* process at issue in this case was initiated after four separate and independent entities had undertaken an objective legal analysis of Contract 143/158, and that the initiation of this internal, administrative process was not in response to pressure from the Guatemalan businessman Ramón Campollo or to favor other national investors at the expense of a foreign investor. According to Respondent, "the *Lesivo* Declaration was issued in response to the contracts' inherent illegalities and Claimant's unwillingness to correct those illegalities in good faith, through a negotiated settlement." (para. 11)

61. Respondent explains thus the *lesividad* process in Guatemala: it is "part of the Executive Branch's inherent powers and of the country's constitutional system of checks and balances which pre-dated Claimant's investment. It provides the executive branch with the power to declare an administrative act that is harmful to the public

interest *lesivo*, thereby opening the door for that executive branch determination to be tested in the courts. Private parties affected by the declaration may challenge it in the court proceeding and have the opportunity to convince the courts to reject the executive branch´s determination and to seek and receive compensation in the event that the court upholds that determination. Until the judiciary makes a determination that a particular contract or action *is* injurious to the interests of the State, the private party retains full rights in the contract notwithstanding the President's *Lesivo* Declaration." (para. 12)

62. It is Respondent's contention that the *Lesivo* Declaration did not cause the harm that Claimant alleges since the declaration addressed only Contract 143/158 and not Contract 402 that, by Claimant's own admission, was the core value of its investment. Respondent points out that any harm was attributable to Claimant's own acts and Claimant cannot shift to Guatemala the responsibility for any customer alarm or confusion that they caused.

3. Reply

63. Claimant contests Respondent's insistence that FVG breached its railway rehabilitation obligations under Contract 402 and points out that it misrepresents what those obligations were and ignores that FEGUA confirmed by official letter that FVG had complied with its rehabilitation obligations, that FVG's lack of profitability was largely due to Respondent's failure to fulfill its own contractual obligations, otherwise FVG would have been profitable on a cash flow basis, and that FVG's failure to obtain sufficient financing and outside investment to rebuild and reopen the South Coast corridor was caused by Respondent's failure to remove squatters from the South Coast right-of-way.

64. Claimant alleges that Respondent misrepresents the circumstances and motivations behind the process which culminated in the *Lesivo* Resolution. According to Claimant, the *lesivo* process was "secretly initiated and pursued by Respondent not out of concern about any alleged legal infirmities in the usufruct equipment contracts (Contracts 143/158), which the Government both internally and externally

acknowledged were 'in effect.' Rather, as confirmed by Respondent's own witnesses and records, the real story is that the alleged legal defects in Contracts 143/158 – which Respondent caused and could have easily resolved on its own without any need for 'negotiation' with FVG – were utilized by Respondent as a mere pretext to issue the *Lesivo* Resolution, which Respondent then proceeded to use as a means to try to coerce FVG to renegotiate and surrender its rights under the Usufruct Contracts. The Government's non-negotiable demands to FVG in exchange for withdrawing the *Lesivo* Resolution included, *inter alia*, (i) requiring FVG to put up a $50 million investment to re-open the entire South Coast corridor or surrender its rights to 'other [interested] investors' such as Ramón Campollo; (ii) relieving the Government of its contractual obligations to remove squatters and make payments to the Railway Trust Fund; (iii) requiring FVG to drop its local breach of contract arbitrations against FEGUA; (iv) increasing the canon fee payments to the Government under the Usufruct Contracts; and (v) forcing FVG to surrender certain railway equipment that had been granted in usufruct. Indeed, Respondent's witnesses in this case freely admit the Government's bad faith motivation behind the *Lesivo* Resolution." (para. 2)

65. Claimant explains that it did not give in to the Government's demands. Instead, like any responsible business would, Claimant issued a press release protesting the Government's hostile and improper action. Claimant argues that Respondent's litigation-inspired theory ignores that: "in addition to Claimant's press release, there were countless newspaper, television and radio reports in Guatemala concerning the *Lesivo* Resolution in the days and weeks after it was published. These reports did not once quote or rely upon Claimant's press release, but, instead, reported the statements of President Berger, the Attorney General and other senior Government officials which trumpeted the Government's action and implacable hostility to FVG. It was the Government's *Lesivo* Resolution and accompanying public statements which poisoned and destroyed FVG's relations with its existing and potential customers, suppliers, lessees, investors and bankers." (para. 3)

66. According to Claimant, President Berger made clear in his public statements that "the reason he declared *lesivo* was not because of any legal defects in the usufruct equipment contracts, but because FVG had not re-opened the South

Coast corridor. He and other Government officials also made clear that they were going to take away the railway usufruct from FVG unless FVG acceded to the Government's extortionate demands, including putting up $50 million within 90 days to re-open the South Coast corridor." (para. 4)

67. Claimant argues that Mr. Campollo's blanket denial of knowledge of or interest in the railway and Claimant's Usufruct rights is not credible and is contradicted by: "(1) the several actions and statements of his acknowledged representative and agent, Héctor Pinto; (2) his financial and personal connections with the family of President Berger; and (3) the fact that, based upon his own business experience in operating a railroad and in the Guatemala commercial real estate sector, he was a direct competitor of Claimant." (para. 5)

68. Claimant requests the Tribunal to determine:

> "a. That the *Lesivo* Resolution and subsequent conduct of the Republic of Guatemala pursuant to and in furtherance of the *Lesivo* Resolution constitute an indirect expropriation of Claimant's covered investments, in violation of CAFTA Article 10.7;
>
> b. That, through these measures, the Republic of Guatemala violated the minimum standard of treatment of CAFTA Article 10.5 by failing to provide, in accordance with customary international law, fair and equitable treatment and full protection and security to Claimant's covered investments;
>
> c. That the Republic of Guatemala has violated the national treatment standard of CAFTA Article 10.3;
>
> d. That the Republic of Guatemala shall pay Claimant $63,778,212 in damages plus compound pre-award interest at 9.34%; and
>
> e. That the Tribunal, pursuant to its power under CAFTA Article 10.26, award Claimant its costs, attorneys' fees and administrative expenses incurred in prosecuting its CAFTA claims." (para. 580)

4. Rejoinder

69. Respondent recognizes the parties continue to disagree on many factual and legal issues, but affirms that the Tribunal, in discharging its Article 48(3) obligation need only decide fundamental issues. It attempts to limit its responses to the essential claims and defenses that the Tribunal must decide.

70. According to Respondent, with respect to expropriation, the Tribunal must determine "whether Claimant has satisfied its burden of demonstrating that the preliminary determination by the Executive branch that Claimant's equipment contract ("Contract 143/158") was *lesivo* interfered with all of its contracts, to the extent that Claimant's entire investment was 'worthless'." (para. 4, emphasis in the original omitted)

71. It is Respondent's contention that Claimant has failed to demonstrate the link between the declaration of *lesividad* of Contract 143/158 and the real estate rights of Claimant under Contract 402, that the Claimant itself estimates to be the source of 92% of potential income. Absent this link, Respondent argues that Claimant cannot prove its assertion that the *Lesivo* Declaration has caused the financial and commercial decimation of Claimant's real estate operations. Respondent points out that the evidence demonstrates that Claimant's income under the real estate contracts it had before the *Lesivo* Declaration has increased since the issuance and publication of that Declaration.

72. Respondent rejects Claimant's argument that the *lesividad* process was motivated by the intent to force Claimant to surrender its right under the Usufruct Contracts to benefit other investors, in particular Mr. Campollo. Respondent argues that there is no evidence to support that argument: "If Guatemala's intention really was to take away Claimant's rights under Contract 402, why would it use an option that did not target Contract 402 specifically? Or one — which Claimant characterizes as a 'legal black hole' — that had no immediate effect, could be overturned by the *Contencioso Administrativo* Court, and would leave the property in Claimant's possession pending the *Contencioso Administrativo* Court decision?" (para. 6) In any case, points out Respondent, Claimant has retained possession of the right-of-way and the railway equipment both legally and factually and has continued to collect revenues from its right-of-way usufruct.

73. In terms of fair and equitable treatment, Respondent thus frames the question for the Tribunal's decision: "whether, in light of the facts, information, and resources that Guatemala had at the time, the initiation of the *lesividad* process falls

below the minimum standard of treatment under customary international law" (para. 7, emphasis in the original omitted).

74. Respondent argues that Claimant articulates the incorrect legal standard under CAFTA and that it has failed to prove that Guatemala's conduct fell below the correct standard of treatment as well as the heightened and inapplicable standard on which Claimant relied.

75. As to the obligation to afford the investment full protection and security, Respondent argues that the question to be determined is not whether Guatemala's efforts with respect to interference would have been sufficient to satisfy its contractual obligations to clear the right-of-way of squatters, but whether "based on Guatemala's resources, its legal framework, and the facts that were known at the time, the question is whether the measures that Guatemala took to protect Claimant's investment were reasonable." (para. 9 emphasis in the original omitted) Respondent contends that Claimant has failed to demonstrate that Guatemala's actions fell short of its commitments under CAFTA. According to Respondent, the facts show that Guatemala has at all relevant times taken reasonable steps to protect Claimant's investment, both before and since the *Lesivo* Declaration.

76. Respondent frames the question to be determined by the Tribunal in respect of national treatment as to "***whether Claimant satisfied its burden of proving that: (1) Claimant and Ramón Campollo were "in like circumstances;" and (2) whether Claimant actually received less favorable treatment as compared to Ramón Campollo***. If the Tribunal finds that Claimant has met its burden with respect to both of these points, it must also consider whether there were any reasons that could justify any proven disparate treatment" (para. 10)It is Respondent's contention that Claimant has failed to prove that: (i) RDC, a commercial railroad operator in Guatemala, and Ramón Campollo, who is primarily in the business of sugar production, whose sugar operation in the Dominican Republic contained a non-commercial, very small rail system for internal company use only, were competitors in the railroad business in Guatemala, and (ii) Mr. Campollo was RDC's competitor for use of the real estate rights arising from the right-of-way usufruct.

Respondent argues further that there is no proof that Claimant received less favorable treatment as compared to Mr. Campollo in these sectors.

77. As to Claimant's damages allegations, Respondent argues that Claimant attempts "to be placed not in the same position it would have been had the *Lesivo* Declaration never been issued, but in the position it would have been if it had not invested its money in FVG and instead had done so in a prosperous and profitable enterprise that generated a whopping 12.9% annual return on equity." (para. 13) Respondent asserts that the question for the Tribunal to decide is "whether Claimant proved that: (1) it suffered quantifiable, compensable damages; and (2) whatever damages it suffered were proximately caused by the *Lesivo* Declaration." (para. 13, emphasis in original omitted) Respondent contends that Claimant did not fulfill its burden of proof, and that the evidence shows that its investment in FVG was worthless long before the *Lesivo* Declaration was issued and that the Declaration had no legal or practical effect on Claimant's investment.

78. Respondent concludes with the request that the Tribunal dismiss all Claimant's claims.

V. THE CLAIM OF INDIRECT EXPROPIATION

79. For convenience of reference, it will be useful to reproduce here the relevant provisions of CAFTA:

> "Article 10.7: Expropriation and Compensation
>
> 1. No Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except:
>
> (a) for a public purpose;
>
> (b) in a non-discriminatory manner;
>
> (c) on payment of prompt, adequate, and effective compensation in accordance with paragraphs 2 through 4; and
>
> (d) in accordance with due process of law and Article 10.5."

80. Article 10 must be interpreted in terms of Annexes 10-B and 10-C. Annex 10-B on "Customary International Law" provides:

"The Parties confirm their shared understanding that "customary international law" generally and as specifically referenced in Articles 10.5, 10.6, and Annex 10-C results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 10.5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens."

Annex 10-C reads as follows:

"The Parties confirm their shared understanding that:

1. Article 10.7.1 is intended to reflect customary international law concerning the obligation of States with respect to expropriation.

2. An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.

3. Article 10.7.1 addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.

4. The second situation addressed by Article 10.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by case, fact-based inquiry that considers, among other factors:

(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;

(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and

(iii) the character of the government action.

(b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations."

81. The Tribunal will first consider Respondent's argument that Claimant cannot claim expropriation of usufruct rights that FVG does not own. It will then proceed to analyze the nature of the *Lesivo* Declaration, its public purpose, whether the Government interfered with reasonable investment backed expectations and their

economic impact on Claimant's investment. To the extent necessary, the Tribunal will complement the summary of the parties' arguments on specific matters.

1. FVG's Usufruct Rights under Contract 143/158

Analysis of the Tribunal

82. Respondent has argued that Claimant cannot claim expropriation of usufruct rights that FVG does not own. For purposes of considering Respondent's argument it will be useful to recall the reasoning which led the Tribunal to the dismissal of the objection *ratione materiae* in the Second Decision on Jurisdiction:

> "141. It is well established before this Tribunal that Contract 41 was legally tendered by the Government and that the only bid was submitted by FVG and accepted by Respondent on December 16, 1997. Contract 41 was signed more than a year later, on March 23, 1999, but never approved by *Acuerdo Gubernativo* and Congress, both approvals being conditions for Contract 41 to become effective.
>
> 142. Shortly after signature of Contract 41, on April 12, 1999, FEGUA authorized FVG by letter to use the towing and traction equipment at the request of FVG. The authorization was renewed in 2000 at FVG's request. The letter of FVG, dated April 16, 2000, explains that the requested equipment is needed by FVG to fulfill its obligations under Contract 402 pending the approval of Contract 41, and then it states: 'The use of the railway equipment we are hereby requesting is subject to the same terms and conditions as apply to the agreement mentioned in item b) above [Contract 41], and will not in any way amend or affect the agreement already mentioned.'
>
> 143. Thus notwithstanding that Contract 41 was never approved, FEGUA let FVG operate the equipment to the extent that, shortly after signature of Contract 41 and three days after FEGUA authorized the use of the railway equipment, on April 15, 1999, train service was established between

Guatemala City and El Chile. It is worth noting that at that time Contract 402 was not yet effective; it became effective more than a month later on May 23, 1999, which implies that the section Guatemala City-El Chile of the railway was rehabilitated before Contract 402 was effective. In December 1999 train service was extended to Puerto Barrios and Puerto Santo Tomás. FVG used the equipment and paid the corresponding canon under the terms of Contract 41 as if it would have been in effect until signature of Contract 143. Afterwards, the equipment continued to be used and the higher canon provided for in Contract 143 was paid and accepted until after the publication of the *Lesivo* Resolution.

144. The Tribunal concludes that both parties to the Contract – FEGUA and FVG – conducted themselves substantially as if the terms of Contract 41 had been in effect – as they have done since the beginning of their relationship in the case of Contract 402. Contract 143 was entered into four years after Contract 41 when it was evident that Contract 41 would not come into effect. The reasons for declaring the Equipment Usufruct Contracts *lesivo* as stated in the "*Exposición de Motivos*" of the *Lesivo* Resolution are substantially the same as those that prevented Contract 41 becoming effective (lack of approval by *Acuerdo Gubernativo* and by Congress) or relate to the need to follow the procedures for public contracting that, notwithstanding the fact that they had already been followed by FVG and FEGUA in respect of the same equipment in the case of Contract 41, had been to no avail to secure the approvals entirely under the Government's control.

145. Respondent has argued that FVG was fully aware of the approval conditions of Contract 143 when it entered into it since its objective was the same: the usufruct of the equipment. Respondent has denied that FEGUA and FVG entered into Contract 143 at the Government's request. Who took the initiative to sign a new contract is irrelevant to the Tribunal's conclusion. FEGUA and FVG were faced with a *de facto* situation which they tried to reflect in Contract 143, and FEGUA benefited from a 25% increase in the canon stipulated in Contract 41.

146. Even if FEGUA's actions with respect to Contract 41/143 and in its allowance to FVG to use the rail equipment were *ultra vires* (not 'pursuant to domestic law'), 'principles of fairness' should prevent the government from raising 'violations of its own law as a jurisdictional defense when [in this case, operating in the guise of FEGUA, it] knowingly overlooked them and [effectively] endorsed an investment which was not in compliance with its law'

147. Based on these considerations, the Tribunal finds that Respondent is precluded from raising any objection to the Tribunal's jurisdiction on the ground that Claimant's investment is not a covered investment under the Treaty or the ICSID Convention."

83. The Tribunal notes that Article 2 of the *Lesivo* Declaration instructs and authorizes the Attorney General of the Nation "to undertake and execute all legal measures required in order *to cease the binding force* of the contract identified above [Contract 143/158] and hold the relevant parties legally accountable, if applicable." (Emphasis added by the Tribunal) The text shows that Respondent considered that Contract 143/158 was binding; otherwise there would have been no purpose in instructing the Attorney General in these terms. The Tribunal also notes that Respondent recognizes that this is the case in its Counter-Memorial: "[...] because Claimant's alleged right to compensation is not yet ripe, because the *Contencioso Administrativo* court has not yet decided the matter and thus Contract 143/158 remains valid and in full force, Guatemala has not violated any duty to pay 'prompt, adequate and effective compensation.'" (Para. 339) Respondent also states that the court may decide that Contract 143/158 is not *lesivo* and leave it permanently in effect. (para. 265)

84. The Tribunal concludes that FVG's rights under Contract 143/158 are in effect and could be expropriated by Respondent. Whether the *Lesivo* Declaration expropriated them and the extent to which it affected Claimant's investment beyond Contract 143/158 are matters to which the Tribunal now turns.

2. The Character of the Government's Action

Analysis of the Tribunal

85. On its face the *Lesivo* Declaration is a measure adopted by the executive branch where the Government agrees to declare Contract 143/158 *lesivo* because it causes harm to the State, and instructs and authorizes the Attorney General to take measures to cease its obligatory character. As instructed, the Attorney General filed a *lesivo* claim with the Administrative Tribunal.

86. After the second hearing on jurisdiction the Tribunal asked the parties, *inter alia*: "(a) On the assumption (which it is understood is in dispute) that a declaration of *lesividad* involves a measure of judgment or discretion, can it really be said that a contract subsequently declared *lesivo* is unlawful *ab initio*; (b) Can a contract be declared *lesivo* as a result of facts occurring after its conclusion? [...]"

87. To the first question Respondent replied that a contract declared *lesivo* by the competent judicial authority is deemed unlawful *ab initio*. According to Respondent, Guatemala cannot unilaterally declare a contract *lesivo* and cease performance; the governmental agency concerned must continue to operate under the contract until the Administrative Tribunal declares the contract unlawful *ab initio*; if it does so, the Administrative Tribunal orders that the parties restore things to their respective positions before the agreement was entered into, thus avoiding any unjust enrichment due to the partial *de facto* performance of the contract declared *lesivo*.

88. Claimant drew a distinction between the concepts of "legality" and "harmfulness to the interests of the State". Claimant explains that the lawfulness of a contract is a matter of the law of contracts and not *lesividad*. According to Claimant, a contract may comply with Guatemalan law and still be harmful to the interests of one of the parties; the legality of a usufruct contract is regulated by the civil law on contracts while the *lesividad* is a procedure regulated by the *Ley de lo Contencioso Administrativo*. It is the view of Claimant that "[t]he availability to the State of separate and distinct remedies in the civil and administrative courts to declare a contract void *ab initio* or voidable due to various legal defects demonstrates that Guatemalan law draws

a clear distinction between the 'legality' of a contract and *'lesividad'* of a contract." Claimant concludes by affirming that the declaration of *lesivo* should not be based on the technical defects of a contract which can be otherwise remedied but because, in the judgment of the President of Guatemala, "the announced interests of the State upon which the contract is based were capricious or because the terms of the contract were not reasonably related to those announced interests."

89. Respondent replied to the second question in the negative and explained that "*lesividad* is determined by legal defects and illegalities relating to the contract's formation and the terms of the contract as such, and not by supervening causes or subsequent conduct by the parties. This helps to explain why a contract declared *lesivo* is deemed unlawful *ab initio*."

90. Claimant replied substantially in similar terms. According to Claimant, "the nature of *lesivo* itself and the structure of the procedures concerning the declaration of *lesividad*, […] indicate that independent facts occurring subsequent to the formation of the contract cannot be considered as a ground for *lesivo*." Claimant considers that this view is confirmed by the fact that "the statute of limitations on declaring *lesividad* runs three years from the date of the contract, not from some subsequent event", and by the fact that none of the declarations of *lesivo* over the last 20 years have relied on independent post-execution facts.

91. The Tribunal concludes 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 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*.

92. The parties dispute a number of issues: the relationship between legality or irregularity and *lesividad;*, whether the power to declare *lesivo* meets the requirements of due process because the affected private party in an administrative contract is not heard or informed before a declaration of *lesividad* is adopted by the

Government; and whether the President has any discretion once an illegality has been brought to his attention, but to declare it *lesivo*. The Tribunal will consider these questions in due course.

3. The Purpose of the Measure

Analysis of the Tribunal

93. Claimant has alleged that the intent of Respondent was not to expropriate for a public purpose but to award Claimant's usufruct rights to Mr. Ramón Campollo or other investors. On the other hand, Respondent has denied any connection between its actions in respect of Claimant's investment and Mr. Campollo or any other investors. The Tribunal will proceed by recalling the timeline of events and contemporary documentary evidence in its consideration of the disputed facts and the contradictory allegations of the parties.

94. Mr. Campollo and Messrs. Duggan and Senn met in Miami in the offices of counsel to Claimant on December 3, 2004. Both parties agree that the purpose of the meeting was to discuss Mr. Campollo's potential interest in investing in the railway and rebuilding the South Coast corridor. The meeting was also attended by Juan Esteban Berger, son of the then President Berger. Prior to that meeting, at the request of Mr. Campollo, RDC, through Mr. Duggan, had advised Mr. Campollo on the operation of the railway in his sugar plantation in the Dominican Republic.

95. On February 17, 2005, Mr. Héctor Pinto, who was a member of the Squatters Commission representing the sugar industry and who, according to Claimant, acted on behalf of Mr. Campollo, sent a letter to FVG with a proposed agreement. Claimant has been unable to locate a copy of the letter and has submitted an email from Mr. Duggan to Mr. Senn which attaches a rough translation in English (Ex C-97). The letter was sent on behalf of Desarrollos G which Claimant considers to be a company owned by Mr. Campollo. Claimant also considers that this proposal is a follow-up to the discussions at the Miami meeting.

96. On March 9, 2005, Mr. Pinto sent by email to FVG a draft contract to be entered into between FVG and Desarrollos G. The email was copied to Juan Esteban

Berger and, according to Claimant, the meta-data contained in this document reveals that the last author of the draft was JEB (Juan Esteban Berger).

97. On March 15, 2005, Messrs. Posner, Duggan, Senn and RDC's President Robert Pietandrea met with Mr. Pinto. According to the testimony of Messrs. Posner, Duggan and Senn, Mr. Pinto stressed that if FVG chose not to collaborate with Mr. Campollo in accordance with the option sent by Mr. Pinto, then Mr. Campollo would take the business with or without FVG. Mr. Pinto was informed that RDC had no interest in Mr. Campollo's proposal but would be willing to consider Mr. Campollo buying into FVG as an investor or business partner.

98. On April 5, 2005, Mr. Pinto called Mr. Senn and on April 6, 2005, Mr. Pinto sent to Mr. Posner a letter by email attaching a draft contract, supposedly the same document that FVG had already received on March 9. The transmittal letter of Mr. Pinto explains that, as a follow up to the recent meeting during Mr. Posner's visit to Guatemala, "le envío para su estudio y consideración la propuesta de intención que se ha discutido con Ferrovías durante más de cuatro meses, tiempo durante el cual se adelantaron gestiones preparativas para el restablecimiento del Ramal Sur o Corredor Pacífico, que pretende conectar Puerto Quetzal a [sic] el centro inter modal de transporte de Ciudad del Sur en Santa Lucía Cotzumalguapa."[2] According to Mr. Pinto, it was of paramount importance to know the opinion on the attached proposal since it was "muy importante iniciar los estudios técnicos de prefactibilidad y la estrategia de desalojo de invasores."[3]

99. The record of the conversation between Mr. Senn and Mr. Pinto was summarized by Mr. Senn in an email to Mr. Posner on April 6, 2005. Mr. Senn writes: "Héctor called me yesterday saying that regardless of what we decide about signing this document, it can't be signed now, may be later [...] because of illegalities in our contract." In the email Mr. Senn characterizes Mr. Pinto as being "obviously Ramón

[2] "I am sending you for your review and consideration the proposal discussed with Ferrovías during more than four months, during which administrative steps were taken in preparation of re-establishing the South Spur or Pacific Corridor in order to connect Puerto Quetzal to the inter-modal transport center of Ciudad del Sur in Santa Lucía Cotzumalguapa." Translation of the Tribunal.

[3] "it was very important to initiate the technical prefeasibility studies and the strategy to remove squatters." Translation of the Tribunal.

[Campollo's] dirty-jobber" and advises that a counter-proposal be done "directly to Ramón and no-one else to avoid falling in his misunderstandings game." The message also explains that "Ramón plays a key role within the local sugar industry and he already sent someone last Friday to talk to Freddie Pérez of Expogranel (General Manager of the sugar export terminal at Puerto Quetzal). His message was to hold the project until we finish discussing some illegalities...I felt Freddie [was] a little concerned about the issue but finally [he] agreed to keep moving forward with our project, FVG-Expogranel, while handling carefully the relation with Ramón." (Ex C-100) Mr. Posner advised Mr. Senn to reconfirm RDC's lack of interest in the proposal sent by Mr. Pinto, but that RDC is open to discuss the counterproposal RDC made at the March 15 meeting.(Ibid)

100. A further meeting of Messrs. Duggan and Senn with Mr. Pinto took place on April 12, 2005.

101. On the same date Dr. Gramajo informed the Legal Coordinator of the Ministry of Communications of the legal issues in respect of Contracts 402, 143/158 and 820.

102. On April 13, 2005, Mr. Pinto informed Mr. Gandara, Vice-Minister of Communications, that the negotiations between the company he represented and FVG had been unsuccessful and requested to be excused from attending further meetings of the Squatter Commission.

103. On April 15, 2005, Messrs. Senn and Duggan met with Mr. J.E. Berger.

104. On the same date, Mr. Campollo informed FVG that he had decided not to participate in the project proposed to him by RDC in Miami. According to Mr. Campollo's testimony, he signed the letter in front of Mr. Pinto and instructed him not to contact or negotiate with FVG on his behalf.

105. Mr. Gramajo, Overseer of FEGUA at the time, testified that, upon receipt of Mr. Pinto's letter, he decided not to move forward with the plan to remove squatters from the South Corridor because the sugar industry withdrew its support, including the company represented by Mr. Pinto.

106. Notwithstanding Mr. Campollo's instruction, Mr. Pinto continued to contact FVG. On February 28, 2006, a week before the March 7, 2006 meeting with President Berger, Mr. Pinto contacted FVG expressing interest in having a meeting on the use of the railway to connect the planned Ciudad del Sur industrial park development in Santa Lucía with Puerto Quetzal. The last email of Mr. Pinto on this topic is dated July 26, 2006.

107. On July 28, 2006, Messrs. Montano and Melville separately informed Mr. Duggan and Mr. Posner, respectively, that there was a push within the government to cancel the usufruct and to declare the concession *lesivo*. According to Claimant, both attributed the action to the doing of Mr. Campollo or that after the concession was cancelled it would be awarded to Mr. Campollo.

108. On September 5, 2006, Mr. Pinto wrote to Emmanuel Seidner, an official working for the Competitiveness Commissioner, informing him that railway service between Puerto Quetzal to Ciudad del Sur would be restored shortly in order to transport sugar to the port. He sent a blind copy to Mr. Senn. The authenticity of this communication has been questioned by Respondent but Claimant has produced the original email from Ms. Váldez, Mr. Pinto's secretary, to Mr. Senn, attaching Mr. Pinto's letter to Mr. Seidner. (Ex C-116) Claimant has argued that Ciudad del Sur was a project of Mr. Campollo. Mr. Campollo has testified that by that time this project had been abandoned for more than a year.

109. The Tribunal observes that it has not had the benefit of Mr. Pinto's testimony because he is now deceased. The contemporaneous documents written by Mr. Pinto or its interlocutors show his persistent interest in the Southern Corridor whether acting on behalf on Mr. Campollo or on his own account. He was aware of the thinking of FEGUA on the illegalities of Contract 143 before Mr. Gramajo wrote to the Legal Coordinator at the Ministry of Communications. It is evident from Mr. Gramajo's testimony that he regarded Mr. Pinto at least as a representative of the sugar industry, if not of Mr. Campollo. The evidence also shows that Mr. Campollo had an interest in the South Corridor and RDC's representatives met him in Miami when seeking interested parties in restoring that segment of the railroad. He later desisted from

pursuing the matter further as stated in his letter of April 15, 2005 (Respondent, Exhibit R-173) and acknowledged by FVG on April 18, 2005 (Respondent, Exhibit R-174). It is significant in this respect that the Usufruct Contracts continue to be in effect more than five years after the *Lesivo* Declaration without any attempt by Respondent to hand over the railway concession to Mr. Campollo.

110. To conclude, notwithstanding the emphasis placed by Claimant on Mr. Campollo being the mover behind the scenes who allegedly would ultimately benefit from the demise of the Usufruct Contacts, the Tribunal is not persuaded by the evidence produced in support of Claimant's allegations. That the purpose of the *Lesivo* Declaration was to deprive Claimant of its usufruct rights for the benefit of Mr. Campollo has not been proven.[4]

111. On the other hand, it is clear from the President Berger's statements that Respondent was dissatisfied with the lack of further investment in the railroad by Claimant and that the *Lesivo* Declaration was used as a tactic to pressure Claimant to invest more, irrespective of its obligations under Contract 402, or forfeit its investment in favor of other unspecified investors. This is a matter that the Tribunal will address when considering the alleged breach of the minimum standard of treatment.

4. Investment-backed Expectations

a) The Parties' Arguments

112. Claimant asserts that the *Lesivo* Declaration has undermined, *inter alia*, the following expectations: "(i) RDC's expectation that FVG would have the exclusive right to use the rolling stock during the entire 50-year term of the Usufruct; (ii) RDC's expectation and understanding that Deed 143 was awarded, executed and approved in accordance with Guatemalan law; (iii) RDC's expectation and understating that the economic terms of Deeds 143/158 were acceptable to the Government; (iv) RDC's expectation and understanding that Deeds 143/158 adequately protected the Government's purported 'historical and cultural patrimony' interests in the rolling stock; (v) RDC's expectation that the Government would, pursuant to its obligation under

[4] See paras. 155-156 below on the issue of whether Mr. Campollo and Claimant were similarly situated.

Deed 402, not 'hinder the rail and non-rail activities of [FVG]', and 'protect the exercise of [FVG's] rights against third parties that may intend to have or want to exercise a right on the real estate granted as onerous usufruct'; (vi) RDC's expectation and understanding that any disputes between it or FVG and the Government would be addressed and resolved through negotiation or binding arbitration rather than unilateral Government action; and (vii) RDC's expectation and understanding that Guatemala would not take any precipitous or arbitrary actions against it that would serve to harm RDC's investment or FVG's business, especially where there is no contention that FVG has breached any obligation under the Usufruct Contracts and there is no evidence that Deeds 143/158 were injurious to the interests of the State." (Memorial, para. 153)

113. Respondent argues that Claimant could not expect that Contract 143/158 would not be challenged under Guatemalan law. Respondent refers to the experience of Claimant with public contracting in Guatemala and to the fact that all three contracts – 402, 820 and 41– were subject to public bidding. Respondent asserts that "Claimant was acutely aware that the lack of Executive approval could lead to the invalidity of a Contract, this being the very reason why Contract 41 never entered into force; a fact that Claimant concedes. That it entered into Contract 143/158 and, in violation of Guatemalan law, tried to contract away this legal requirement cannot create a legitimate expectation that the absence of this legal requirement would not later be challenged by the Government using a legal remedy that existed when Claimant entered into this Contract." (Rejoinder, para. 58)

114. Respondent contends that "performance of a contract cannot preclude Guatemala from utilizing pre-existing measures, within their time limits, to remedy legal defects under that contract. A bright-line ruling that a State is precluded from questioning the validity of a contract because it had performed under that contract - which, when taken to the extreme, could prevent even contracts initiated under coercion or through bribery- would severely and improperly restrict State sovereignty." (Rejoinder, para. 60)

115. Respondent insists that the question for the Tribunal is not whether Contract 143/158 is *lesivo* but whether the Government acted reasonably in reaching the conclusion that it was *lesivo* and in issuing the Declaration. Respondent contends that "even if these officials [Government officials who studied whether Contract 143/158 was *lesivo*] in good faith reached an incorrect legal determination about whether this contract was *lesivo* – which Guatemala contends they did not – that does not constitute an expropriation under CAFTA or a violation of any legitimate expectation Claimant may have. Claimant cannot have a legitimate expectation that the Government would make no mistakes in assessing Claimant's legal rights under the subject contract (Rejoinder, para. 64)

b) Analysis of the Tribunal

116. It is reasonable to argue that an investor, or any party to a contract, may not have legitimate expectations that a government would not make mistakes in assessing one's legal rights. This is not the issue. The question is whether, if mistakes are made, other parties who had acted on such mistakes in good faith and to their own detriment, should have the right to expect that the party who made the mistake would bear the consequences.

117. In the instant case Claimant participated in the bidding for three contracts which it won. The first two were approved by *acuerdo gubernativo* while the third, Contract 41, was signed but never approved. At the second objections to jurisdiction phase, the Tribunal asked the parties:

> "(e) Why was Contract 41 never approved? Why did each side proceed under Contract 41 (and then Contracts 143 and 158) as though there was a legal contract in place?" (Second Decision on Jurisdiction (para. 91)

118. Respondent replied that the reasons for the lack of approval of Contract 41 "remain essentially unclear based on the evidence of record." Respondent noted that "Ferrovías never utilized the legal remedies open to it in such circumstance. Respondent emphatically denies that the parties ever considered that Contract 41 entered into force or operated as if it were in force. On the other hand, Contracts 143

and 158 are "technically in force and must be observed by the parties – notwithstanding its [sic] illegalities – at least until such time as the *Contencioso Administrativo* court decides whether those Contracts are *lesivo* and should be declared null *ab initio"*. (Second Decision, para. 104)

119. In turn Claimant replied that:

> "it is not correct to state that Contract 41 was never "approved" by the Government since the Government had approved and published the bidding terms and conditions. At most, according to Claimant, it can be argued that Contract 41 was not ratified by the President. Claimant also observes that, "Despite the Government's purported position that such ratification was necessary and essential, it never provided FVG with any reason or explanation as to why it did not or could not obtain ratification […] Even to this day, FVG does not know or understand why the Government never obtained Executive ratification of Contracts 41 and 143, and Respondent's witnesses have certainly not offered any logical or credible explanation for the Government's failure to do so." (Second Decision, para. 105. Footnotes omitted)

120. To this day the Tribunal has not been given any explanation for the absence of ratification of Contract 41 by the Respondent.[5] Absent such an explanation, in its view, in a situation where three contracts are let that relate to the same operation, an investor who had won all three, two of which had been approved by the Respondent or its agencies, could reasonably expect that the third contract would also be ratified. In this respect the Tribunal observes, as it did in its Second Decision on Jurisdiction, that notwithstanding that Contract 41 was never ratified by *acuerdo gubernativo*, FEGUA let FVG operate the equipment to the extent that, shortly after signature of Contract 41 and three days after FEGUA authorized the use of the railway equipment by an exchange of letters with FVG, on April 15, 1999, train service

[5] "I also wish to clarify that I did ask President Álvaro Arzú to approve Equipment Contract 41 by Executive Resolution. I do not know if Ferrovías, for their part, requested the same. I can confirm that while I was Overseer we never received the approval, and I do not know the reason why President Arzú's administration did not do it [...]" Witness Statement of Andrés Porras, Overseer of FEGUA from January 1997 to March 2000, para. 23.

was established between Guatemala City and El Chile. It is also worth noting that at that time Contract 402 was not yet effective; it became effective more than a month later on May 23, 1999, which indicates that the section Guatemala City-El Chile of the railway was rehabilitated before Contract 402 was effective. This factual context shows that both parties moved to implement the rehabilitation of the railroad and restoration of service once the contracts were awarded and signed.

121. The arrangement to use the equipment through exchanges of letters lasted until 2003 when Contract 143 was signed. According to Respondent, Claimant was aware of the need of the *acuerdo gubernativo* because of its participation in the bidding of Contract 41 and, therefore, could not have a legitimate expectation that the contract would not be declared *lesivo* because of lack of compliance with Guatemalan law.

122. The Tribunal notes that Claimant has argued that, while the bidding conditions required the ratification of Contract 41 by *acuerdo gubernativo*, it does not follow that for the type of equipment covered in Contract 143 and given that FEGUA is an autonomous, decentralized agency, Guatemalan law actually requires ratification by *acuerdo gubernativo*. Respondent disagrees and the Tribunal does not need to decide between the two positions, it nevertheless notes that there are credible arguments based on the laws of Guatemala to suggest that Contract 143 may not have required *acuerdo gubernativo*. The Tribunal further notes that, although the Government never bothered to ratify Contract 41, it benefited from the re-opening of the railway service with the equipment leased through the exchanges of letters on Contract 143/158, and FEGUA accepted payment of the canon for the use of the equipment without protest. The Attorney General's opinion of August 1, 2005 points out the special situation of FEGUA as an institution subject to the State's control for purposes of contract approvals: "[...] in accordance with the Government Contracts Law [Ley de Contrataciones del Estado], the prior contract [Contract 41] should have been approved by the Board of Directors, but given that the entity is being overseen, we face a *sui generis* case not provided for in the Procurement Law." (Ex. R-15, para a)) In this situation it is a reasonable analogy to consider that the Overseer of FEGUA replaced FEGUA's Board, rather than the President of Guatemala doing so. (Mayora

Second Opinion, para. 3.4.3) As for the lack of public bidding, the equipment covered by Contract 143 was substantially the same as that included in Contract 41, and FVG had squarely won the bid for this contract. Respondent was well aware that the railway equipment was needed to run the railroad. Notably because of the narrow gauge of the railroad track, the equipment could not be used anywhere else nor was it practical or economically feasible to bring suitable equipment from somewhere else. Respondent also accepted and approved at the highest level (including Congress) Contract 402, by which FVG reserved its right to opt out of this contract if it did not get the railway equipment. FVG needed the equipment to fulfill its obligations under Contract 402 and FEGUA confirmed that it had fulfilled its obligations under that contract providing service with equipment leased under the exchange of letters. In those circumstances, in the Tribunal's view, it was legitimate for the investor to believe that its actions and those of its counterpart were not harmful to the interest of the State. The investor was providing a service which at the highest levels Government had decided to privatize and which in state hands had already irretrievably broken down. There was nothing, at the time the contracts were concluded, to suggest that they were contrary to the interests of Guatemala. On the contrary, they were procured through competitive bidding, the terms of which were prepared by the Government itself.

123. In the Tribunal's view, the expectation of Claimant to have a legally valid contract was not misplaced. It was created by the actions of Respondent and of its agency, FEGUA.

5. The Economic Impact of the Government's Action

a) The Parties' Arguments

124. Claimant describes the impact of *lesivo* as follows:

> (i) It caused a critical number of FVG's railway customers to refuse to continue to do business with FVG;
> (ii) It caused FVG's principal suppliers of goods, services and short-term financing to significantly reduce or eliminate their credit terms and/or services to FVG;
> (iii) Potential new customers, lenders, investors and joint venture partners immediately backed away from negotiations and discussions with FVG after having previously expressed interest in doing business with FVG; and

(iv) Local courts, police and municipalities consistently relied upon the *Lesivo* Resolution as a basis to deny protection to, issue rulings against and allow theft of and vandalism against FVG's Usufruct property." (Memorial, para. 133)

125. Respondent disputes that the Declaration had any such effects and indicates that, in any case, the Declaration affected only Contract 143/158 and not Contract 402 which Claimant considered to be the core of its investment. Respondent recalls that FVG could terminate Contract 402 only if it could not acquire the railway equipment pursuant to a separate bidding process and as a consequence would not be able to comply with the purposes of that contract. Respondent presumes that this would require Claimant to show that it could not acquire the equipment elsewhere. Respondent concludes in respect of Contract 402 that Claimant's argument that it could no longer operate under Contract 402 if it lost the right to use FEGUA's equipment is without merit and the *Lesivo* Declaration had no effect on Contract 402.

126. According to Respondent, the mere initiation of the *lesividad* process did not interfere with Contract 143/158 in law or in fact and, if Claimant suffered damage, it was due to Claimant's own actions in publicizing the Declaration. Respondent points out that it did not hold press conferences or take out pre-prepared press releases in all the popular Guatemalan newspapers.

127. Respondent maintains that it negotiated in good faith to cure the defects of Contract 143/158 and that Claimant squandered those opportunities. In particular Respondent refers to FEGUA's proposal to FVG of August 24, 2006. (Ex. C44) In addition, Respondent asserts that Claimant bears responsibility for publishing statements that pre-judged the result of the judicial review of Contract 143/158 before it began. Respondent concludes on this point that "to the extent Claimant suffered any damages or lost business as a result of the *Lesivo* Declaration, it was a result of its own misguided public relations strategy, and without any encouragement or help from Guatemala. In essence, Claimant created a self-fulfilling prophecy by repeatedly informing the country and its investors that it was 'dead man walking', and risky business partner" (Counter-Memorial, para. 273).

128. Respondent argues that even if the Tribunal were to find that the *Lesivo* Declaration and subsequent acts interfered with Claimant's investment such

interference was not substantial. Referring to the abundant case-law on this subject, Respondent contends that the measures equivalent to expropriation must be not mere restrictions but of "such magnitude as to '*annihilate*' the investment, '*radically deprive*' Claimant of the economic use and enjoyment of its investment, '*neutralize*' the benefits, economic value of the use enjoyment or disposition of the investor's property, render Claimant's property rights '*useless*' due to a '*substantially complete deprivation*' of the economic use and enjoyment of rights to property or '*destroy*' the business in question" (Counter-Memorial, para. 317, footnotes omitted). Respondent affirms that Claimant has not shown that the *Lesivo* Declaration had any of these effects.

129. Respondent refers to Claimant's own statements in the Memorial to the effect that "RDC's investment in the rehabilitation of the railroad was wholly unconnected to the profits FVG would have earned over the life of the Usufruct from its program to lease the right of way and adjacent real estate parcels for non-railway purposes", and concludes that the claim of substantial interference is unsustainable because the *Lesivo* Declaration did not deprive Claimant of its rights under the most lucrative component of its investment, Contract 402. Furthermore, as defined by Claimant, the investment comprises Contracts 402, 41, 820 and 143/158 and therefore the *Lesivo* Declaration relates to only a small portion of its investment.

130. Respondent insists that any loss of railway customers was due to Claimant's press campaign, and to the fact that it ended railway service in 2007. Respondent points out that all agencies and branches of the Government have acted consistently with the understanding that Contract 143/158 was still in effect. Respondent refers to several examples: the Administrative Court declined a request in 2007 and in 2008 to grant injunctive suspension of Contract 143/158, "thereby recognizing that FVG retained its rights under that agreement." (Counter-Memorial, para. 325); and the police and municipalities have continued "to uphold the validity of Contract 143/158 (and 402) and have continued to evict squatters from the land." (ibid.)

131. Respondent adds that, if Claimant suffered any interference, it is not irreversible or irrevocable and, therefore, not permanent because the *Lesivo* Declaration has not been confirmed by the Administrative Tribunal. Respondent reiterates that the *Lesivo* Declaration is devoid of legal effect and only the Administrative Tribunal has the power to declare Contract 143/158 null and void for *lesividad.* Respondent emphasizes that Claimant retains full ownership and possession of the rights granted pursuant to each of the Usufruct Contracts and remains in possession of the railway equipment contemplated under Contract 143/158.

132. Claimant points out that Respondent linked the issuance of the Resolution to the alleged failure to comply with its rehabilitation obligations under Contract 402 and its unwillingness to surrender substantial rights under that contract. Claimant argues that the fact that it would not need FEGUA's equipment for the South Coast segment is irrelevant because, if FVG did not have that equipment, it could not fulfill its performance obligations under Contract 402 and "had the Government taken away the FEGUA equipment from FVG, FVG could have immediately exercised its right under Clause 18 of Contract 402 to terminate that contract without further liability or obligation" (Reply, para. 261).

133. Claimant argues that Respondent did not, in the weeks after the issuance of the *Lesivo* Declaration, disavow any of its statements regarding its intent to use the Declaration to force FVG to amend Contract 402 – under the threat of terminating the Usufruct Contracts and taking the entire railway – because FVG would not be able to provide railway services. According to Claimant this is how the action of Respondent was perceived by current and potential customers, suppliers and lenders.

134. Claimant recalls that the case law requires substantial deprivation or impairment of the investor's economic rights or reasonably expected economic benefits. Claimant argues that the fact that FVG continues to earn income from one long-term property lease and four right-of-way easements does not show that Claimant has not been substantially deprived of the expected economic benefits of its investment. Claimant emphasizes that both the lease and easements date back from

before the *Lesivo* Declaration and that it has not been able to secure any additional ones.

135. Claimant denies that its press release caused or contributed to any losses of FVG and contends that the evidence shows that the actions and public statements of the President, the Attorney General and other high officials caused FVG to be perceived as a dead man walking.

136. Respondent insists in its Rejoinder that Claimant has failed to show that Guatemala substantially interfered with its investment. Respondent points out that Claimant had conceded in its Reply that the bulk of its income came from real estate rights granted pursuant to Contract 402, that RDC's investment in the rehabilitation of the railroad was unconnected to the profits FVG would earn over the life of the usufruct from real estate leases, that the records show that real estate income has increased since the *Lesivo* Declaration, that the equipment covered by Contract 143/158 could be used only within Phase I of the project. Furthermore, Respondent points out to the limited evidence, as stipulated by Claimant's counsel, supporting the allegations of Claimant in respect of the effect of the *Lesivo* Resolution on customers, suppliers or lenders whether current or potential. Respondent also points out that Claimant's customers continued to do business with Claimant or would have done business with Claimant, if Claimant had not voluntarily ceased operations in 2007.

137. Respondent insists on the possibility of the *Lesivo* Declaration being overturned, and the fact that in the meantime the railway equipment remains in the hands of FVG to support its argument that the Declaration had no permanent or lasting effect. According to Respondent, "Claimant's argument boils down to a suggestion that the multi-year length of the proceedings is alone sufficient to prove its claim." (Rejoinder, para. 82) Respondent also insists in the lack of a causal link between the *Lesivo* Declaration and the alleged damage to Claimant's investment.

138. According to Respondent, "it is not unreasonable to conclude, and is likely a higher probability, that FVG was pleased to seize on the *Lesivo* Declaration as an excuse to close an unprofitable business. As far back as the annual report for 2002, FVG made clear that the fiber optic contracts that it anticipated in its business plan had

not materialized (due to no fault of Guatemala), leaving a large hole in its revenues from leasing activity – activity that Claimant says represented 92 percent of the expected benefits from its investment. And as made clear in the Counter-Memorial, the writing was on the wall that Claimant's investment was doomed to fall well before the *Lesivo* Declaration was published, because, Respondent argues, Claimant itself acknowledged that it needed approximately US$100 million to restore the railway in the Southern corridor of Guatemala in order to make its venture profitable and that it did not have any viable source of funding to obtain this capital. Without this investment, Claimant was doomed to more years of continuous losses, and needed capital infusions by the shareholders of FVG to keep the company from sinking into bankruptcy. If ongoing capital infusions from FVG were needed since profits from the railroad business were non-existent, as they were in fact, Claimant's economic incentive was to close railway operations as rapidly as possible." (Rejoinder, para. 98)

b) Analysis of the Tribunal

139. The Tribunal will first consider the link between the availability of the equipment and Contract 402; then the extent to which Respondent linked the issues of Contract 143/158 to the overall investment notwithstanding that the *Lesivo* Declaration addressed only Contract 143/158; and lastly the effect of the Declaration on Claimant's investment.

140. It is a fact that the right-of-way and the equipment contracts were bid separately. Clause 10(e) of Contract 402 provides for the right of FVG to "Acquire railway and non-railway equipment owned by FEGUA, as it may be convenient for its operations, under the terms of the bidding conditions from which this contract arises." (Claimant's translation) Rule 4.1.6 of the bidding rules for Contract 402 in relevant part provides that: "Bidders may inspect the railway equipment and equipment not directly related to the railway owned by FEGUA. Said equipment shall be auctioned at a future date after the adjudication of the Railway Usufruct Contract and the contractor shall have the opportunity to acquire the equipment which he considers appropriate for his operations." (Translation of the Tribunal) Therefore, the phrase in Clause 10(e) of Contract 402 "under the terms of the bidding conditions from which this contract

arises" simply means that the bidder who won the railroad usufruct contract would have the opportunity to bid for the equipment in the future as would other interested parties.

141. In case Claimant could not obtain the railway equipment of FEGUA, Clause 18 of Contract 402 enabled Claimant to terminate it: "III In the event that COMPAÑIA DESARROLLADORA FERROVIARIA, SOCIEDAD ANONIMA is unable to exercise the conferred rights it is entitled to with regards to the railway equipment according to the contract and bidding terms referred to in the second clause of this contract, or notwithstanding, having exercised them, it is not able to acquire the railway equipment in accordance with what is established in the tenth clause of this contract and as a consequence it is not able to comply with the purposes of this contract, for reasons not attributable to it, then it may terminate this contract without any responsibility on its part." (Claimant's translation) Respondent has argued that, in the situation foreseen in this Clause, Claimant would need to show that it could not acquire the equipment somewhere else. Claimant has disputed that this is the case. As the Tribunal understands it, the consequence of not fulfilling the purpose of the contract is directly related to the inability to acquire FEGUA's equipment, and to no other contingency.

142. The concern of Claimant for a way out in the event described was understandable in light of the terms of Clause 16 of Contract 402: "The Usufructuary's failure to begin railway restoration and failure to render cargo transportation services under the terms of sections two, three, four, five, and six of the THIRTEENTH CLAUSE of this contract: In the event that the USUFRUCTUARY fails to restore the railway and fails to render cargo transportation services under the terms of sections two, three, four, five, and six of the THIRTEENTH CLAUSE hereof, the Usufructuary shall surrender to FEGUA the real property where the railway yet to be restored is located, and any such property shall no longer be subject to this usufruct." To comply with its obligations under Contract 402 Claimant needed the equipment of FEGUA, given the narrow gauge of the railroad track and the difficulty of obtaining this narrow gauge equipment elsewhere. Notwithstanding the vicissitudes related to the use of FEGUA's railway equipment, FVG has never exercised the option of surrender.

143. Contrary to Respondent's argument, the facts show that Respondent itself considered the equipment of FEGUA an important element in the negotiation of the alleged illegalities surrounding Contract 143/158. Respondent on numerous occasions in its pleadings has manifested how it has negotiated with Claimant and has made every effort to solve any illegalities. However, this effort came with strings attached which went beyond any such illegalities. In this respect, the Tribunal finds it useful to recall its considerations on the *ratione temporis* objection in the Second Decision on Jurisdiction:

> "133. The *lesivo* process proceeded in parallel to negotiations of FEGUA with FVG regarding issues in dispute in the local proceedings; to the extent that Claimant was aware of such process, which is disputed by Claimant, it was used to negotiate other pending issues. Suffice here to mention that, in the settlement proposal communicated to FVG by FEGUA in the meeting of August 24, 2006, of seven items, only the seventh is related to the Equipment Usufruct Contracts. More importantly, the *Lesivo* Resolution in the "Exposición de Motivos" does not list items such as the conservation of the historic and cultural patrimony of railway equipment, nor does it list the other six items part of the settlement proposed by Respondent on August 24, 2006.
>
> 134. Expressed differently, the grounds for the *Lesivo* Resolution ("Exposición de Motivos") even if they had been cured by FVG, would not have satisfied the conditions of the settlement proposed on August 24, 2006. While this confirms, as argued by Claimant, the use of the *lesividad* process as an element of pressure to achieve other results which seem unrelated to the *lesividad* declaration, this does not make the dispute in connection with the *Lesivo* Resolution and the subsequent conduct of Respondent an integral part of other disputes which may have existed or may still exist in the local arbitration proceedings [...]."

144. Respondent has asked rhetorically why would it choose the *lesivo* process if it had other means more certain and straight forward to terminate the rights of Claimant. Only Respondent can answer that question. The fact is that it chose to link

the alleged illegalities or irregularities which motivated the *Lesivo* Resolution to other matters in dispute related to Contracts 402 and 820. The *Lesivo* Declaration itself focused on Contract 143/158 and without the equipment provided under this contract the train service could not be carried on.

145. Each party blames the other for statements made in the press following the publication of the *Lesivo* Declaration, which allegedly added to the impact of the Declaration on FVG. Respondent has focused in particular on the paid press release of FVG published on September 4, 2005. It was addressed to FVG's customers, suppliers, collaborators and the public and reads in part as follows: "This is now more than an investment for us; it is a struggle for justice. Although we have lost faith in the Guatemalan legal and political systems, we remain convinced that the railway plays an important role in a country that abandoned its railway in 1996 and currently does not depend on either unrealistic schemes or government subsidies. For this reason, we will not only continue to advocate for implementation of our business plan as we originally conceived it, but also to fight for the right to do so against a government that has gone out of its way to obstruct our progress by violating the terms of the railroad infrastructure trust and begin something that will ultimately result in the expropriation of our usufruct. This is a commitment we have to our 62 shareholders, our customers and our employees." (Ex R-105) The statement expressed disappointment but also a willingness to move ahead notwithstanding the difficulties. The news had already been in the press for a few days when FVG's press release was published. Thus *El Periódico* published an article on August 30, 2006, with the title "Ferrovías de Guatemala is left without trains" where both Mr. Gramajo and Mr. Senn are quoted, but they spoke in more measured terms than what the title gives to understand and none said what the FVG was left without trains.(Ex. R-104) In fact, the statements by the President and other officers of the Government as reported in the press could be construed to be as damaging as any that Claimant may have issued.

146. To put this matter in perspective, the Tribunal observes, first, that the existence of a dispute between the Government and FVG was known before the issuance of the *Lesivo* Declaration; for instance, the article in the *Siglo XXI* edition of September 8, 2006 (Ex. C-136) speaks of a worsening dispute. Second, the *lesivo*

process is not a routine procedure and its extraordinary character would have been of interest to the press; it would have been news *per se*. Third, the statements of President Berger are clear and consistent in linking *lesividad* to the overall investment of Claimant. Thus on September 5, 2006, the *Diario de Centro América* reported that the previous day the President had explained that "the declaration of *lesividad* arises from the fact that the US$50 million investment under said contract did not occur. However, he added, Ferrovías [FVG] has a 90-day term to enter into dialogue with the corresponding authorities." (Ex. C-131) Similarly in a speech transmitted by *El Independiente*, Third Broadcast of September 8, 2006 President Berger said: "[...] I am worried about the size of the company; my concern is that it does not have the financial resources. We do not mean to harm anybody; if it [the company] came today to tell us that it will invest the US$50 million and make the wide gauge work from Tecún Umán to Santa Lucía Cotzumalguapa, which for strategic purposes would move what we sell to Mexico, what comes from Mexico, and what goes to our ports, we would sit at the table. I am surprised because that was the 90-day arrangement and (unintelligible 01:18), they can invest, and we fully supported them. [...]" (Ex. C-132) The 90-day term – at least in the statement quoted first – is clearly related to the 90-day period that the Government has to file the *lesivo* claim with the Administrative Tribunal from the day of publication of the *Lesivo* Declaration.

147. Respondent has played down the effects of the Declaration because Claimant to this day retains the equipment concerned and its rights under Contract 402. But 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, existing or potential. The negative connotation of being associated with a company whose contract with the Government is considered *lesivo* by agreement of all members of that Government cannot be discounted. Furthermore, the uncertainty created by the *Lesivo* Declaration may last for a considerable period of time. Even if the claim of *lesivo* would eventually be dismissed, it would be, from a business point of view, difficult, if not impossible, to return to the situation *ex ante*.

148. Claimant has placed particular emphasis on the similarities of the *Shufeldt* case[6] with the dispute before the Tribunal. In *Shufeldt* a concession contract was terminated by legislative decree signed by the President of Guatemala because it was harmful to the interests of the State. According to Claimant, the grounds for the measure taken by Guatemala to terminate the concession after six years of having benefited from it, bear remarkable similarity to those adduced by Respondent in the case of Contract 143/158 -*inter alia*, lack of authority of the Minister of Agriculture to enter into the concession contract, lack of approval by the National Assembly, no public bidding, etc.- Respondent has pointed out that the legislative decree once signed and published brought the concession contract to an end and Mr. Shufeldt was deprived of all his contract rights, which is not the effect of the *Lesivo* Declaration in respect of Contract 143/158. Respondent has further explained that Guatemala's main arguments in the *Shufeldt* case "related to the nullity *ab initio* of the contract due to lack of legislative approval and lack of Government authority to enter into a contract which violated its tax laws. In the present case, however, while similar arguments may have been a principal defense involved at the jurisdictional phase, they have been accorded no such status in terms of Guatemala's expropriation defense. Guatemala has consistently argued that the lack of *effect* (let alone substantial effect) upon Claimant's investment is the determinative defense to Claimant's expropriation claim." (Rejoinder, para. 128) Leaving aside that this is a misstatement of Respondent's overall position[7], the Tribunal agrees that the *Lesivo* Declaration is different in character from the legislative measure taken by Respondent in the case of *Shufeldt*. The question for the Tribunal is whether notwithstanding the differences, the measure here had equivalent effects on the investment.

149. Respondent was fully aware of the powerful effect of a *lesivo* declaration when it chose to use its publication to renegotiate all issues in respect of the three

[6] *Percy Shufeldt (US) v. Guatemala*, 2 U.N.R.I.A.A. 1079, Decision of July 24, 1930.

[7] In its Counter-Memorial Respondent argued that Claimant could not prove that had any usufruct rights under Guatemalan law: "With respect to Contract 143/158, Claimant's expropriation claim is unsustainable, as this contract is not valid, never came into force and therefore affords Claimant no protection under Guatemalan law. Guatemala could not expropriate alleged rights that Claimant never had." (para. 234)

contracts, as evidenced by the settlement offer of August 24, 2006 and the negotiations that ensued before the Attorney General filed the *lesivo* claim with the Administrative Tribunal. Respondent's argument that Claimant would have been glad to seize on this opportunity to close a loss-making business, does not jibe with the fact that FVG continued to provide the service for more than a year after the *Lesivo* Declaration was published until, October 1, 2007. It would not have been in its interest to make matters worse. Furthermore, if, as Respondent argues, the economic interest of Claimant relies on the right-of-way and real estate associated with the railroad, Claimant would have an interest in preserving the service even at a loss, lest it be deprived of the real estate rights for not rendering its service.

150. The effect of the *Lesivo* Declaration is evident in the drop in the volume of freight carried by the railroad post-*lesivo* as compared with the previous year, in the fact that suppliers refused FVG credit, in the reluctance of customers to enter into long-term arrangements with FVG, and in the increase in squatters, industrial or otherwise. The perception created by the Declaration is evident in the decision of the municipality of San Antonio La Paz to install a water pipeline in the right-of-way without requesting authorization from FVG because due to *lesivo* FVG could not grant it (Ex. C-50) and in the paving of the right-of-way by the Municipality of Puerto Barrios, the port to be served by the restored section of the railroad.

151. The question here is whether in the circumstances there was an expropriation of the railway enterprise. The authorities on expropriation are numerous and largely depend on their own facts. A common theme is that an effect of the measures is that the claimant is deprived substantially of the use and benefits of the investment. Thus the statements to this effect in cases such as, *inter alia*, *Metalclad Corporation v United Mexican States*,[8] *Pope and Talbot, Inc v Canada*,[9] *Técnicas Medioambientales Tecmed SA v United Mexican States*,[10] *CMS Gas Transmission v*

[8] ICSID Case No. ARB(AF)/97/1, Award of August 30, 2000, para. 103: 'Thus, expropriation … includes … interference with the use of property which has the effect of depriving the owner, *in whole or in significant part*, or the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State' (emphasis added).
[9] NAFTA (UNCITRAL), Partial Award of June 26, 2000, para. 102.
[10] ICSID Case No. ARB (AF)/00/2, Award of May 20, 2003.

Argentina,[11] *Telenor Mobile Communications SA v Republic of Hungary*[12] and *Fireman's Fund Insurance Company v United Mexican States*.[13]

152. As to the circumstances here, the Tribunal would note: (a) that more than five years after the publication of the *Lesivo* Declaration, Contract 143/158 and Contract 402 remain in effect; (b) Claimant continues to be in possession of the railway equipment; (c) Claimant continues to receive rents associated with its real estate rights under Contract 402; and (d) such rents amount to 92% of revenues of FVG. For these reasons, the Tribunal concludes that the effect on Claimants' investment does not rise to the level of an indirect expropriation.

VI. NATIONAL TREATMENT

153. The Tribunal turns to the allegation that Respondent breached Article 10.3 of CAFTA. The Tribunal has already concluded that Claimant has not shown that the purpose of the *Lesivo* Resolution was to favor Mr. Campollo. It is on this premise that Claimant has in great measure based its allegation under Article 10.3. As noted by the Tribunal, more than five years after the *Lesivo* Resolution, Claimant continues to have its contractual rights to the right-of-way and to remain in possession of the railway equipment. This by itself is sufficient basis for rejecting Claimants' allegation that Respondent treated Claimant differently from Mr. Campollo. Furthermore, the Tribunal considers that Respondent has failed to show that Claimant and Mr. Campollo are foreign and domestic investors in "like circumstances." According to Claimant, both are competitors in the same economic sector since they have been competing to invest and operate the railroad and in leasing and developing the railroad's assets. Claimant supports this statement by citing the fact that Mr. Campollo has certain interests in the sugar industry in the Dominican Republic, and operates a railroad there purely for the

[11] ICSID Case No. ARB/01/8, Award of May 12, 2005, para. 262: 'The essential question is therefore to establish whether the enjoyment of the property has been effectively neutralized. The standard that a number of tribunals have applied in recent cases ... is that of substantial deprivation'.
[12] ICSID Case No ARB/04/15, Award of September 13, 2006, para. 65: '...the interference with the investor's rights must be such as *substantially to deprive* the investor of the economic value, use or enjoyment of its investment' (emphasis added).
[13] ICSID Case No ARB(AF)/02/1, Award of July 14, 2006, para. 176(c): 'The taking must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof'.

transportation of the produce of his estate. In the Tribunal's view, the obvious 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 defeats the "like circumstances" argument.

154. Claimant contends that, in any case, "even absent the complicity between the Government and Mr. Campollo, Guatemala discriminated against RDC when it sought to coerce RDC into surrendering unrestored rail segments in favor of 'other [interested] investors' in exchange for the Government abandoning the *Lesivo* Resolution." (Memorial, para. 165) The Tribunal will address the substance of this contention under the minimum standard of treatment. As to the expression "other investors", without further substantiation (which Claimant has failed to provide), it is too vague to state a separate basis of claim. The Tribunal is in no position to determine who these investors are and whether they are in "like circumstances", nor has the Tribunal been presented with evidence of the identity of these investors.

155. To conclude, the Tribunal finds that the allegation of breach by Respondent of its obligations under Article 10.3 of CAFTA is without merit.

VII. MINIMUM STANDARD OF TREATMENT

1. The Parties' Arguments

156. Claimant argues that Respondent did not treat it fairly and equitably, contrary to Article 10.5 of CAFTA. Claimant refers to this standard of treatment as understood by arbitral tribunals in *Waste Management II* and *Tecmed*.[14] According to Claimant, this standard requires the State to respect the reasonable expectations that were taken into account and reasonably relied upon by the foreign investor; in that regard the conduct of the State must be transparent, consistent, non-discriminatory and not based on unjustifiable or arbitrary distinctions. According to Claimant, this is an objective standard unrelated to whether the State has had any deliberate or malicious intention or manifested bad faith.

[14] *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award of April 30, 2004, (*Waste Management II*); *Técnicas Medioambientales S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award of May 29, 2003.

157. Claimant relates the breach of this standard to the *Lesivo* Resolution. Claimant contends that the *lesivo* procedure does not define what makes a contract detrimental to the interests of the State and, therefore, the Government can declare such contract *lesivo* for reasons unsupported by the facts and within the control of the Government regardless of whether a contract is in truth harmful to the State's interests. According to Claimant, the *lesivo* procedure does not afford due process since it does not allow the investor an opportunity to contest or respond to the Government's allegations before the declaration is issued. Claimant argues that as applied in this case the *lesivo* procedure was "arbitrary, grossly unfair, unjust or idiosyncratic, [was] discriminatory [and] involve[d] a lack of due process leading to an outcome which offends judicial propriety"[15]. Claimant proceeds to list the actions which allegedly breached Respondent obligations under the fair and equitable treatment standard:

> "(i) Basing the *Lesivo* Resolution on grounds that are directly contrary to the facts and prior actions, representations and agreements of the Government;
>
> (ii) Basing the *Lesivo* Resolution on grounds that were entirely the fault of the Government and easily within the Government's control to address and correct (if even necessary) through less extreme measures;
>
> (iii) Issuing the *Lesivo* Resolution just prior to the expiration of the three-year limitations period after FVG refused the Government's demands that it agree, for no consideration (other than the Government abandoning the *Lesivo* Resolution), to modify the economic terms of the Usufruct Contracts to the Government's benefit and surrender substantial rights under the Contracts;
>
> (iv) Declaring Deeds 143/158 detrimental or injurious to the interests of the State when no demonstrable injury to the State existed;
>
> …
>
> (vi) Failing to act in good faith towards RDC and its investment by implementing a measure with intent to discriminate and knowledge of the unlawfulness of such implementation." (Memorial, para. 149)

158. Claimant also contends, citing *Tecmed* and *Metalclad*, that the fair and equitable treatment standard includes the concept of transparency. Claimant alleges that Guatemala failed to ensure a transparent and predictable framework for FVG's

[15] *Waste Management II*, *op. cit.,* para. 98.

business and with the *Lesivo* Declaration undermined RDC's reasonable and legitimate investment-backed expectations such as:

> "(i)RDC's expectation that FVG would have the exclusive right to use the rolling stock during the entire 50-year term of the Usufruct;
>
> (ii) RDC's expectation and understanding that Deed 143 was awarded, executed and approved in accordance with Guatemalan law;
>
> (iii) RDC's expectation and understating that the economic terms of Deeds 143/158 were acceptable to the Government;
>
> (iv) RDC's expectation and understanding that Deeds 143/158 adequately protected the Government's purported "historical and cultural patrimony" interests in the rolling stock;
>
> (v) RDC's expectation that the Government would, pursuant to its obligation under Deed 402, not "hinder the rail and non-rail activities of [FVG]," and "protect[] the exercise of [FVG's] rights against third parties that may intend to have or want to exercise a right on the real estate granted as onerous usufruct";
>
> (vi) RDC's expectation and understanding that any disputes between it or FVG and the Government would be addressed and resolved through negotiation or binding arbitration rather than unilateral Government action; and
>
> (vii) RDC's expectation and understanding that Guatemala would not take any precipitous or arbitrary actions against it that would serve to harm RDC's investment or FVG's business, especially where there is no allegation or contention that FVG has breached any obligation under the Usufruct Contracts and there is no evidence that Deeds 143/158 were injurious to the interests of the State." (Memorial, para. 154)

159. Respondent stresses that under CAFTA the obligation of fair and equitable treatment requires only the minimum standard of treatment under customary international law and does not create additional substantive rights. Respondent asserts that Claimant carries the burden of proof that the standards of conduct it invokes as part of its fair and equitable treatment claim are indeed part of the minimum standard of treatment under customary international law. Furthermore, according to Respondent, Claimant may not rely on the definition of fair and equitable treatment provided by international tribunals that were not similarly bound by the minimum standard of treatment of customary international law.

160. Respondent refers with approval to the statement in the *Glamis Gold Award*[16] that arbitral awards do not constitute State practice and thus cannot create or prove customary international law, and argues that, in order for Claimant to meet its burden, Claimant may only rely on treaties that require or jurisprudence that interprets the "customary international law" standard of treatment.

161. Respondent argues that "Claimant has *failed* to demonstrate that the three alleged standards of treatment –non-arbitrariness, transparency and adherence to an investor's legitimate expectations- are elements of the minimum standard of treatment." (Counter-Memorial, para. 354. Emphasis in the original) According to Respondent, even if Claimant had succeeded in doing so, it still failed to demonstrate that Guatemala breached this standard. Respondent recalls that customary international law places a heavy burden upon a claimant to demonstrate that a State has breached an applicable standard of conduct and refers to the large amount of deference accorded by arbitral tribunals to respondent States in determining whether their action violates the fair and equitable treatment standard.

162. Respondent refers with approval to how the minimum standard of treatment was described by the arbitral tribunals in *Waste Management II*,[17] *GAMI*,[18] *Thunderbird*[19] and *Genin*[20] and asserts that Claimant has completely failed to demonstrate that Guatemala's conduct fell short of the minimum standard of treatment required by customary international law.

163. Respondent affirms that Guatemala acted at all times in good faith in respect of Claimant's investment. It refers to the description in *Waste Management II* of the two elements of acting in good faith (which Respondent accepts is one of the obligations comprised in the minimum standard of treatment). The first element, whether the State acted "improperly or "without justification", is a requirement that the

[16] *Glamis Gold, Ltd. v. The United States of America,* UNCITRAL (NAFTA), Award of June 8, 2009, para. 605.
[17] *Waste Management II*, *op.cit.,* para. 98.
[18] *Gami Investments, Inc. v. Mexico* , UNCITRAL (NAFTA), Final Award of November 15, 2004, para. 97.
[19] *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL (NAFTA), Award of January 26, 2006, para. 194.
[20] *Genin and others v. Estonia,* ICSID Case No. ARB/99/2, Award of June 25, 2001, para. 367.

State act rationally in accordance with its own laws. The second element requires that the State acted 'deliberately" or "consciously" in order to destroy the relevant investment.[21]

164. According to Respondent, "[...] Guatemala has acted rationally, in accordance with its own laws, and without malicious or improper intent. … Guatemala applied the *lesividad* procedure consistently with the letter and spirit of its laws, acting in good faith. At no point in time did the Government act with "intent to discriminate and knowledge of the unlawfulness" of its conduct. In fact, there was no unlawfulness, much less a known unlawfulness; Guatemala sought, and ensured, the faithful and good faith application of its extant laws concerning *lesividad*." (Counter-Memorial, para. 371)

165. Respondent explains that: "Once the illegalities of Contract 143/158 were raised, each of the Government's agents acted pursuant to Guatemalan law and all concluded that the contract must be declared *lesivo*; and that is what the President did. The *Acuerdo Gubernativo* which instructed the Attorney General to initiate proceedings before the *Contencioso Administrativo* court was signed by all of the required Ministers and the President, and was published in the Official Gazette within the three-year statute of limitations period. The Attorney General filed the case within the 90-day period required under Article 23 of the *Ley De Lo Contencioso Administrativo*. The *Contencioso Administrativo* courts have also acted consistently with their mandate, offering Claimant an opportunity to be heard, and even rejected the provisional measures requested by the Attorney General to suspend the validity of Contract 143/158 pending the final decision regarding its *lesividad*." (Counter-Memorial, para. 373. Footnotes omitted)

166. Respondent insists that: "Guatemala's sole intent and motivation was to apply its laws, and obtain a functioning railroad system. Rather than turn the railroad over to Ramón Campollo upon publishing the *Lesivo* Declaration, as Claimant's conspiracy theory suggests, Guatemala continued to meet with Claimant after the *Lesivo* Declaration was published, to negotiate a contract that would enable the

[21] *Waste Management II*, *op cit*, para. 138.

railroad to operate. Negotiations ended when FVG stated that it had no interest in entering into new equipment contracts. Despite Guatemala's efforts to negotiate, Claimant ceased railway operations in 2007, and left Guatemala without an operational railroad.' (Counter-Memorial, para. 374. Footnote omitted)

167. Respondent rejects the claim that it denied Claimant justice or due process of law. First, Respondent argues that the *lesividad* process "affords due process to the private party and ensures that the Executive follows a process of submitting its determinations to the courts in order to revoke its administrative acts that it believes are injurious to the public good, rather than simply allowing the Government to unilaterally revoke those acts [...], and affords private parties not only an opportunity to be heard, but an opportunity to overturn the initial declaration of *lesividad*, recourse for declarations that were improperly issued, and, if a contract *is* declared null and void after the administrative phase, the ability to file an indemnity claim for work that had previously been completed."(Counter-Memorial, para. 381.)

168. According to Respondent, in determining whether a particular procedure affords due process tribunals do not second guess State actions. Tribunals have held that no violation of due process occurs when the State applies a pre-existing law that is fair on its face, and "tribunals have explained that initial decisions that have the potential to be overturned upon further review do not generally violate the fair and equitable treatment standard under customary international law." (Counter-Memorial, para. 387) Respondent contends that Claimant's assertion that the *lesividad* procedure does not accord due process is contrary to each of these three rules and affirms that Guatemala has been transparent and strictly observed established procedure to declare Contract 143/158 *lesivo*: "[...] the process started upon request by FEGUA's overseer, followed by legal opinions from all concerned Ministries and FEGUA, as well as the President's Secretary General, and culminated with the decision by the President to declare the equipment contracts *lesivo*. Although not required to do so by law, the Government even informed Claimant of the process and halted it in order to accommodate negotiations in the hopes of reaching a compromise. Since a negotiated solution was impossible, the *Lesivo* Resolution was published in accordance with the law within the established time period to do so. Following publication, the Attorney

General filed its complaint before the *Contencioso Administrativo* Court, where the process remains pending [...]" (Counter-Memorial, para. 197).

169. Respondent affirms that mere arbitrariness does not constitute a breach of the fair and equal treatment standard under CAFTA, and that the *Lesivo* Declaration was not arbitrary by any objective standard: "In light of the five legal opinions from independent agencies and outside counsel, each of which concluded that Contract 143/158 must be declared *lesivo*. In view of Claimant's indifference toward negotiation, and the pending statute of limitations deadline, the President's decision to declare Contract 143/158 *lesivo* was not only reasonable, but required. Under these circumstances, Guatemalan law affords the President no discretion; he must initiate the *lesividad* process via *Acuerdo Gubernativo* [...]" (Counter-Memorial, para. 408)

170. Respondent denies that it discriminated against Claimant. According to Respondent, the existence of a discriminatory measure requires a fact-based inquiry and a comparison of the complainant to a similarly-situated person. Claimant has not explained how the *lesividad* process is discriminatory and has not provided "the Tribunal with a proper basis of comparison, describe a distinction between itself and domestic investors, and demonstrate that the State action was unreasonable." (Counter-Memorial, para. 405) In any case, Respondent argues that there was no discriminatory effect because a tribunal would make the final decision.

171. Respondent re-affirms that Claimant has not satisfied its burden of demonstrating that to act transparently is an element of the customary international law minimum standard of treatment and its belief that it acted transparently: "Claimant was aware of each aspect of the *lesividad* process. First, [...] Claimant was aware of the illegalities in Contract 143/158, and participated in negotiations with Guatemalan officials to cure these deficiencies. Second, Claimant was aware that Guatemala was considering initiating the *lesividad* process. As counsel for Claimant stipulated for the record at the Hearing on Jurisdiction, there was a document regarding the *lesividad* of Claimant's concession contracts that was being circulated among Government Ministers for signature in May 2006 [...]" (Counter-Memorial, para. 420. Footnotes omitted) Furthermore, "Claimant has also been given notice and has been afforded a

full opportunity to be heard in its own defense in further proceedings before the *Contencioso Administrativo* court. True to Guatemalan law, the *Contencioso Administrativo* courts have reinforced the principle that a *lesivo* declaration itself has no effect upon the validity of a contract. On two separate occasions, the *Contencioso Administrativo* courts declined to temporarily suspend Contract 143/158 while the final decision regarding the validity of that contract was pending. What is more, Guatemalan courts have ruled that the *Lesivo* Declaration had no effect upon Claimant's investment or rights under Contract 402, and police and other authorities continue to recognize the validity of Claimant's entire investment [...]." (Counter-Memorial, para. 422. Footnotes omitted)

172. Respondent also argues that Claimant has not demonstrated that the doctrine of "legitimate expectations" is part of the minimum standard of treatment. According to Respondent, the cases on which Claimant relies – *Sempra, Tecmed and Waste Management II* –-address "the more narrow contours of the minimum standard of treatment under customary international law, to determine if that minimum standard itself requires that a State act according to an investor's legitimate expectations." (Counter-Memorial, para. 211) Respondent refers to the warning in the *MTD Decision on Annulment*[22] that "*The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have.* A tribunal which sought to generate from such expectations a set of rights different from those contained in or enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly [...]" (Counter-Memorial, para. 427) Respondent also relies on the fact that the *Glamis Gold*[23] tribunal accorded no weight to the claimant's argument based on legitimate expectations and concluded that not living up to expectations cannot be sufficient to find a breach of NAFTA.

173. In any case, according to Respondent, Claimant's expectations were not legitimate and Claimant was aware, given its previous experience in Guatemala, that

[22] *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7, Decision on Annulment of March 21, 2007, paras. 67-69.
[23] *Glamis Gold, op cit,* para. 620.

Contract 143/158 was plagued by formation defects: “Because Contract 143/158 did not comply with the formation requirements of which Claimant was well-aware -having previously been awarded two contracts as a result of a public bid, and having admitted that Contract 41 never entered into force because it never received the requisite approval- Claimant could not have generated any legitimate expectations based on the terms of Contract 143/158. Hence, these expectations are unreasonable.” (Counter-Memorial, para. 435) Claimant could not expect that Guatemala would not enforce its laws.

174. Respondent adds that, even if Claimant’s expectations were considered reasonable, Respondent has not frustrated them since Claimant remains in full possession of the railway equipment, has initiated more than 50 legal proceedings relating to the theft of rails and more than 50 legal proceedings to dislodge squatters along the right of way granted under Contract 402. Furthermore, Respondent argues that Claimant could not expect that, because there are arbitration clauses in the contracts, Respondent would refrain from upholding its own laws, and denies that it took any precipitous or arbitrary action on the part of Guatemala.

175. Respondent addresses the argument that the process of *lesividad* is as such contrary to the minimum standard: acceptance of this argument would undermine the requirement that fair and equitable treatment be determined by a case-specific, fact-based inquiry, and would violate notions of comity and sovereignty. Respondent refers to its previous arguments that the *lesivo* process is not inherently unfair, unreasonable or inequitable exercise of State power but “a judicially recognized constitutional and reasonable measure designed to uphold the rule of law.” (Counter-Memorial, para. 449)

176. Finally, Respondent asserts that the factual allegations made by Claimant (Memorial, para. 149) are either false or do not constitute a breach of the fair and equitable treatment standard. It was not true that the *Lesivo* Declaration was taken on grounds directly contrary to the Government’s representations or that the *Lesivo* Declaration was predicated upon a situation that was entirely the fault of the Government. It was not contrary to the minimum standard of treatment to issue the

Lesivo Declaration on the last day that it could be issued or to request that Claimant comply with its obligations under Contract 402. To presuppose that Contract 143/158 was not actually injurious to the State mischaracterizes the effect of the *Lesivo* Declaration. That Declaration merely demonstrates that the President and his Cabinet had enough evidence to submit the question whether the contract was *lesivo* to the Administrative Tribunal.

177. In its Reply Claimant observes that the terms of CAFTA and NAFTA are essentially the same in describing the fair and equitable obligation and considers that arbitral awards in NAFTA cases are particularly relevant to this Tribunal. After a review of NAFTA awards since 2001, Claimant concludes that *Glamis Gold* is an outlier in its formulation of the minimum standard of treatment and notes that all these tribunals held that customary international law may evolve over time. Claimant refers in particular to *Mondev*[24] and *Merrill & Ring*[25] for the care they took to establish this evolution and notes that there is agreement among NAFTA tribunals that fair and equitable treatment can only be discerned when applied to the facts of each case.

178. Claimant then considers the period for assessing Respondent's conduct. According to Claimant, it is permissible to refer to conduct of Respondent prior to CAFTA's entry into force in support of its claims; acts or omissions by Respondent may be relevant in determining whether the State has subsequently committed a breach of its obligations. Claimant asserts that Guatemala had an obligation to refrain from acts that would defeat the object and purpose of CAFTA from the date it signed this treaty. In a footnote Claimant explains that Article 28 of the Vienna Convention provides "an appropriate lens for viewing Respondent's conduct in the period between CAFTA's signing and entry into force, consistent with customary international law." (Reply, para. 341, footnote 800)

179. According to Claimant, it is well established that fair and equal treatment encompasses the obligation of the State to act in good faith and failure to act in good

[24] *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 (NAFTA), Award, of October 11, 2002, para. 125.
[25] *Merrill & Ring Forestry L.P. v. Canada*, UNCITRAL (NAFTA), Award of March 31, 2010, paras. 202-212.

faith is proof of a breach of the fair and equitable treatment standard under customary international law. Claimant refers to examples of violations of good faith identified in arbitral awards in the investment context which exist in the instant case: "(i) situations of coercion and harassment directed at the investor; (ii) a deliberate conspiracy to defeat the investment; (iii) use of threats of rescission to bring a concessionaire to the re-negotiation table; and (iv) termination of an investment for reasons other than the one put forth by the government [...]" (Reply, para. 343)

180. Claimant points out that the defects in Contract 143/158 were entirely within the Government's control to fix and that it never made an offer to fix them because Respondent was never concerned about these defects except to use them as a threat instrument. According to Claimant, the *lesivo* strategy was first set forth in Mr. Gramajo's Options Paper of April 2005 where it is proposed "seeking the 'nonamicable Termination' of Contract 143 and … using the lack of Executive approval of this contract as a basis for renegotiating the terms of the Contracts 402 and 820 to relieve FEGUA of its outstanding $2 million debt to the Railway Trust Fund, its obligation to make further contributions to the Trust Fund and its obligation to remove squatters. Notably missing from the Options Paper was the 'good faith option' of simply securing Executive approval for the Contract." (Reply, para. 347)

181. Claimant observes that the Attorney General's opinion of August 1, 2005 stated that Contract 143/158 was *lesivo* but this infirmity could be resolved by means other than *lesividad* such as early termination, annulment or mutual agreement and notes that when on January 13, 2006 Mr. Gramajo requested the President to declare Contract 143/158 *lesivo* he ignored the other options and cited as irregularities provisions copied from Contract 41.

182. Claimant disputes Respondent's assertion that the High-Level Railroad Commission was a good faith exercise. Claimant argues that the opposite was true because in parallel the Government was preparing the *Lesivo* Declaration. Claimant refers to the fact that President Berger signed the *Lesivo* Declaration on August 11, 2006, but that Respondent waited until the week of August 21 to tell Claimant that if it would not agree to changes in the Usufruct Contracts, a declaration of *lesividad* would

be issued. Respondent alleges that the offer it received at the meeting of August 24 would have altered the economic terms of FVG's concession to its detriment; in that offer there was only a minor reference to the equipment contracts in order to rectify the terms deemed to cause lesion to the interests of the State. Claimant maintains that only learned then, for the first time, that the *Lesivo* Declaration was directed to Contract 143/158.

183. Claimant questions the inevitability of the *lesivo* process and the alleged lack of discretion of the President: the legal opinions of Respondent contemplated other solutions and in fact the grounds for *lesividad* were under the Government's control. Claimant points out that in the various legal opinions of Respondent the only substantial harm to the State's interests is that Respondent was denied the benefit of other potential bidders for the equipment who may have offered a higher price. Claimant finds the proposition ludicrous given that FVG had the exclusive right to the only narrow gauge railway in Guatemala and in 1997 FVG had been the only bidder.

184. In support of its argument that the Respondent acted in bad faith Claimant refers to President Berger's statement that the *Lesivo* Resolution was issued not because of the defects in Contract 143/158 but because FVG failed to rebuild and re-open the South Coast corridor and that FVG had 90 days to guarantee a USD50 million investment or otherwise he would take away the railway concession and call for a new bidding process. Claimant also refers to the secret minutes of the discussion tables after the *Lesivo* Declaration which show that the Attorney General used the timing of the *lesivo* action in the Administrative Tribunal to "increase pressure to advance the negotiations'. In this respect, Claimant explains that: "Negotiations between FVG and the Government ended not because FVG was unwilling to enter into a new usufruct equipment contract -the Government never made such a stand-alone offer -but because FVG was unwilling to accede to the Government's extortionate demands to surrender its fundamental rights under the Usufruct Contracts." (Reply, para. 354) Claimant concludes by referring to the holding of the tribunal in *Waste*

Management II[26] that deliberately setting out to destroy or frustrate the investment by improper means is a breach of the minimum standard of treatment.

185. Claimant asserts that Respondent denied Claimant due process of law and rebuts Respondent's defenses in respect of the *lesivo* process. Claimant explains that the question is not whether *lesividad* process is constitutional under Guatemalan law but whether it accords with due process requirements of international law. Claimant contends that there are no defined legal criteria or precedent that the Administrative Tribunal may use to perform a meaningful review of the President's action and the process has been pending for years when it should have been completed within six months. Claimant asserts that the publication of the *Lesivo* Resolution had drastic consequences even if, as claimed by Respondent, it was only the first step in the initiation of a court process. Claimant also contends that it is absurd to affirm that it is reasonable that the Government make an initial decision in a purely internal deliberation when the *Lesivo* Declaration is a public declaration by the President of the Republic and his Cabinet. Claimant adds that during to the entire process leading to the *Lesivo* Resolution the internal and outside legal opinions were kept from Claimant and Claimant was not notified of the alleged technical and legal grounds for the *Lesivo* Resolution until May 15, 2007, six months after Respondent had commenced its action in the Administrative tribunal.

186. Claimant disputes that it has the opportunity to obtain recourse if the Declaration is held by the Administrative Tribunal to have been issued improperly. According to Claimant, the governing law does not provide for declaratory relief or damages. Moreover the focus would be on whether Government agencies complied with the procedural requirements, because there are no substantive requirements with which to comply or for the Administrative Tribunal to assess.

187. Claimant disputes Respondent's contention that the obligation to refrain from acting arbitrarily is not an element of the minimum standard of treatment. While Claimant recognizes that CAFTA – as it is also the case for NAFTA – does not contain a separate provision on arbitrary treatment, "NAFTA tribunals have reviewed a State's

[26] *Waste Management II, op. cit.*, para.138.

conduct for arbitrariness or otherwise acknowledged that arbitrary actions are prohibited by the obligation to provide fair and equitable treatment under customary international law minimum standard of treatment [...]" (Reply, para. 373) The issue is what is the standard to be applied. Claimant refers to *Waste Management II* which speaks of conduct "arbitrary, grossly unfair, unjust or idiosyncratic."[27] Claimant admits that mere arbitrariness may not be sufficient but few NAFTA tribunals have required the manifest arbitrariness that Respondent seeks to require in this proceeding. On the other hand, Claimant states that, even if the standard of manifest arbitrariness is to be applied, to which it said it had no objection, "it is not difficult to divine such arbitrariness in Respondent's conduct." (Reply, para. 374)

188. According to Claimant, "[...] the *Lesivo* Resolution as applied in this case was arbitrary and violated the fair and equitable treatment obligation in CAFTA Article 10.5 because it was not based on any defined legal standards, but on the Executive's personal whim and discretion; it did not serve any legitimate public purpose; and it was taken for reasons other than those put forward by the Government." (Reply, para. 381)

189. On Respondent's contention that Claimant has not met its burden of proof on whether legitimate expectations are part of fair and equitable treatment, Claimant refers to *Waste Management II*'s statement that in applying the standard of review under customary international law minimum standard of treatment "it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."[28] Claimant also refers to the *Glamis Gold* tribunal's statement that Article 1105(1) of NAFTA "requires the evaluation of whether the State made any specific assurance or commitment to the investor so as to induce its expectations."[29]

190. Claimant refers to Respondent's assertion that Claimant should have known the law of the country including the law on *lesivo*, and states that: "Claimant had every reason to expect that Guatemala would not use the *lesivo* process as a strategy and means to force Claimant to renegotiate and surrender substantial rights

[27] *Waste Management II*, *op.cit.*, para. 98.
[28] *Ibid*. para. 99.
[29] *Glamis Gold, op.cit.*, para. 620.

under the Usufruct Contracts to benefit the Government and the mutual economic interests of Ramón Campollo and President Berger's family." Reply, para.394) As to Respondent's assertion that Claimant's legitimate expectations had not been frustrated because Claimant retains possession of the equipment, Claimant reiterates that this is nothing more than form over substance and that "[b]y itself, the *Lesivo* Resolution rendered Claimant's possession of such equipment *worthless* because it destroyed FVG's railroad business." (Reply, para. 396. Emphasis in the original)

191. As to transparency, Claimant recalls that CAFTA's preamble includes an explicit objective to "PROMOTE transparency...in international trade and investment" and argues that the following actions demonstrate a fundamental lack of transparency: "(i) the lack of any objective standards for a declaration of *lesividad* in Article 20 of the *Ley De Contencioso Administrativo*; (ii) Respondent's deliberate withholding of its intention to declare Contracts 143/158 *lesivo* until the day before the deadline to publish the declaration; and (iii) Respondent's deliberate withholding from Claimant of the asserted legal grounds for declaring Contracts 143/158 *lesivo* until months after its action was formally filed in the *Contensioso Administrativo* court [...]" (Reply, para. 397)

192. In its Rejoinder Respondent argues that Claimant has failed to prove that the standard of fair and equitable treatment imposes: "(a) a duty to refrain from acting in bad faith; (b) an obligation to afford due process; (c) a duty to refrain from engaging in arbitrary or discriminatory conduct; (d) an obligation to refrain from frustrating an investor's legitimate expectations; and (e) a duty to provide transparency and stability to foreign investments." (para. 132). According to Respondent, Claimant has tried to satisfy its burden of proof by citing previous awards and by relying on the 2000 plus BITs in existence; but, this is not sufficient evidence. Relying on *Glamis Gold*, Respondent reiterates previous affirmations that they do not constitute state practice and cannot create or prove customary international law.[30] As to the BITs, it is Respondent's opinion that, even if such treaties could demonstrate *opinio iuris*, they do

[30] *Glamis Gold*, *op.cit.*, para. 605.

not define the standard and do not establish State agreement with respect to the individual types of conduct invoked in this case.

193. Respondent also contends that Claimant has failed to establish that Guatemala's conduct fell short of the minimum standard of treatment. First, there is no evidence to support Claimant's conspiracy theories underlying the intention behind the issuance of the *Lesivo* Declaration. Second, Respondent disputes that the Options Paper demonstrates a bad faith strategy on the part of the Government; this paper does not reflect the use of *lesividad* as a pressure mechanism to take away Claimant's rights under Contracts 402 and 820 or to force a renegotiation of those agreements. Third, Respondent insists that FEGUA negotiated with FVG "in good faith and with the intent to address the illegalities contained in Contract 143/158 and the hope that the parties could simultaneously address issues related to other aspects of the relationship." (Rejoinder, para. 165) Respondent adds that: "Pursuant to Guatemalan law, Guatemala could not have solved the problems related to Contract 143/158 by itself. It needed FVG's -and therefore the Claimant's- cooperation, which it never obtained." (ibid.)

194. Respondent refers to the letter of Mr. Senn to Vice-Minister Díaz and stresses its importance for the following reasons: "First, it demonstrates that, as of November 2004, Claimant was aware that Contract 143/158 had legal defects. Second, it expressly confirms that Claimant was aware that the Government did not recognize the validity of Contract 143/158 due to these illegalities. Third, it serves as contemporaneous evidence of Claimant's awareness that some sort of remedy was in order, and shows that, rather than refuse to negotiate because the defects in Contract 143/158 "were entirely within the Government's control to resolve and that they could easily be resolved without any 'negotiation' with Claimant," FVG chose to negotiate with FEGUA in an attempt to resolve the Contract 143/158 problem by "presenting an amendment to the contract, or a new contract, before the end of the year." Fourth, and finally, it offers contemporaneous insight into FVG's impression of its negotiations with FEGUA. While Claimant's witnesses now purport to recall that the Government's "explicit" agenda was to "coerce Claimant into either substantially giving up its property rights or forcing it to abandon its investment without any compensation," Claimant's 17

November 2004 letter gave no such indication. Nor did it discuss a fear that Guatemala would terminate FVG's rights in order to favor Ramón Campollo" (Rejoinder, para. 171. Footnotes omitted).

195. Respondent insists that it was prepared to make reciprocal concessions when it proposed a draft settlement in August 2006: "This would necessarily include a path to conduct a new public bid and to provide that any new railway contract would be approved by the President, as required by Guatemalan law. These were some of the principal defects that had been identified by the Attorney General and other agencies, and necessarily ones that would need to be corrected; the Government acknowledged in the drafts presented to FVG that the legal defects with the railway equipment contract would need to be remedied as part of any negotiated solution. FVG, however, refused to negotiate, sending to the meeting only Mr. Senn, who indicated that he did not have a power of attorney or authority to reach an agreement on behalf of FVG. The Government therefore published the *Lesivo* Declaration on the last possible day before the statute of limitations would expire." (Rejoinder, para. 173. Footnotes omitted)

196. Respondent addresses the issue of publishing the *Lesivo* Declaration on the last day before the three-year statutory term expired and explains that, contrary to what Claimant argues, it shows its good faith in making a last-minute attempt to solve the pending issues after a lengthy negotiation process. Respondent also affirms that "*there is no proof whatsoever that the Government would have been unwilling to stop the Lesivo Declaration if Claimant had agreed to negotiate a path forward to resolve the legal defects in Contract 143/158 prior to the publication of that resolution, even if the parties could not reach agreement on the others issues set forth in the settlement draft.* However, there is ample proof that the Government would have been willing to do so, as demonstrated by its willingness in 2004 and 2005 to attempt to negotiate a resolution of these defects as well as by the language included in the draft agreement presented to FVG on 24 August 24 2006 wherein the Government made clear that it wanted FVG to agree to a path that would remedy these defects, and by the Government's continued efforts to negotiate a path forward to cure the defects in the equipment contract even after the *Lesivo* Declaration was issued." (Rejoinder, para. 176. Emphasis in the original; footnotes omitted)

197. Respondent argues that Claimant cannot convert a standard bargaining situation into bad faith and a treaty violation and insists that Guatemala negotiated in good faith to resolve all issues that were of concern to the parties including the legal defects of Contract 143/158 but did not use the defects to threaten Claimant and force its hand. In Respondent's opinion, *"Lesividad* also was the *least intrusive* solution to the problem for Claimant, in that requesting a final determination from the *Contencioso Administrativo* Court would fulfill the Government's obligation to seek a remedy for the illegalities of Contract 143/158, and provide adequate safeguard for Claimant's investment, while at the same time permitting Claimant to retain possession of the equipment pending the Court's decision. If the *Contencioso Administrativo* Court decided that Contract 143/158 was not, in fact, *lesivo* to the interests of the State, the contract would be validated despite its illegalities." (Rejoinder, para. 181. Footnote omitted, emphasis in the original) Respondent refers to the holding of the Tribunal in its Second Decision on Jurisdiction that "principles of fairness should prevent the government from raising violations of its own law as a defense when [in this case, operating in the guise of FEGUA, it] knowingly overlooked them and [effectively] endorsed an investment which was not in compliance with its law." (Rejoinder, para. 185) Respondent argues that the Tribunal cannot adopt in the merits context as a finding that initiating the *lesividad* process was "unfair" or "inequitable." According to Respondent: "A finding that Guatemala would be precluded by CAFTA to question the validity of a contract within the processes available under domestic law, simply because it had performed under that contract for a period of time, would severely and improperly restrict State sovereignty. Taken to the extreme, a bright-line rule that a State is estopped from exercising pre-existing domestic remedies to question the validity of a contract simply because the State had operated under that contract for a period of time could prevent a State from terminating a contract initiated by bribery or corruption." (Ibid)

198. According to Respondent, the facts do not support the preliminary conclusion of the Tribunal in the Second Decision on Jurisdiction to the effect that FEGUA "knowingly overlooked [the legal defects in Contract 143/158] and [effectively] endorsed an investment which was not in compliance with its law". Respondent

contends that the more developed record shows that Mr. Gramajo informed FVG as soon as it learned of the legal defects and that FEGUA negotiated with FVG while at all times maintaining that Contract 143/158 was invalid. Responded argues that FEGUA did not accept payments under Contract 143/158 and allowed FVG to use the railway equipment pursuant to the prior authorizations issued by the predecessor of Mr. Gramajo as shown by Mr. Gramajo's letter of April 12, 2004 to G. Zachrisson. FEGUA did not endorse Contract 143/158 as proven by the letter of FVG to the Vice-Minister of Communications dated November 15, 2004. In Respondent's opinion Claimant should not be entitled to rely on equitable arguments because no one can benefit from his own wrong and "FVG and Claimant knew what the legal requirements were for the equipment contract and sought to evade them by entering into back-dated lease agreements and later Contract 143/158." (Rejoinder, para. 187)

199. As to denial of justice or due process, Respondent argues that "the Court has amply demonstrated both its independence and its willingness to uphold Claimant's rights in this very case. Thus, although the Attorney General sought a provisional suspension from the *Contencioso Administrativo* Court which would temporarily suspend Contract 143/158, the Court rejected the Attorney General's request, and rejected his subsequent petition to reconsider the initial rejection. Similarly, in 2010, the *Contencioso Administrativo* Court overturned an initial declaration of *lesividad*." (Rejoinder, para. 190. Footnotes omitted) Respondent adds that the Administrative Tribunal is competent to consider the formal and substantial aspects of a declaration of *lesividad*, and if the focus of the proceedings has been on the procedural requirements of the law, it is because Claimant chose to challenge the *Lesivo* Declaration on procedural rather than substantive grounds. Respondent concludes this is a failure of Claimant's litigation strategy rather than of Guatemala's judicial system.

200. Respondent recalls that Claimant has had the opportunity to be heard by the Constitutional Court and this Court decided that the *amparo* action filed by Claimant was untimely. According to Respondent, Claimant has failed to prove its case based on the length of the *contencioso administrativo* process as demonstrated by the

documents filed in or issued by the Administrative Tribunal in respect of the *lesividad* of Contract 143/158.

201. Respondent contends that the *Lesivo* Declaration and subsequent actions were not arbitrary or discriminatory, and ”encourages the Tribunal to adopt the standard articulated by the NAFTA tribunal in *International Thunderbird* and by the International Court of Justice in *ELSI*, both of which considered the severity of an arbitrary measure. In *International Thunderbird*, the tribunal discussed a breach in terms of ‘manifest arbitrariness falling below acceptable international standards.’ In *ELSI*, the ICJ stated that arbitrariness under customary international law ‘is not so much something opposed to *a* rule of law, as something opposed to *the* rule of law...It is a *wilful [sic] disregard of due process of law*, an act which *shocks*, or at least surprises, a sense of juridical propriety [...]’” (Rejoinder, para. 204. Footnotes omitted, emphasis added by Respondent)

202. Respondent takes issue with the reasons given by Claimant in support of its submission that the *Lesivo* Declaration was arbitrary. The first reason adduced by Claimant is that the Declaration was not based on defined legal standards, did not serve a public purpose and was taken for reasons other than those put forward by the Government. According to Respondent, the Declaration was based on fact and reason and the absence of a list of pre-ordained circumstances that are harmful to the interests of the State does not equate with the absence of any legal standard on which to objectively assess the matter; the *lesivo* process serves the legitimate public purpose of upholding the law, “to ensure that the Government is not bound to perform contracts which violate its laws, and to ensure that the Government is not bound *ad eternum* to perform a contract which is, or may become, harmful to the public interest” (Rejoinder, para. 211); and the record shows that the actions before and after the *Lesivo* Declaration were proper to remedy the legal defects of Contract 143/158.

203. Respondent insists at every turn that Claimant has failed to show the elements it claims that are covered in the minimum treatment standard and to rely on arbitral awards to prove State practice. Thus, in the context of whether frustrating Claimant’s legitimate expectations or failing to provide transparency and stability is in breach of the obligation to accord fair and equitable treatment, Guatemala states:

"Though Claimant alleges that Guatemala 'apparently missed the point that the tribunal in *Waste Management II* was putting forward a standard of review for fair and equitable treatment under the customary minimum standard, having first conducted a comprehensive review of other NAFTA cases that had applied this standard,' it appears that it is Claimant that has missed Guatemala's point: decisions by international tribunals 'do not constitute State practice and thus cannot create or prove customary international law.'" (Rejoinder, para. 217. Footnotes omitted, underlining added by Respondent)

204. Respondent argues that the obligation of transparency is limited to the investor having the opportunity to know the rules and regulations that will govern its investment. Respondent first points out the contradiction in Claimant's argument in respect of the *Lesivo* Declaration: it affirms at the same time that it had kept the issuance of the Declaration secret and that it was used as a threat instrument. Then Respondent asserts that the extent of the standards and the standards themselves were readily available to Claimant at the time it invested.

205. As to legitimate expectations, Respondent affirms that Claimant has failed to prove that they were legitimate or that Guatemala has frustrated them. Respondent argues that there is no evidence that the *lesivo* process was used to force Claimant to renegotiate and surrender its rights under the Usufruct Contracts to benefit the Government and the mutual economic interests of Ramón Campollo and/or President Berger's family. Respondent refers to the Second Decision on Jurisdiction and explains that "It is understandable that the Tribunal in its Second Decision on Objections to Jurisdiction, based on the limited record then before it, may have jumped to the conclusion that Guatemala may have used the *Lesivo* Declaration as a pressure instrument given the comment made by the then-Attorney General in this 28 September meeting, but the full record simply does not bear out this is what occurred. It is important to note that this was an internal Government meeting that took place at the *end* of the many months of negotiations between the Government and FVG to try and sort out the disputes between them. There was record of only one meeting between parties after this internal meeting, which took place on 4 October 2006, and there is no indication at all that the *Contencioso Administrativo* proceeding was even

discussed in that meeting, let alone used as a pressure tool." (Rejoinder, para. 237. Footnotes omitted)

206. Respondent confirms that it has used *lesividad* in conformity with its "normal function" from a procedural and substantive point of view and affirms that the question for this Tribunal must be limited to procedure since Claimant has failed to establish that *lesividad* was used as part of a conspiracy to give Claimant's investment to Ramón Campollo and the question of whether it was correct to issue the *Lesivo* Declaration is irrelevant and beyond the Tribunal's jurisdiction. Respondent asserts that it met all procedural requirements under the relevant laws.

2. Non-Disputing Parties' Submissions

207. Three non-disputing State parties -the United States, El Salvador and Honduras- filed submissions on the minimum standard of treatment of aliens. The United States refers to Article 10.5(1) and (2) and explains: "These provisions demonstrate the CAFTA-DR Parties' express intent to incorporate the minimum standard of treatment required by customary international as the standard for treatment in CAFTA-DR Article 10.5. Furthermore, they express an intent to guide the interpretation of that Article by the Parties' understanding of customary international law, *i.e*., the law that develops from the practice and *opinio iuris* of States themselves, rather than by interpretations of similar but differently worked treaty provisions. The burden is on the claimant to establish the existence and applicability of a relevant obligation under customary international that meets these requirements."

208. After considering the provisions of Article 10.5, El Salvador concludes: "the proper interpretation of the requirement to provide 'Fair and Equitable Treatment' as part of the minimum standard of treatment under customary international, as required by CAFTA, can only be derived from the analysis of general and consistent State practice resulting from a sense of legal obligation. International awards are relevant to the determination of the appropriate interpretation under CAFTA, but only if and to the extent they actually examine State practice resulting from a sense of legal obligation. Therefore, international arbitral awards that refer to 'Fair and Equitable' as an autonomous standard, as well as investment treaties that use 'Fair and Equitable

Treatment' without reference to customary international law, are not relevant for purposes of the interpretation of the standard under CAFTA Article 10.5"

209. El Salvador notes that the interpretation of the standard of minimum treatment by NAFTA tribunals has not always been clear and uniform and states: "El Salvador considers that, in most respects, the interpretation and reasoning of the arbitral tribunal in the NAFTA arbitration between Glamis Gold and the United states of America correctly reflects the interpretation of the requirement to provide 'Fair and Equitable Treatment' as part of the minimum standard of treatment under customary international law, and therefore, under CAFTA Article 10.5. Thus in El Salvador's view, to violate the minimum standard of treatment under customary international law included in CAFTA Article 10.5, a measure attributable to the State 'must be sufficiently egregious and shocking -a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons- so as to fail below accepted international standards."

210. El Salvador considers that Article 10.5 does not include obligations of transparency, reasonableness, refraining from mere arbitrariness, or not frustrating investors' legitimate expectations. El Salvador informs the Tribunal that its interpretation is consistent with that expressed by the United States during the *Glamis Gold* arbitration and concludes: "El Salvador considers that the customary international law minimum standard of treatment articulated in *Neer v. Mexico* has not changed significantly over time. El Salvador agrees with the view expressed by the United States in the *Glamis Gold* arbitration that the recognition that customary international law may evolve over time does not require that any particular standard must have evolved within a certain amount of time." (Footnotes omitted)

211. In its submission Honduras observes that Article 10.5 bears the title of "Minimum Standard of Treatment" and not of "Fair and Equitable Treatment", which is only a "concept" included in the minimum treatment, and coincides in substance with the submissions of the United States and El Salvador.

3. Analysis of the Tribunal

a) The Applicable Standard

212. For purposes of easy reference, it will be useful to reproduce here the terms of Article 10.5 of CAFTA on the minimum standard of treatment:

> **"**1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
>
> 2. For greater certainty, 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. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
>
> > (a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
> >
> > (b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.
>
> 3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article."

A footnote to this article directs the Tribunal to interpret it in accordance with Annex 10-B on customary international law:

> "The Parties confirm their shared understanding that 'customary international law' generally and as specifically referenced in Articles 10.5, 10.6, and Annex 10-C results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 10.5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens."

213. The Tribunal refers also to the Preamble of the Treaty where the State parties declare that have concluded CAFTA, inter alia, to:

> **"ENSURE** a *predictable* commercial framework for business planning and investment;
> **PROMOTE** *transparency* and eliminate bribery and corruption in international trade and investment;

> **SEEK** to facilitate regional trade by promoting efficient and *transparent* customs procedures that reduce costs and ensure *predictability* for their importers and exporters." (Emphasis added by the Tribunal)

214. Article 1.2(1) on Objectives which applies to the entire agreement provides that:

> "The objectives of this Agreement, as elaborated more specifically through its *principles and rules*, including national treatment, most-favored-nation treatment, and *transparency* [...]" (Emphasis added by the Tribunal)

215. The following paragraph states:

> "2. The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law."

216. The Tribunal notes that the Mixed Commission in the *Neer* case did not formulate the minimum standard of treatment after an analysis of State practice. After reviewing commentaries by J.B. Moore, De Lapradelle and Politis, the Mixed Commission stated: "Without attempting to announce a precise formula, it is in the opinion of the Commission possible to go a little further than the authors quoted, and to hold (first) that the propriety of governmental acts should be put to the test of international standards, and (second) that the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful 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. Whether the insufficiency proceeds from deficient execution of an intelligent law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial." (*Neer*, para. 4) It is ironic that the decision considered reflecting the expression of the minimum standard of treatment in customary international law is based on the opinions of commentators and, on its own admission, went further than their views without an analysis of State practice followed because of a sense of obligation. By the strict standards of proof of customary international law applied in *Glamis Gold*, *Neer* would fail to prove its famous statement – "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"[31] – to be an expression of customary international law.

217. The Tribunal notes further that, as such, arbitral awards do not constitute State practice, but it is also true that parties in international proceedings use them in their pleadings in support of their arguments of what the law is on a specific issue. There is ample evidence of such practice in these proceedings. It is an efficient manner for a party in a judicial process to show what it believes to be the law. The problem, as the Mixed Commission in *Neer* already recognized, rests in "[...] the difficulty of devising a general formula for determining the boundary between an international delinquency of this type and an unsatisfactory use of power included in national sovereignty."[32] The difficulty in drawing this boundary is at the origin of the diversity of decisions on the minimum standard of treatment.

218. The parties have taken opposite stands on whether the minimum standard of treatment has evolved since *Neer*'s formulation. This matter has been dealt with extensively by previous tribunals in cases under NAFTA. The Tribunal refers positively in particular to the *ADF* award which accepts the evolution of customary international law noted in *Mondev*[33] and records the NAFTA parties' views in this respect: "[...] it is important to bear in mind that the Respondent United States accepts that the customary international law referred to in Article 1105(1) is not 'frozen in time' and that the minimum standard of treatment evolves. The FTC Interpretation of 31 July 2001, in the view of the United States, refers to customary international law 'as it exists today'. It is equally important to note that Canada and Mexico accept the view of the United States on this point even as they stress that 'the threshold [for violation of that standard] remains high.' Put in slightly different terms, what customary international law projects is not a static photograph of the minimum standard of treatment of aliens as it stood in 1927 when the Award in the *Neer* case was rendered. For both customary international law and the minimum standard of treatment of aliens it

[31] *L.F.H. Neer and Pauline Neer (U.S.A.) v. United Mexican States* (1926) 4 *R.I.A.A*, p. 61, para. 4.
[32] *Ibid*.
[33] *Mondev*, *op. cit.,* para. 125.

incorporates, are constantly in a process of development."[34] The Tribunal adopts this reasoning in *ADF* and shares the conclusion that the minimum standard of treatment is "constantly in a process of development," including since *Neer*'s formulation.

219. Regarding the content of the standard, the Tribunal refers to and adopts the conclusion reached by the tribunal in *Waste Management II* in considering NAFTA Article 1105 standard of review and after surveying NAFTA arbitral awards: "[...] 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."[35] The Tribunal finds that *Waste Management II* persuasively integrates the accumulated analysis of prior NAFTA Tribunals and reflects a balanced description of the minimum standard of treatment. The Tribunal accordingly adopts the *Waste Management II* articulation of the minimum standard for purposes of this case.

b) The Application of the Minimum Standard of Treatment

220. The Tribunal will start with Claimant's allegation that its rights to due process were breached when it was not heard before the decision of *lesividad* was taken by *acuerdo gubernativo*. As explained by expert Aguilar of Respondent, there is no right to be heard before the President makes his decision:

> "33. Since the administrative procedure for the issuance of the ***Acuerdo Gubernativo*** that finds the *lesividad* of an action or decision *does not originate by the petition of the private party, nor does the declaration includes constitutive effects binding to the private party that deprive them of their rights*, given that they are no part of the process for the issuance of the

[34] *ADF Group Inc. v. United States*, ICSID Case No. ARB (AF)/00/1 (NAFTA), Award of January 9, 2003, para. 179.
[35] *Waste Management II, op. cit.*, para. 98.

acuerdo gubernativo, a hearing prior to the issuance of the same is not granted, nor should it be granted, to them.

34. Therefore, the lack of a hearing in the government process declaring the *lesividad* does not violate the due process principle, because the private party is not part of the process, which is purely an internal process of the government, and the declaration to be issued will not prejudice or diminish the exercise of their rights." (Aguilar, First Opinion. Emphasis in the original)

221. The Tribunal notes that in the instant case FVG became a respondent once the Attorney General filed the claim of *lesivo* with the Administrative Tribunal. Hence the private party is a party in the subsequent proceeding even if the declaration does not include "constitutive effects binding to the private party". Furthermore, the other respondent party in the *lesivo* proceeding before the Administrative Tribunal is FEGUA, the counterparty of FVG in Contract 143/158. Not only has FEGUA been aware of the overall *lesivo* process but it took the first step in this process by its letter to the President on January 13, 2006. The Tribunal considers that there is a lack of equality-in-arms between the two contractual parties and an element of unfairness in the process because the private party has no right to be heard before the President decides that an act of the Government is *lesivo*. On the other hand, in the circumstances of this case, Claimant has fully participated in proceedings before the Administrative Tribunal and, given the fact that the Tribunal has found a breach of the minimum standard on other grounds, the Tribunal finds it unnecessary to determine whether a breach of due process has occurred on this ground.

222. Claimant has also argued that the *lesividad* procedure is flawed because of the vagueness of the grounds to determine that a measure is "harmful to the interests of the State." While the Tribunal agrees that the phrase is indeterminate and could be improved by adding guidance, like in Article 63 of the Spanish Law adduced by Respondent as an example in these proceedings (RL-47), the Tribunal also realizes that it may be difficult to list beforehand what may be harmful to the interests of the State. In any case, to allow the Government to invalidate its own acts during a period of three years since their occurrence is, by any standard, an extraordinary remedy which may be easily abused in its application. Whether it has been abused in the instant case and to such an extent as constituting a breach of the minimum standard of treatment, are matters addressed next by the Tribunal.

223. The Tribunal will consider this question from the perspective of the uncertainty created by the time elapsed since FVG started to use the railway equipment, the understanding by Respondent of the actions which it has considered to be harmful to its interests, and the use of *lesivo* in the wider context of the relationship of Respondent with Claimant.

224. Respondent's expert Aguilar opines: "The State of Guatemala never awarded to, or acknowledged, Ferrovías any property right for the usage of railroad equipment as none of the documents signed by Ferrovías and FEGUA's Overseer gave Ferrovías a legitimate property right [...]" (Second Opinion, para. 31) Furthermore, **"**Ferrovías was not entitled to take possession, or usufruct, of the railroad equipment owned by the State of Guatemala before the President of the Republic and his Cabinet approved Contract 41." According to expert Aguilar, "The State interests that were harmed in the present case were the loss of usage and usufruct of the railroad equipment owned by the State of Guatemala because the equipment was appropriated by Ferrovías. This is acknowledged by Article 464, Civil Code, which reads: *'Property is the right to enjoy and dispose of goods within the limits and, in compliance with, the obligations established by the law.'* In the case of Contract 143/158, the particular State interest, as owner of the railroad equipment, was to claim the property illegally held by Ferrovías. This interest is not vague or ambiguous, and it is the same interest that was expressed in the Complaint filed before the *Contencioso-Administrativo* Court. (Second Opinion, para. 83. Emphasis in the original)

225. The Tribunal finds it appropriate to recall that Contract 41, which never became effective due to lack of *acuerdo gubernativo* and *acuerdo congresional* (clause 3.6.4 of the Bidding Conditions), was signed on March 23, 1999. Claimant restored service in the first phase of the railroad project, at that time, with the railway equipment subject to Contract 41, under exchanges of letters between FVG and FEGUA and more than four years later under Contract 143/158. By the time the *acuerdo gubernativo* related to the *lesividad* was signed on August 11, 2006, train service had been provided in the said segment of the railroad for more than seven years using that same railway equipment. Additionally, FEGUA had received payment

for the use of the railway equipment as provided in Contract 41 and later in Contract 143/158.

226. Respondent was fully aware that FVG needed the railway equipment under Contract 41 to provide the train service under Contract 402, otherwise FVG had the option to terminate Contract 402. For reasons which are to this day unknown, and for which the Tribunal has received no satisfactory explanation, it failed to take the next steps in order that Contract 41 could become effective. Furthermore, the Overseer of FEGUA recognized that FVG had fulfilled its obligations under Phases I and II of Contract 402 for which it used that railway equipment. To say now that FVG appropriated the railway equipment and harmed the State by depriving it of its property flies in the face of these facts and of logic.

227. The Respondent's settlement offer of August 24, 2006 contradicts its legal arguments before this Tribunal in one important respect. It has been maintained by Respondent's expert that "The President of the Republic **was obliged** to issue, in Council of Ministers, the Declaration of *Lesividad* of Contracts 143 and 158, because if he had failed to do so, there being reasonable grounds to do so, he would have incurred […] **joint and several liability;** a declaration of *lesividad* cannot be issued in a discretionary manner, which includes declaration of *lesividad* of Contracts 143 and 158." (First Opinion, para. 72. Emphasis in the original) This opinion notwithstanding, Clause 3, paragraph B) of the settlement offer provides that "Ferrocarriles de Guatemala –FEGUA–, through its Legal Representative, is bound to request the Solicitor General's Office as Representative of the State of Guatemala to fully waive to [sic] the Claim under Administrative Law identified with number-----filed before the First Court of Claims under Administrative Law [...]".This implies that the process before the Administrative Tribunal may be withdrawn at the request of the Attorney General, which belies the alleged inevitability of the *Lesivo* process. This is further confirmed by the minutes of the meeting of the round table, held on August 30, 2006, without FVG representatives. Point three of the minutes reads in part: "Only the governmental representatives were invited to the meeting, which was held in order to hear the Opinion of the Attorney General of Guatemala, who noted that according to the law the PGN may not reverse the procedures unless a direct order to that effect is issued by

the President of the Republic. He was informed that a discussion table had been assembled to address the issue with the parties involved. He agreed that he would not file any legal actions until the discussion process was concluded." (Ex. R-36) Thus, in the settlement offer the Overseer of FEGUA would have committed himself to request the Attorney General to waive the *lesivo* claim and in turn he would have needed an order of the President. The Tribunal notes that these are Respondent's documents, drafted by Respondent, and they contradict the arguments made by Respondent and its expert that the President has no discretion in matters of *lesividad*. He has discretion and used it with the approval of his Government for a purpose different from that for which it was justified, namely, to obtain additional concessions, including further investments by Claimant, unrelated to the basis for the *Lesivo* Declaration. Respondent has not been able to show any example in support of the alleged liability of the President if he had not declared *lesivo* Contract 143/158.

228. As regards the grounds ("*motivos*") of the *Lesivo* Declaration, it is striking that four out of a total of five grounds are related to the bidding conditions of Contract 41. The Tribunal will review and comment on each of them:

> *Motivo* a) considers that the right to discuss the terms of Contract 41 awarded to FVG by the bidding board is contrary to Article 19 of Respondent's Procurement Law. The Tribunal finds it difficult to understand the relevance of this reason since it concerns the award of the non-ratified contract.
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> *Motivo b*) relates to the fourth clause of Contract 143/158 which permits that other property different from that listed in the inventory may be incorporated in violation to the terms of Article 90 of the law on Government Contracting. The Tribunal recalls that this is what clause fourth of Contract 41 already provided from the start: "This is a general description and the parties accept to include other property that by nature is incorporated to the aforesaid equipment, owing to the nature and purposes of the contract as well as for its effectiveness."
>
> *Motivo c*) states that the sixth clause of Contract 143/158 contradicts item V of the first clause of that contract as well as clause 6.4 of the bidding

conditions of Contract 41. This ground is in turn contradicted by the terms of the next ground, *Motivo d)*

Motivo d) states that the parties applied the bidding conditions for a contract that they had terminated when they should have proceeded to a new bidding. Evidently whether or not the parties applied the prior bidding conditions, reference to the bidding conditions of Contract 41 was a good enough reason for the Respondent to motivate the *Lesivo* Declaration.

229. More significantly, several of the provisions of Contract 41 (*Motivos* a) and b)) were considered nine years later contrary to Articles 19 and 90 of the Public Procurement Law and, to the extent that they had been incorporated in Contract 143/158, were grounds for the Declaration of *lesivo*. Further to the *Exposición de Motivos,* the whereas clauses ("*considerandos*") of the *Lesivo* Declaration refer to the legal opinions of the Attorney General and of FEGUA, and explain that they are the basis for the Declaration. Both opinions include, as part of the reasons in support of the *lesividad* of Contract 143/158, elements taken from Contract 41, such as for instance, the duration of the contract or the frequency of payment of the canon. These examples show the legal uncertainty inherent to *lesivo*. Even if Contract 41 had been ratified, for a period of three years the Government may have found cause for declaring it *lesivo* on the grounds adduced nine years later in respect of Contract 143/158.

230. The settlement offer was made on the eve of the publication of the *Lesivo* Declaration. Respondent has argued that it sought to dispose of all issues pending with Claimant. The offer is evidence of that, since it sets forth the contentious issues between Respondent and Claimant in respect of Contract 402, Contract 820 and Contract 143/158. The Tribunal understands that the transaction proposed on August 24, 2006 would have consisted in a package of concessions between the two parties. What the Tribunal finds objectionable is that Respondent links the publication of the *Lesivo* Declaration of Contract 143/158 to a settlement of issues unrelated to the Declaration itself and to its justification, and that, in order to avoid its publication, Claimant had to agree to undertakings which would not necessarily cure the "illegalities" or "irregularities" of Contract 143/158.

231. Respondent has indicated that there is no evidence that Respondent would not have agreed to limit the undertakings required in the settlement offer to Contract 143/158 if Claimant had not abandoned the negotiations. This is speculative and there is no evidence in the proceedings to show that at any point in time Respondent ever proposed to Claimant to correct what made Contract 143/158 *lesivo* without further conditions.

232. The fact that the Respondent did not use the *Lesivo* Declaration for its intended purpose is evident in Respondent's own minutes of the meeting of the round table of September 28, 2006: "The Attorney General indicated that the PGN is ready to file the pertaining actions in the case regarding the *lesivo* declaration of the Contract for Onerous Usufruct of Railroad Equipment. He noted that such actions were deferred pending the results of the discussion table, but that he thinks that if no progress is made by the discussion table the actions should be brought without delay. The Attorney General also believes that if the PGN initiated the legal procedures this would increase pressure to advance the negotiations." (para. 3 of the Minutes. Ex. R-36) As noted previously by the Tribunal, President Berger was blunt in his statements as reported in the press about what motivated the *Lesivo* Declaration: "the declaration of *lesividad* arises from the fact that the US$50 million investment under said contract did not occur. However, he added, Ferrovías [FVG] has a 90-day term to enter into dialogue with the corresponding authorities." (Ex. C-131) The statement substantially coincides with the transcript of the President's broadcast on September 4, 2006. (Ex. C-132)

233. The Tribunal has already pointed out that the *lesivo* procedure has characteristics which may be easily abused by the Government. The 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. It is inconceivable that just any illegality would harm the interests of the State without the President's having to exercise his own judgment in the matter. An investor in Guatemala would have no certainty that, at any time within three years of its investment, the State may declare the investment *lesivo*, if a flaw is discovered by the State in, for instance, the

authorization of the investment, irrespective of the flawless performance by the investor of its obligations as part of such authorization. Unless such an extraordinary remedy is used in truly exceptional circumstances such as in cases of corruption, to give an example of concern to Respondent, it creates situations which have the potential to violate the minimum standard of treatment of aliens under customary international law.

234. In the circumstances of this case, the *lesivo* remedy has been used under a cloak of formal correctness allegedly in defense of the rule of law, in fact for exacting concessions unrelated to the finding of *lesivo*. Even if FEGUA's actions with respect to Contract 41/143 and in allowing FVG to use the rail equipment were *ultra vires* (not "pursuant to domestic law"), which has not been convincingly established for the Tribunal, the Government should be precluded from raising violations of its own law as a defense when, for a substantial period of time it knowingly overlooked them, obtained benefits from them, and it had the power to correct them.

235. In the Tribunal's view, the manner in which and the grounds on which Respondent applied the *lesivo* remedy in the circumstances of this case constituted a breach of the minimum standard of treatment in Article 10.5 of CAFTA by being, in the words of *Waste Management II*, "arbitrary, grossly unfair, [and] unjust." In particular the Tribunal stresses the following facts, which taken together demonstrate the arbitrary, grossly unfair, and unjust nature of *lesivo* in this case, including by evidencing that *lesivo* was in breach of representations made by Guatemala upon which Claimant reasonably relied: a) the Government declared *lesivo* Contract 143/158 for the use of railway equipment for which FEGUA received rents without protest; b) that contract had been concluded at the initiative of FEGUA[36] because the

[36] "CODEFE undertook the commitment vis-à-vis Ferrocarriles de Guatemala by means of Official Letter No. GG-020-2000 to the effect that, while it was [in the process of] obtaining the respective approval of the railway equipment onerous usufruct (public deed No. 41), it would pay, monthly, for the use of traction and hauling equipment as stipulated in subsection b) of the aforementioned agreement, i.e., 1% of the Gross Railroad Freight Traffic, which situation FEGUA accepted in accordance with Official Letters GaP 076-99 and O23-2000. As to date, this contract has not been legalized, as indicated in Clause Sixth thereof, and as the responsible party for safeguarding the interests of the State, we do hereby make the formal request for payment of the amount obtained from the total value of the Gross Transport Handled for the Use of the Railway Equipment owned by FEGUA, from the date of commencement of commercial

Government itself failed, for unknown reasons, to ratify Contract 41 after FVG had won it through public bidding; c) failure of Government ratification and lack of public bidding for the use under Contract 143/158 of the same equipment as under Contract 41, both under control of the Government, and which it had the power to remedy, were in part the justification to declare *lesivo* Contract 143/158; d) other grounds for *lesivo* referred to terms of Contract 41 that the Government itself had proposed and FVG and FEGUA had copied in Contract 143/158; e) the railway equipment in question had been used since the initiation of the rail service in 1998 with full knowledge of the Government and without which Claimant could not have performed its obligations under Contract 402; f) FEGUA certified that such obligations under Phase I and II of the railway rehabilitation had been performed satisfactorily by FVG, which had used the very same railway equipment, first under the exchanges of letters between FEGUA and FVG and later under Contract 143/158; g) the conditions proposed by the Government for not proceeding with *lesivo* were for the most part unrelated to the curing of *lesivo* and the *Lesivo* Declaration was used as a tactic to pressure Claimant to invest more, irrespective of its obligations under Contract 402, or forfeit its investment in favor of other unspecified investors.

236. What effect the breach had on Claimant's investment will be addressed by the Tribunal as part of its damages assessment.

VIII. FULL PROTECTION AND SECURITY

237. Claimant's remaining contention is that Respondent failed to afford Claimant's investment full protection and security within the meaning of CAFTA Article 10.5. As set forth above in the recitation of the parties' respective positions, Claimant supports this contention mainly by arguing that Guatemala failed to protect FVG's right-of-way from squatters. While the issue of squatters had been the subject of considerable dispute between the parties prior to the *Lesivo* Declaration, including the formation of a Presidential Squatters Commission in January 2005 and FVG's initiation

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operations to 31 December 2001, on an urgent basis. **Given the silence of the Higher Authorities for approval of Contract No. 41, we are ready to renegotiate the contract**." (Letter of FEGUA's Overseer to Mr. Senn of FVG of Aug. 22, 2002 (Ex R-198). Emphasis added by the Tribunal).

of a domestic arbitration in Guatemala later that year, the Tribunal reiterates that its jurisdiction extends to "acts or omissions of Respondent related to squatters, but only to the extent that these result from the *Lesivo* Resolution." (Second Decision on Objections to Jurisdiction, para. 155).

238. Article 10.5(1) of CAFTA reflects that "full protection and security" is a core component of the minimum standard of treatment. Without minimizing the importance of this protection to the CAFTA framework, the Tribunal concludes for reasons of procedural economy that it is not necessary to reach Claimant's allegation that Respondent failed to provide full protection and security from squatters. The parties' arguments on this issue raise factually complex questions, including the extent to which the harm complained of by Claimant should be attributed to the *Lesivo* Declaration, as opposed to the pre-existing dispute between the parties relating to the squatters. Given that there was a continuous problem of squatters – as reflected by the Presidential Commission and ongoing arbitration – it is difficult on this record to isolate only those aspects of the larger issue over which we have jurisdiction. At the same time, even if the Claimant were able to establish a breach of this CAFTA protection, Claimant would be entitled to no greater relief than is already warranted by Respondent's breach of the minimum standard discussed above. Accordingly, the Tribunal will not consider the alleged breach of full protection and security.

IX. DAMAGES

1. The Parties' Arguments

239. In its Memorial Claimant contends that the damages should cover the fair market value of its investment, including the adjusted amount of the investment as of the date of the violations of CAFTA, consequential damages of lost profits from that date to the end of the Usufruct, and pre-award interest at a commercially reasonable rate, namely at the rate paid by Respondent on its private debt obligations, compounded semi-annually.

240. In its Counter-Memorial Respondent recalls the provisions of CAFTA on compensation in the case of an expropriation. It notes that CAFTA does not establish a standard of compensation for breaches of other obligations under the treaty and that

the principle of reparation under customary international law would apply to such breaches. Respondent refers to Claimant's statements to show that the railway equipment was not a required component of its investment or was of secondary priority, contends that there is no causal nexus between the publication of the *Lesivo* Declaration and any damage or loss suffered by Claimant or, if there was, it was FVG's own doing by its press campaign or by mismanaging its business well before the *Lesivo* Declaration was published.

241. Respondent points out that Claimant has engaged in double-counting by requesting damages for lost profits and lost investment and calculating its damages based on a discounted cash flow analysis ("DCF"). Respondent contends that FVG had no profits during its operation and its assessment of future lost profits is speculative and unsubstantiated. Respondent explains that Claimant's net capital contribution ("NCC") approach to calculating damages is inappropriate because this method is used in cases where the alleged expropriation took place shortly after the investment was made and prevented the investor from exploiting its investment. Respondent argues that by the time the *Lesivo* Declaration was issued, the viability of FVG was in question and no buyer would base the value of the business on the amount of the historical investment without reference to actual results. Respondent disputes the discount rate use by Claimant in its calculations as being grossly underestimated and contends that an appropriate analysis shows that, at the time of the *Lesivo* Resolution, FVG had a negative fair market value and Claimant has not suffered any damages.

242. As regards pre-award interest, Respondent argues that compound interest as claimed by Claimant need to be justified on the facts of the particular case since the traditional principle that compound interest is not allowed continues to apply.

243. In its Reply Claimant contends that the appropriate standard for measuring compensation in the case of an illegal expropriation is not the fair market value prescribed in CAFTA but the customary international law standard of full

reparation set forth in *Chorzów*.[37] According to Claimant, this is also the standard to apply for breaches of the minimum standard of treatment and national treatment obligations.

244. Claimant contends that, under the full reparation standard, it is entitled to recover the amount invested and the lost profits. Claimant also contends that the possibility of double counting is avoided by amortizing its sunk costs over the life of the usufruct after the *Lesivo* Declaration.

245. Claimant disputes that FVG was not profitable as affirmed by Respondent. Claimant explains that "the future cash flows to be discounted consist not of future profits or earnings but of future cash flow: gross income less the expenses necessary to produce that income." (Reply, para. 487) Furthermore, according to Claimant, accounting results must be adjusted to reflect the rents that were not paid into the railway trust. Claimant adds that: "it is axiomatic that a respondent cannot rely upon its own breaches or fault in order to argue that a claimant has not met the standards for proving entitlement to recovery." (Reply, para. 489)

246. Claimant also contends on the basis of Article 36(2) of the ILC Articles that even if FVG had not shown profitability prior to the *Lesivo* Resolution, international law does not require prior profitability to recover damages on account of lost profits and it is possible to justify an award of damages on grounds of the track record of successful investments in similar circumstances. Claimant disputes Respondent's argument that the real estate valuations or utility easement projections are speculative. Furthermore, according to Claimant, even if lost profits are not awarded by the Tribunal, there is no authority to support the contention of Respondent's expert that recovery of the net capital contribution is only appropriate when the expropriation takes place close to the time of the original investment. Claimant finds support for this contention in *Vivendi II*[38] and *Phelps Dodge.*[39]

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[37] *The Factory At Chorzów (Ger. V. Pol.), Claim for Indemnity, The Merits,* 1928, P.C.I.J. (Ser. A.), No. 17, (Sept. 13), p. 40.
[38] *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Second Award of August 20, 2007, para.8.3.19.
[39] *Phelps Dodge Corp. and Overseas Private Investment Corp. v. Islamic Republic of Iran*, Award No. 217-99-2 of March 19, 1986, reprinted in 10 Iran-U.S. Claims Tribunal Reports 121, para. I, 31.

247. Claimant argues that Respondent's Weighted Average Cost of Capital ("WACC") is inflated and unreasonable because, *inter alia*, it is assumed that Claimant would have borrowed funds in Guatemala and that the WACC should be computed with a 50/50 weighting between railroad cost of capital and real estate cost of capital. According to Claimant, this weighting does not correspond to the factual situation of an 8% contribution by the railroad and a 92% contribution by real estate.

248. Claimant contends that it can recover the amount it invested and the amount invested by the minority shareholders. For its contention, Claimant relies on Article 10.16.1 of CAFTA and the explanation given by the United States as a non-party submission in the GAMI arbitration in respect to parallel Article 1117 of NAFTA.[40]

249. Claimant argues that it has established causation for its damages. According to Claimant, "It is irrelevant that FVG would not have needed the FEGUA equipment for the eventually restored South Coast right-of-way; if FVG did not have the FEGUA equipment, it could not fulfill its performance obligations under Contract 402 because there was not a sufficient inventory of replacement narrow gauge rolling stock available elsewhere in the world that could be obtained at a reasonable cost." (Reply, 569) Claimant then refers to the devastating *de facto* effect of the Declaration on the value of Claimant's investment as if it had declared the entire usufruct harmful to the interests of the State, disputes the effect of its own press release and affirms that "Respondent has not presented any evidence that any current or prospective customer, supplier, lender or lessee first learned about the *Lesivo* Declaration from Claimant's press release or took any action as a result of it." (Reply, para. 572)

250. Claimant submits a revised claim of $63,778,212 after deducting $2,704,310 on account of revenues obtained since the Declaration of *Lesivo* in an effort to mitigate its damages. As to compound interest, Claimant argues that there is no reason for simple interest taking into account the compensatory function of the interest awarded and ignores the financial reality in which businesses operate. Claimant also refers to the increasing tendency of arbitral tribunals to award compound interest as Respondent itself has recognized.

[40] *GAMI*, *op.cit.,* Submission of the United States of June 30, 2003, paras. 9-10 and 12.

251. In its Rejoinder Respondent disagrees with the interpretation given to Article 10.7.2 of CAFTA by Claimant. Respondent points out that the words “lawful” and “unlawful” do not appear in Article 10.7, and that to apply the Claimant’s reasoning would ignore the State parties’ decision to measure damages as provided in this article. The fair market value of the investment is sufficient to wipe out the effects of the *Lesivo* Declaration and it is the appropriate measure of damages in accordance with the *Chorzów* criteria. According to Respondent, the way in which Claimant applies *Chorzów* compensates it twice for its investment.

252. Respondent insists on the speculative character of Claimant’s future profits claim. Respondent acknowledges that lost profits decrease from $36.16 million in the Memorial to $22.19 million in the Reply, but Respondent contends that the lost profits claim continues to be unsubstantiated and extremely optimistic whether lost profits relate to the operation of the railroad or to the real estate leasing and development rights. Respondent also insists that the correction introduced by Claimant to reduce double counting is not enough because the net present value of the amortizations deducted from future cash flows is substantially lower than the amount computed as lost investment.

253. Respondent explains that the historical approach of considering that Claimant possessed an asset, with a fair market value approximately equal to the sum of the amounts invested in FVG, is not appropriate because a portion of these amounts were used to cover operational losses of FVG. For this reason, an alternative historical approach would be to look at the value of FVG’s equity as reflected in its books just prior to the *Lesivo* Declaration (US$4.2 million as of December 2006), as this method would take into account both the capital contributions and the accumulated losses. However, Dr. Spiller [Respondent’s expert] also explained in his First Report that, given FVG’s severe financial distress prior to the *Lesivo* Declaration, this figure would result in an overestimation of FVG’s fair market value at that time. (Rejoinder, para. 367)

254. Respondent disputes that the amount claimed for business termination was used for such purpose and, according to the evidence submitted by Claimant,

Respondent points out that only $119,235 was spent in severance payments out of a total of $1.35 million claimed by Claimant.

255. Respondent also disagrees with the interpretation given by Claimant to Article 10.16.1 and to the jurisprudence applying the related Article 1117 of NAFTA. According to Respondent, Article 10.16.1(b) "only speaks of a claimant's ability to seek compensation for damages suffered *by the enterprise* it owns or controls. What is more, CAFTA Article 10.26.2(b) and (c) specifically require that any damages awarded under CAFTA Article 10.16.1(b) be awarded and paid directly to the enterprise, not the individual claimant-investor." (Rejoinder, para. 375. Emphasis added by Respondent) Furthermore, Respondent points out that all other FVG minority shareholders are Guatemalan and do not qualify as claimant or investor of a party to CAFTA.

256. Respondent reiterates its disagreement with the discount rate applied by Claimant, that before the *Lesivo* Declaration FVG was worthless, and that Claimant has failed to prove a causal connection between the damages it claims and the *Lesivo* Declaration.

257. Respondent argues that, in case of any damages awarded to Claimant by the Tribunal, the Tribunal "should condition Guatemala's obligation to pay on Claimant's first renouncing and forfeiting all of the rights it has under the usufruct contracts (402, 143/158 and 41), returning all lands and equipment covered by those contracts to Guatemala." (Rejoinder, para. 398)

258. As to compound interest, according to Respondent, Claimant has failed to show the existence of special circumstances that would justify compounding in this case and there is equally no justification for applying the "coerced loan" rationale to arrive at the interest rate proposed by Claimant. Respondent proposes instead to apply a pre-award interest rate equivalent to six-month LIBOR plus two percentage points.

2. Analysis of the Tribunal

259. The Tribunal observes that CAFTA's provisions on compensation refer only to compensation in case of expropriation. The Tribunal has concluded that the

investment has not been expropriated. The question arises of the compensation standard to be applied in the case of breaches of CAFTA other than expropriation.

260. CAFTA directs the Tribunal to interpret Article 10.5 on the minimum standard of treatment in accordance with Annex B on customary international law. Under customary international law as reflected in the ILC Articles, "The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act." (Article 31.1) The Tribunal needs to determine the amount of compensation to be paid on account of the injury suffered by Claimant as a consequence of the breach of the minimum standard of treatment. The Tribunal has determined that Claimant's investment was not expropriated because it continued to enjoy its contractual rights under Contract 143/158 and it has remained in possession of the equipment covered under that contract. The Tribunal has also determined that the *Lesivo* Declaration had a significant effect on Claimant's overall investment but it has recognized that Contract 402 continues to be in force and that FVG continues to receive rents from the real estate appurtenant to the right-of-way. Therefore, the issue is how to assess the compensation on account of a measure which has an injurious effect, falling short of expropriation on assets which continue in possession of Claimant.

261. Before turning to the assessment of compensation, the Tribunal needs to address two preliminary matters: (a) the renunciation by Claimant to its rights under the Usufruct Contracts in case compensation is awarded by the Tribunal, and (b) the interpretation of Article 10.16.1 of CAFTA.

262. On the first of these matters Respondent has argued that, "if the Tribunal awards any damages to Claimant for Guatemala's alleged breaches of its obligations under CAFTA, it should condition Guatemala's obligation to pay on Claimant's first renouncing and forfeiting all of the rights it has under the usufruct contracts (402, 143/158 and 41), returning all lands and equipment covered by those contracts to Guatemala" (Rejoinder, para. 398). At the hearing, in answer to a question of the Tribunal, counsel to Claimant stated: "[...] if you awarded full reparation, however you define that, if you awarded full reparations, whether its for whatever State action that

violates international law, once you award full reparations, then the payer of those reparations, the State, is subrogated to all of our rights under the Contract, its Contract, it seems to me. And therefore, it seems to me that the fashioning of your Award to the extent that you'd concluded that what you were awarding were full reparations, fashioning it in that fashion you would automatically cause Guatemala to be subrogated to our rights under the leases." (December 16, day eight, p. 2134 of transcript)

263. The return of investment assets conditional on payment of the award is not uncommon in indirect expropriation cases. Thus in *ADC v. Hungary*, the claimant on receipt of compensation was required to transfer to the respondent its shareholding in the relevant investment vehicle.[41] Similarly, in *Tecmed v. Mexico*, the claimant was required to take all necessary steps to transfer to the respondent or its nominee the assets comprising the hazardous landfill which was the focus of the dispute.[42] It is less obviously appropriate in cases involving breach of the fair and equitable treatment standard, but it is not unknown. In *CMS v. Argentina*, for example, the claimant was a US company which owned a 29.42% share in an Argentine gas utility company. Following regulatory action by the respondent in the wake of the Argentine fiscal crisis of the early 2000s, the tribunal found that the fair and equitable treatment standard of the relevant BIT had been breached. The tribunal awarded the claimant compensation conditional on the transfer of its shareholding in the utility to the respondent.[43]

264. In the present case only Contract 143/158 was directly affected by the *Lesivo* Resolution, and it could be argued that the remedy should concern only that contract. The Tribunal does not agree, for three reasons. First and most important, neither Party has taken this point (see paragraphs 54-5, 69 and 79-80 above). On the contrary, both contemplate a Tribunal award which fully resolves the dispute by ensuring that the parties do not need to persist in a relationship which has become antagonistic and acrimonious. Secondly, the Claimant has effectively made its

[41] ICSID Case No. ARB/03/16, Award of October 2, 2006, para. 543.4.
[42] *Tecmed*, *op. cit*, para. 199.
[43] *CMS Gas Transmission Company v. The Argentine Republic*, Award of 12 May 2005. The Award was later partially annulled, but not for any reason connected to the form of the remedy. See Decision of Annulment of 25 September 2007.

election, withdrawing from Guatemala following the passing of the *Lesivo* Resolution, and the Tribunal considers that its conduct in that respect was reasonable. Thirdly, the investment concerned the renovation and running of a railway as a whole.

265. The Tribunal is also concerned that to restrict the scope of the remedy to Contract 143/158 would be to create an undesirable risk of double recovery, *e.g.* through the sale of Claimant's shares in FVG to a third party which might then acquire a right to litigate with respect to the same conduct considered by this Award. The Tribunal notes that it has the capacity to render an award tailored so as to minimize the risk of double recovery between the parties.[44] In the circumstances this situation is best resolved by requiring Claimant, on the full and effective payment of the prescribed compensation by Respondent, to transfer to Respondent or its nominee all the Claimant's shares in FVG.

266. As to the interpretation of Article 10.16.1 of CAFTA, the Tribunal notes a certain inconsistency in the way Claimant has pleaded its case. On the one hand, Claimant filed its arbitration request both on its own behalf and on behalf of FVG. On the other hand, Claimant has pleaded that compensation be paid by Respondent to Claimant. Article 10.16.1(a) covers submission to arbitration of a claimant on its own behalf. Article 10.16.1(b) provides for submission to arbitration by a claimant on behalf of "an enterprise of the respondent that is a juridical person that the claimant owns or controls directly or indirectly." As pointed out by Respondent, Claimant ignores Article 10.26.2's requirement that, where a claim is submitted to arbitration under Article 10.16.1(b), an award of monetary damages shall provide that the sum be paid to the enterprise. In the instant case, the minority shareholders of FVG are all nationals of Respondent and do not qualify as investors under CAFTA. For these reasons the amounts awarded for its loss from its investment should be paid to Claimant and be

[44] See further *Sempra Energy International v The Argentine Republic*, ICSID Case No ARB/02/16, Decision on Jurisdiction of May 11, 2005, para. 102 ("international law and decisions offer numerous mechanisms for preventing the possibility of double recovery"); *Suez, Sociedad General de Aguas de Barcelona SA and InterAguas Servicios Integrales del Agua SA v The Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Jurisdiction of May 16, 2006, para. 51 ("any eventual award in this case could be fashioned in such a way as to prevent double recovery").

calculated on the basis of the percentage of the total amount invested by FVG's shareholders, which was contributed by Claimant.

267. To summarize, for the reasons that have been given, the Tribunal considers that reparation is due to Claimant to compensate it fully for the injury suffered. It further considers that, in the circumstances of the case and to resolve the dispute between the parties, the payment of the amount awarded should be subject to Claimant relinquishing its rights under all the contracts, *i.e.* Contracts 402 and 143/158.[45] As noted, Respondent has pleaded that payment of the award be on condition that Claimant return the right of way and equipment to Guatemala. Since FVG and not Claimant is the party to the Usufruct Contracts, the Tribunal considers that the effect sought by Respondent would be appropriately achieved from a legal standpoint by conditioning payment of the award upon the transfer of Claimant's shares in FVG to Respondent.

268. Turning now to the assessment of damages, the Tribunal recalls that the parties disagree on the amount, on the applicable method of calculation, on the discount rate to apply, and on the components to be included in the calculation. In the Tribunal's view, the diverging results in the calculation of damages performed by the parties' experts show the malleability and uncertainty of such calculations.

269. The Tribunal agrees with Respondent that, given the past performance of FVG, the claim of lost profits is speculative. To say the least, it has not been proved that after eight years of operation a sharp improvement in FVG's performance was in the offing, as Claimant's experts have assumed. However, there are in the experts' considerations certain known quantities related to the amount invested and the actual rents received from leases of the real estate. The Tribunal will anchor its assessment to these certainties, which have the additional merit of arguably representing benefits which may be considered to accrue to Respondent on payment of the amount awarded to Claimant.

270. In the Tribunal's view, quantum in the present case has three elements. First, it is unquestioned that Claimant invested funds in the rehabilitation and operation

[45] Contract 41 never became effective and need not be further considered.

of the railway sufficient to complete Phases I and II. As revised in the Reply, $19,025,321 represents the total amount invested in FVG by Claimant and local shareholders, of which $15,108,861 (79%) were contributed by Claimant. A portion of these funds claimed as investment, viz. $10.8 million, was invested by FVG's shareholders to cover the losses of FVG (Counter-Memorial, para. 615, First Report, of Dr. Spiller, Respondent's expert, para. 82 and Exhibit C-27); of this, $8,532,000 corresponds to the 79% contributed by Claimant. The Tribunal considers that the funds invested by Claimant to cover these losses represent the risks Claimant took when investing in Guatemala and cannot be attributed to any action of Guatemala contrary to CAFTA. Furthermore, the railway equipment in FVG's possession is considered valuable property by Respondent. The Respondent's Attorney General has pleaded before the Administrative Tribunal that the railway equipment is "*un patrimonio millonario*". Part of the funds invested by FVG's shareholders were used to restore the railway equipment necessary to bring trains back into service. While Respondent has contended that the railway equipment has not been well maintained, approximately a year and a half prior to the *Lesivo* Resolution FEGUA's Overseer presented to FVG's Chairman on behalf of the FEGUA-affiliated Railroad Museum an award for "the rescue and restoration of the Historic Railway Patrimony of Guatemala" (Memorial, para. 120). Based on these considerations, the Tribunal awards Claimant $6,576,861 ($15,108,861 minus $8,532,000).

271. Second, FVG receives rents for leasing the real estate. These rents at the time of the *Lesivo* Declaration amounted to $716,316 per year (Reply, para. 520). Over the 42 years left of the Usufruct and as calculated by Claimant, the net present value ("NPV") of these leases is $10,751,437. Respondent disputes the discount rate applied by Claimant as being too low at 12.9%. Respondent claims that a rate of 18.75% would be more appropriate. Claimant explains that the difference between the two rates arises from three factors:

(a) Respondent's expert assumes that Claimant would have borrowed in Guatemala rather than in the United States, which has an impact on the rate of 1.8 percentage points.

(b) The size premium of Morningstar used by Respondent's expert is based on "category 10b" data rather than "category 10" data, which increases the discount rate by a further 2.66 percentage points. Dr. Pratt, Claimant's expert, explains that, when calculating the cost of equity for a company using the Morningstar categories, the category 10 size premium should be utilized and not the category 10b premium, which includes "an abundance of distressed companies". He further explains that Category 10 reflects the bottom 10 percent of the combined stock on the NYSE, ASE and NASDAQ, while 10b includes the bottom 5 percent of the combined stocks on these exchanges.[46]

(c) Respondent's expert assumes a 50/50 weighted railway cost of capital and real estate cost of capital instead of the actual 8% contribution by the railroad and the 92% contribution by the real estate, which increases the rate by a further 1.5 points.

272. On the other hand, Dr. Spiller, Respondent's expert, has insisted in that "it is not standard valuation practice to assign a cost of debt to a company operating in a particular developing country, experiencing substantial operational and financial difficulties, as if it was a successful and profitable company operating in the US and other jurisdictions, as assumed by Dr. Pratt." (Second Report, para 85). On the issue of the size of the premium, Dr. Spiller argues that, (a) "[g]iven that the size of FVG places it in the 10b group, whether under Claimants' own experts' assessment, or my own, there is no credible reason to use any other category for selecting the size premium" (Ibid. para. 91); (b) the same troubled companies are also included in the 10 group only that their effect on the premium is diluted; and (c) FVG needs to be compared with companies in a similar situation and FVG had shown negative results during the seven years prior to its valuation (ibid. paras. 88 and 89). As to the relative weights of the railway cost of capital and the real estate cost of capital, Dr. Spiller explains that, "Railroad activities account for an average 50% contribution to FVG's EBITDA over the remaining years of the concession, while real estate exploitation

[46] Report of Shannon Pratt Valuations, Inc. p. 10.

represents the remaining 50%. However, when calculated as net present value, railroad activities' contribution to EBITDA increases to 60% of the total, leaving the remaining 40% to real estate activities. Since railroad activities have a higher WACC rate, I judged the 50/50 distribution more conservative and thus adopted it for our combined WACC rate" (Ibid. para. 97)

273. The Tribunal considers that, as to the first factor, FVG's cost of capital should be used to value FVG assets, including the income stream from the real estate leases. The fact that RDC borrowed funds in the United States, rather than Guatemala, does not detract from this conclusion. To the extent that RDC borrowed funds in the United States and then used those funds to finance FVG, this was in effect a subsidy that would be inappropriate to incorporate into the valuation analysis of a FVG asset. As regards Morningstar categories 10 and 10b, in the Tribunal's view, the size premium for companies in group 10b is justified given the size and uncertain financial condition of FVG. As regards the calculation of the WACC, the Tribunal accepts the weight given by Claimant to the railway cost of capital (8%) and the real estate cost of capital (92%) because it reflects the actual situation.

274. To conclude and based on the preceding considerations, the Tribunal finds that a discount rate of 12.9% plus 2.66 percentage points (the effect of using the 10b instead of the 10 size premium) plus 1.8 percentage points (the effect of using FVG's cost of capital), for a total of 17.36%, would be an appropriate discount rate to calculate the NPV of existing leases.

275. Thirdly, as for future leases, while the Tribunal does not deny that such leases could have materialized, the Tribunal considers that after eight years of operation Claimant had secured only the leases taken into account here. They show the difficulty of Claimant in enlarging its real estate lease portfolio as registered in FVG's annual reports and pointed out by Respondent (p. 293 and ff. of Counter-Memorial). Hence, only the leases in place at the time of the *Lesivo* Declaration have been taken into account.

276. Claimant has also included as part of its claim the lost revenues from Tecún Umán trans loading operations. This segment of the railroad connects México

to Tecún Umán and was disrupted by hurricane Stan. According to Claimant, at the time of filing the Reply it was scheduled to resume operations in 2011 (Reply, para. 521). Since the service at Tecún Umán was interrupted long before the *Lesivo* Declaration through no fault of Guatemala and the Tribunal has no evidence of service resumption in 2011, the Tribunal has not included future revenues of the Tecún Umán trans loading operations in its assessment of damages.

277. To sum up and based on these considerations, the Tribunal determines that Claimant is entitled to: (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* Declaration which permitted an orderly closure of the railroad service (Reply, para. 550); and (c) 82% (the percentage of shares in FVG held by Claimant, and which will be transferred to Respondent after full payment of the Award by Respondent) of $4,121,281.62 (which is $3,379,450.93), the NPV of the existing real estate leases measured over their remaining life as of the date of *Lesivo*, minus 82% of rents paid to FVG under such leases post-*Lesivo* and until payment by Respondent of the awarded compensation, at which point Respondent will receive Claimant's shares in FVG. Because the Tribunal cannot determine at this time when Respondent will pay the award, there will be a need for a final calculation of this amount.

X. INTEREST

278. Claimant has argued for compound interest at a rate of 9.34% based on the rate that Respondent paid to private and public creditors in 2006 and on the notion of a coerced loan from Claimant to Respondent. Respondent has suggested a pre-award interest rate equivalent to six-month LIBOR plus two percentage points. The Tribunal disagrees with the coerced loan rationale of Claimant to arrive at the proposed rate of interest. The rationale for pre-award interest rests on a claimant's loss for not being able to dispose of the funds awarded from the moment the breach of an international obligation has been determined in the award. Claimant would not have been able to obtain the rate of interest claimed in its normal course of business nor would have paid such rate for funds borrowed to replace those due for the breach of an obligation by Respondent.

279. The Tribunal considers that the rate proposed by Respondent is a commercially reasonable rate and determines that this is the interest rate that shall apply to the awarded funds from the date of the *Lesivo* Declaration until such funds are paid.

280. The parties disagree on whether compound interest is applicable. Claimant relies on an increasing number of precedents that have awarded compound interest. Respondent pleads that compound interest needs to be justified on the basis of special circumstances which Claimant has failed to show exist in its case.

281. The Tribunal observes that the determination of whether or not a compound interest rate is applicable needs to be justified by the Tribunal as any other determination. Given the length of these proceedings because of two jurisdictional phases in which the jurisdictional objections of Respondent were rejected, and several postponements in the procedural calendar at the Government's request, the Tribunal determines that compound interest is justified.

XI. COSTS

282. Each party has pleaded that it be awarded counsel fees and expenses as well as the administrative expenses of ICSID and the fees and expenses of the Tribunal. CAFTA Article 10.26.1 permits the award of costs and attorney's fees in accordance with that section and the applicable arbitration rules. The ICSID Arbitration Rules only require that the award contain "any decision of the Tribunal regarding the cost of the proceeding" (Rule 47). On the basis of the discretion bestowed on the Tribunal by CAFTA and the applicable arbitration rules, the Tribunal determines that they shall be responsible for their own counsel fees and expenses. As to administrative expenses of ICSID and the fees and expenses of the Tribunal, the Tribunal distinguishes between the jurisdictional phases and the merits phase of the proceedings. Given that Respondent's objections to jurisdiction were twice rejected in an unusually protracted process, Respondent shall be responsible for the administrative expenses of ICSID and fees and expenses of the Tribunal related to the two jurisdictional phases. Each party shall be responsible for 50% of the administrative

expenses of ICSID and 50% of the fees and expenses of the Tribunal related to the merits phase.

XII. DECISION

283. On the basis of the preceding considerations the Tribunal has unanimously decided as follows:

1. That Respondent breached the minimum standard of treatment under Article 10.5 of CAFTA in respect of Claimant's investment.

2. That Respondent shall 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* Declaration which permitted an orderly closure of the railroad service; and c) 82% (the percentage of shares in FVG held by Claimant) of $4,121,281.62 ($3,379,450.93) – the NPV of the existing real estate leases measured over their remaining life as of the date of *Lesivo* – minus 82% of rents paid to FVG under such leases post-*lesivo* and until payment by Respondent of the compensation here awarded. Because the Tribunal cannot determine at this time when Respondent will pay the award, there will be a need for a final calculation of this amount.

3. That, on payment of the awarded compensation, Claimant shall forfeit and renounce all its rights under the Usufruct Contracts and transfer to Respondent Claimant's shares in FVG.

4. That the awarded amount of compensation shall carry compound interest at a rate equivalent to six-month LIBOR plus two percentage points as from the date of the *Lesivo* Declaration to the date of payment.

5. That Respondent shall be responsible for the administrative expenses of ICSID and fees and expenses of the Tribunal related to the two jurisdictional phases. As calculated by the ICSID Secretariat, such fees and expenses amount to $384,854.01. Since each party has advanced 50% of the amounts requested by the ICSID Secretariat to finance these

proceedings, Respondent shall pay Claimant $192,427.00. Such amount shall carry interest at the rate set forth in sub-paragraph 4 above.

6. That each party shall be responsible for 50% of the remainder of administrative expenses of ICSID and of the fees and expenses of the Tribunal.
7. That each party shall be responsible for its own counsel fees and expenses.
8. That all other claims are dismissed.

Done in Washington, D.C.

The Tribunal

Hon. Stuart E. Eizenstat

Arbitrator

May 24, 2012

Professor James Crawford

Arbitrator

May 29, 2012

Dr. Andrés Rigo Sureda

President of the Tribunal

May 24, 2012