ICSID (INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES)

ICSID Case No. ARB/03/25

FRAPORT AG FRANKFURT AIRPORT SERVICES WORLDWIDE V. REPUBLIC OF THE PHILIPPINES (I)

AWARD

16 August 2007

Tribunal:
W. Michael Reisman (Appointed by the State)
Bernardo M. Cremades Sanz-Pastor (Appointed by the investor)
L. Yves Fortier (President)

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# Award

## GLOSSARY

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<td>ADB</td>
<td>Asian Development Bank</td>
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<td>ADL</td>
<td>Anti-Dummy Law</td>
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<td>AEDC</td>
<td>Asia's Emerging Dragon Corporation</td>
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<td>ARCA</td>
<td>Amended and Restated Concession Agreement</td>
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<tr>
<td>&quot;BIT&quot; or &quot;Treaty&quot;</td>
<td>Agreement between the Federal Republic of Germany and the Republic of the Philippines on the Promotion and Reciprocal Protection of Investments</td>
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<td>Blue Ribbon Committee</td>
<td>Senate Committee on Accountability of Public Officers and Investigations</td>
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<td>BOT Law</td>
<td>Republic Act No. 7718 entitled &quot;An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector and for Other Purposes&quot;</td>
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<td>BSP</td>
<td>Bangko Sentral ng Filipinas</td>
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<td>Clark</td>
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<td>EPC Contract</td>
<td>Agreement entered into by Takenaka, PIATCO, and Takenaka's wholly owned offshore procurement supplier, Asahikosan Corporation, for the construction of Terminal 3</td>
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I. PROCEDURE

A. Overview

1. At the outset of its present Award, the Tribunal deems it necessary to set out certain facets of the dispute between the parties to this arbitration. This overview is meant to shed some light on the reasons why this arbitration has proceeded, in some respects, in a most unusual manner.

2. The investment at issue in this arbitration was made by the Claimant, a German company incorporated as Fraport AG Frankfurt Services Worldwide (“Fraport” or the “Claimant”), which has established itself as a leader in the international airport business. The Claimant’s investment was made in a Philippine company, Philippine International Air Terminals Co., Inc., later known as...
PIATCO. Fraport's investment in PIATCO, both as a shareholder and lender, was influenced by the fact that the Respondent had, prior to the investment at issue, conferred upon PIATCO the concession rights for the construction and operation of a new international passenger airport terminal in Manila, otherwise known as "Ninoy Aquino International Airport Passenger Terminal III" or Terminal 3.

3. Pursuant to the ICSID arbitration provisions contained in the "Agreement between the Federal Republic of Germany and the Republic of the Philippines on the Promotion and Reciprocal Protection of Investments" dated 18 April 1997 and in force since 2 February 2000 (the "BIT" or "Treaty"), the Claimant initiated this arbitration on the basis of a number of allegations of breach by the Republic of the Philippines (the "Republic", the "Philippines", the "Government" or the "Respondent") of its obligations towards Fraport as an investor in the Philippines.

4. The Respondent, in turn, has challenged the jurisdiction of the Tribunal in this regard and denies all liability under the Treaty. In the course of the proceeding, the Respondent has alleged that the Claimant made its investment in violation of the laws of the Philippines, in particular foreign ownership and control legislation known as the AntiDummy Law (the "ADL").

5. In the course of the proceeding, the Respondent has also made allegations of fraud and corruption on the part of PIATCO shareholders, including the Claimant, as well as on the part of various Philippine public officials. In connection with its allegations of fraud and corruption, the Respondent contends that relevant evidence can be found in documents and submissions filed in a related pending ICC arbitration initiated by PIATCO against the Respondent. The Respondent has further alleged that such evidence could be uncovered in the course of ongoing investigations in Germany, as well as in the Philippines, the United States and Hong Kong.

B. Registration of the Request for Arbitration

6. On 17 September 2003, the Claimant filed its request for arbitration (the "Request") with the International Centre for Settlement of Investment Disputes ("ICSID" or the "Centre") against the Respondent for the resolution of divergencies having arisen amongst the parties to this arbitration. The Request was submitted in accordance with the ICSID arbitration provisions contained in the Treaty, in particular paragraph 2 of Article 9 of the BIT entitled "Settlement of Disputes between a Contracting State and an Investor of another Contracting State":

"If such divergencies cannot be settled according to the provisions of paragraph (1) of this Article within six months from the date of request for settlement, the investor concerned may submit the dispute to: [...] (b) the International Centre for the Settlement of Investment Disputes through conciliation or arbitration."

7. On 17 September 2003, the Centre acknowledged receipt of the Request in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the "ICSID Institution Rules"). On 23 September 2003, the Centre submitted a copy of the Request to the Republic of the Philippines and to its Embassy in Washington, D.C.

8. On 9 October 2003, pursuant to Article 36(3) of the ICSID Convention and Rule 6 of the ICSID...
Institution Rules, the Request was registered by the Centre. On the same day, ICSID’s Acting Secretary-General, pursuant to Rule 7 of the ICSID Institution Rules, notified the parties of the registration and invited them to proceed to the constitution of the Tribunal as soon as possible.

C. Constitution of the Tribunal and Commencement of the Proceeding

9. Regarding the constitution of the Tribunal in this arbitration, it was agreed by the parties that the Tribunal would consist of three members. It was further agreed that each party would appoint an arbitrator and that the third arbitrator, i.e. the President of the Tribunal, would be appointed by agreement of the parties or, failing such agreement, by the Centre.

10. On 25 November 2003, as set forth at paragraph 90(a) of its Request, the Claimant confirmed its appointment of Dr. Bernardo M. Cremades, a national of Spain, as its party-appointed arbitrator. On 24 December 2003, the Respondent appointed Professor W. Michael Reisman, a national of the United States of America, as its party-appointed arbitrator. The parties subsequently agreed upon the appointment of Mr. L. Yves Fortier, a national of Canada, as President of the Tribunal. The President’s appointment was confirmed on 11 February 2004.

11. On this same date, the Centre wrote to the parties confirming the constitution of the Tribunal and indicating that the proceeding was deemed to have commenced on 11 February 2004 pursuant to Rule 6(1) of the ICSID’s Rules of Procedure for Arbitration Proceedings (the "ICSID Arbitration Rules"). The parties were further informed that Ms. Aurelia Antonietti, Counsel at ICSID, would serve as Secretary of the Tribunal. Over the course of the proceeding, Ms. Antonietti was replaced by Ms. Corinne Clave at ICSID, who in turn was replaced by Ms. Eloise Obadia, Senior Counsel at ICSID, on 31 January 2007.

12. On 28 January 2005, it was further agreed by the parties, following the suggestion of the Tribunal, that Ms. Renee Theriault of the law firm of Ogilvy Renault, an associate of the President of the Tribunal, would act as Assistant to the Tribunal.

D. Written and Oral Phases of the Proceeding

13. In accordance with Rule 13(1) of the ICSID Arbitration Rules, and after consultation with the parties and the Centre, the Tribunal held its First Session in Washington, D.C. on 20 April 2004. During this First Session, the parties confirmed that they did not have any objections to the proper constitution of the Tribunal or to any member of the Tribunal. It was also agreed that the place of arbitration would be at the seat of the Centre in Washington, D.C.

14. In its first Procedural Order dated 23 April 2004, contained in the Minutes of the First Session, the Tribunal ordered that the Respondent file its objection to jurisdiction, if any, by no later than at the expiration of the time limit fixed for the filing of its CounterMemorial. In the event, the proceeding would be bifurcated, with the issue of jurisdiction and liability to be determined as part of the first phase and the issue of quantum, if required, as part of the second phase.
The Tribunal also established a timetable for the written procedure on liability and objection(s) to jurisdiction, if any, as follows: the Claimant's Memorial by 10 August 2004; the Respondent's Counter-Memorial by 10 December 2004; the Claimant's Reply by 10 March 2005; the Respondent's Rejoinder by 10 June 2005; and in the event that the Respondent filed an objection to jurisdiction with its Counter-Memorial, the Claimant’s Sur-Rejoinder was to be filed by 10 July 2005.

During the First Session, it was also decided, provisionally, that pursuant to Rule 41 of the ICSID Arbitration Rules, a pre-hearing conference between the Tribunal and the parties would be held on 26 July 2005 in Washington, D.C. The oral phase of the proceeding with respect to jurisdiction, in the event of an objection thereto, and liability was scheduled to take place in Washington, D.C. from 29 August 2005 to 9 September 2005.

The Tribunal was first informed of the related ICC arbitration initiated by PIATCO against the Respondent during the First Session. In that arbitration, PIATCO claims from the Respondent amounts allegedly owing pursuant to the concession agreements applicable to the construction and operation of Terminal 3.

On 1 July 2004, the Claimant formally submitted a request for the production by the Respondent of certain documents, including the submissions it made to PIATCO (and submissions and documents it would be making) in the related ICC arbitration. On 27 July 2004, the Tribunal issued a Procedural Order addressing some of the issues raised by this request. On 3 August 2004, a further Procedural Order was issued regarding the parties’ Confidentiality Agreement. Thereafter, on 10 August 2004, the Claimant submitted its Memorial.

On 18 October 2004, by Procedural Order, the Tribunal directed the Respondent to produce to the Claimant all of its submissions and documents in the related ICC arbitration proceedings on an "ongoing basis". The Tribunal noted in its Procedural Order:

"While the present ICSID arbitration and the ICC arbitration are not strictly speaking, parallel arbitrations, the Tribunal accepts Claimant’s representations that the underlying issues in both arbitration are, in substantial part, overlapping.

In the circumstances, there exists a real possibility that the two arbitral tribunals, presented with and asked to consider similar facts, could render conflicting or inconsistent decisions regarding those facts. This is not a desirable outcome."

On 24 November 2004, the Respondent sought an extension of the time for the filing of its Counter-Memorial. On 30 November 2004, the Claimant wrote to the Tribunal indicating that the parties had agreed to an amended timetable, whereby the Respondent would file its Counter-Memorial by 20 December 2004; the Claimant would file its Reply by 8 April 2005; the Respondent would file its Rejoinder by 13 July 2005; and, in the event that the Respondent filed an objection to jurisdiction with its Counter-Memorial, the Claimant would file its Sur-Rejoinder in this regard by 13 August 2005.

On 21 December 2004, the Respondent submitted its Counter-Memorial, including its formal objections to jurisdiction. A corrected version of the Respondent’s Counter-Memorial was submitted on 21 January 2005.
22. Also on 21 December 2004, the Respondent filed an expropriation complaint against PIATCO before the Regional Trial Court of Pasay City in the Philippines. By virtue of this complaint, the Respondent sought a writ of possession authorizing it to take immediate possession of the airport terminal at issue in this arbitration (the "Philippine expropriation proceedings"). The writ was issued and the Respondent was granted possession of the Terminal. To this date, the Respondent is the owner of the Terminal and has made a provisional payment to PIATCO representing the proffered value of the Terminal of approximately US$60 million, of which US$29 million was reportedly transferred to the Claimant.

23. On 23 December 2004, following the expropriation, the Claimant submitted an application for interim measures for the preservation of its rights pursuant to Article 47 of the ICSID Convention and Rule 39 of the ICSID Arbitration Rules.

24. On 27 January 2005, the Tribunal convened an in-person meeting with the parties in Washington, D.C. to dispose of the Claimant's application for interim measures and, if any, all outstanding requests for document production on the part of both the Claimant and the Respondent. The Tribunal also requested a full status report from the parties with respect to the expropriation proceedings in the Philippines. During this meeting, the Claimant confirmed that its application for interim measures was withdrawn. The issue of document production was also extensively discussed, including whether the timetable for written pleadings ought to be modified in light of the parties' recent submissions and the document production process. The Tribunal decided, inter alia, that the timetable would remain unchanged. The Tribunal also confirmed that the oral phase of the proceeding would commence, as previously scheduled, on 29 August 2005, and that the pre-hearing conference would be held on 17 August 2005.

25. In the interim, the Tribunal issued a number of additional Procedural Orders: Procedural Order No. 6 on 15 February 2005 regarding the Respondent's requests for production of documents of 26 August 2004, 29 October 2004 and 11 November 2004; Procedural Order No. 7 on 31 March 2005 regarding the Claimant's request for an order compelling the Respondent to produce documents withheld on the basis of privilege; and Procedural Order No. 8 on 8 July 2005 regarding the Respondent's request for production of documents dated 14 June 2005. On various occasions, the Tribunal reminded the parties that their respective disclosure obligations were of a continuing nature.

26. On 8 April 2005, the Claimant filed its Reply. A corrected version of the Claimant's Reply was submitted on 27 April 2005.

27. On 8 July 2005, the Respondent filed a request seeking an order that the deadline for the filing of its Rejoinder due on 13 July 2005 be stayed or at a minimum extended by six months and that the Claimant's Sur-Rejoinder and the hearing on jurisdiction and liability be rescheduled accordingly. Citing "exceptional circumstances" in support of its request, the Respondent invoked the recent political crisis in the Philippines which had led to the resignation of important cabinet ministers and had prevented proper communication between the Respondent and its counsel in Washington. The Respondent also referred to the unavailability of one of its key witnesses, Secretary Gloria Tan Climaco, due to medical reasons. The Respondent also stressed that it had not received some of the documents which the Tribunal had ordered the Claimant to produce, or the documents which the

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1 This matter is addressed in more detail in Chapter III of this Award ("The Philippine Expropriation Proceedings").
ICC tribunal, in the related PIATCO arbitration, had ordered PIATCO to produce to the Philippines. Finally, as part of the Respondent's request, the Tribunal was apprised of the ongoing investigations involving Fraport in the Philippines, Germany and the United States. Such circumstances, the Respondent argued, impeded its ability to fully present its case.

28. On 11 July 2005, the Tribunal informed the parties that the deadline for the submission of the Respondent's Rejoinder was maintained. Accordingly, the Respondent filed its Rejoinder on 13 July 2005, under protest and with the following reservation:

"The Republic submits this Rejoinder under substantial objection and reserving the right to submit additional evidence that is currently unavailable for reasons described in our 8 July 2005 letter to the Tribunal [...]."

29. On 19 July 2005, the Tribunal issued its Procedural Order No. 9 addressing the Respondent's request for a postponement of the hearing on jurisdiction and liability. The Tribunal indicated that it was not minded at that time to reschedule the hearing but that it would only issue a final decision in this regard following a telephone meeting with the parties which it scheduled for 26 July 2005.

30. On 26 July 2005, the Tribunal held a telephone meeting with the parties.

31. On 3 August 2005, the Tribunal issued Procedural Order No. 10 granting the Respondent's request for a postponement of the hearing on jurisdiction and liability. The Tribunal said, in part:

"3. Having considered the Parties’ submissions and deliberated, the Tribunal has decided, with considerable reluctance, that Respondent's Request should be granted. The overriding circumstance which, in the final analysis, swayed the Tribunal is the situation which obtains today with respect to the many documents produced recently by Claimant to Respondent as well as those documents which will soon be produced by PIATCO to the Republic of the Philippines in a related ICC arbitration.

4. The Tribunal accepts that all of these documents, once produced, will need to be examined and analyzed by Respondent and its experts. Claimant has asked that Respondent file a witness statement and/or expert statement with respect to such documents, in accordance with paragraph 7 of the April 23, 2004 Procedural Order. Respondent, for its part, has requested the opportunity to make a 'supplemental submission to the Tribunal' with respect to any new evidence which such documents may reveal, as well as the right to submit additional declarations from various witnesses.

5. Last Friday 29 July 2005, Respondent filed yet another request regarding the production of documents by Claimant. On Sunday 31 July 2005, Claimant responded to this request by stating clearly that it 'has produced all of the documents that the Tribunal has ordered.'

6. Claimant has also made a request for the production of documents by Respondent based on the witness statement of Edgar R. Navales, which was submitted with the Respondent's Rejoinder on 13 July 2005.

7. In these circumstances, the Tribunal is concerned lest, if the hearing dates are maintained, both Parties may be prevented from fully presenting their case. The Tribunal is also
concerned that, even if it issues, prior to 29 August 2005, orders and directions which dispose of all pending Applications and Requests, there be a serious risk that the evidentiary record will be incomplete and that the efficient conduct of the hearing would thus be impeded.

8. In the opinion of the Tribunal, these circumstances are truly extraordinary and constitute valid reasons for the exercise by the Tribunal of its discretion to postpone the Hearing in accordance with the Tribunal's Order of April 23, 2004.

9. The Tribunal has, of course, considered whether a postponement of the Hearing could cause irreparable prejudice to Claimant. The Tribunal has reached the conclusion that it would not.

10. However, the Tribunal will maintain the dates of 29 (at 2 p.m.), 30 and, if necessary, 31 August for a hearing with the Parties. At this hearing, the Tribunal, after consultation with the Parties, will fix, peremptorily, dates in early 2006 for the hearing on jurisdiction and liability.

11. At this hearing, the Tribunal will also hear the Parties' oral submissions on all other Requests and Applications which are presently pending. The Tribunal intends to issue rulings on all of these outstanding matters promptly thereafter. The Tribunal will also establish at that time a definitive procedural timetable and calendar for the efficient conduct of this arbitration.

12. Before the end of this week, the Tribunal will distribute to the Parties a list of all pending requests and applications of which it remains seized and which will be on the Agenda of the hearing at the end of the month. In the meantime, the Parties are ordered to refrain from filing any further submissions with the Tribunal.

13. In the present circumstances, the filing by Claimant of its Sur-Rejoinder which was due on 13 August is suspended. A new date for the filing of Claimant's Sur-Rejoinder will be fixed at the August hearing."

32. A procedural hearing was accordingly held on 29 and 30 August 2005 in Washington, D.C., at the conclusion of which the Tribunal issued Procedural Order No. 11, as contained in the minutes of this hearing dated 1 September 2005. A schedule for the production of further documents was established. The Tribunal also decided that the Respondent would be allowed to file an additional submission by 17 October 2005 in order to address documents recently produced by the Claimant. Similarly, the Claimant was given the right to file a Sur-Rejoinder by 17 November 2005 in response thereto. The Tribunal also directed the parties to report to the Tribunal, on an ongoing basis, on the progress of discussions which they were having involving the sale of Fraport's equity and related interests in PIATCO to Manila Hotel Corporation as well as developments in the various related legal proceedings, particularly in the Philippines and in Germany, to which the Republic of the Philippines, PIATCO and/or Fraport were parties. Finally, it was decided that the hearing on jurisdiction and liability would be held in Washington, D.C. from 6 to 17 January 2006 and that a pre-hearing conference would be held in December 2005 between the President and the parties at a date to be fixed later after consultation with the parties.

33. On 12 October 2005, five days prior to the deadline set for its Supplemental Submission, the Respondent requested an extension of time until 20 January 2006, invoking in support of its request various alleged deficiencies in the Claimant’s production of documents. As part of its request, the
Respondent also asked that the Claimant's Sur-Rejoinder and the hearing on jurisdiction and liability be rescheduled accordingly. Two days later, on 14 October 2005, the Respondent also made an application to submit various additional witness statements.

34. On 14 October 2005, the Tribunal issued Procedural Order No. 12 informing the parties that the Tribunal granted the Respondent a one-week extension for the filing of its Supplemental Submission, i.e. to 24 October 2005. The deadline for the filing of the Claimant's Sur-Rejoinder was accordingly also extended by one week, i.e. to 24 November 2005. All other dates set by the Tribunal during the August 2005 hearing were maintained.


36. On the same date, by way of Procedural Order No. 13, the parties were informed that the Respondent's application to submit additional witness statements by Messrs. Silverstone, Pringle and Pieth, as well as Secretary Gutierrez, was granted. Its request to submit statements by two other witnesses was denied.

37. On 19 October 2005, following instruction from the President, the Secretary of the Tribunal informed the parties verbally that the Tribunal, having considered the parties' submissions, had decided, unanimously, that the Respondent's request for reconsideration of Procedural Order No. 12 was denied, without prejudice, and that a more detailed order would follow.

38. On 20 October 2005, the Tribunal issued its Procedural Order No. 14 setting forth detailed reasons for the dismissal of the Respondent's request for reconsideration of its Procedural Order No. 12. The Tribunal stated, in part, as follows:

"6. The Tribunal remains concerned with the non-production to the Respondent of the PIATCO documents in the ICC arbitration. The Tribunal recalls that in its Procedural Order No. 4 of October 18, 2004, it accepted that 'the underlying issues in both arbitrations are, in substantial part, overlapping' (at page 1). The Tribunal remains of that view.

7. Regarding production by PIATCO to the Republic of the Philippines in the ICC arbitration, the Tribunal notes the statement by counsel for PIATCO that '[d]ocument production shall re-commence immediately and shall be completed by 9 December 2005'.

8. This is the principal reason why the Respondent's request for reconsideration is denied, but without prejudice. While the Tribunal will not be held hostage to the production of PIATCO documents in the ICC arbitration, it will nevertheless consider any further application which either Party may make as document production on the part of PIATCO proceeds." (emphasis in original)


40. Subsequently, in the period prior to the hearing on jurisdiction and liability, the Tribunal was seized of numerous requests from both parties and issued a number of further Procedural Orders: Procedural Order No. 15 on 8 November 2005 rejecting the Claimant's request for an order
compelling the Respondent to produce a document over which it had claimed privilege; and Procedural Order No. 16 on 9 December 2005 pursuant to which the Tribunal, inter alia, granted the Claimant's request for an order directing the Respondent not to share with the Special Prosecutor of the Office of the Ombudsman documents marked confidential, granted the Respondent's request for an order allowing the late submission of a witness submission from Mr. Mendoza, denied the Respondent's request for an order accepting an affidavit from Mr. Maurits Van Linder and directed the Respondent to provide to the Claimant copies of all of its submissions in the ICC arbitration.

41. On 15 December 2005, the President of the Tribunal held a pre-hearing conference with the parties in Washington, D.C. During this conference, various directions were issued by the President with respect to the orderly conduct of the oral hearing in January 2006.

42. On 20 December 2005, the Tribunal issued Procedural Order No. 17 pursuant to which the Tribunal directed the Respondent to produce immediately to the Claimant all of its submissions in the ICC arbitration that it had not previously provided. The Respondent was also allowed to submit written statements by Messrs. Barrenchea and De Ocampo, provided they were limited to rebutting issues raised in the Claimant's SurRejoinder, by no later than 30 December 2005. Oral testimony on the part of Mr. Barrenchea for the purpose of rebutting accusations made against Secretary Climaco, in the absence of exceptional circumstances justifying the introduction of such testimony, would not be allowed.

43. On 21 December 2005, the Tribunal issued Procedural Order No. 18 granting the Respondent's request that Mr. Villaraza be permitted to testify at the hearing on jurisdiction and liability by videoconference.

44. On 22 December 2005, the Tribunal issued Procedural Order No. 19 denying both the Claimant's request for production of counsel for the Respondent's communications with the German Prosecutor and the Respondent's request for an order regarding access to the German Prosecutor's documents.

45. On 27 December 2005, the Respondent made a further request for a postponement of the hearing on jurisdiction and liability scheduled to commence less than 10 days later or, alternatively, a stay of proceedings, pending the resolution of ongoing litigation in Germany relating to its access to the German Prosecutor's documents and the production by PIATCO of documents in the ICC arbitration.

46. On 29 December 2005, by Procedural Order No. 20, the Tribunal ruled that the Respondent's request for a postponement or a stay of the oral proceedings would be heard at the outset of the hearing on 6 January 2006. The Tribunal further ordered the parties to refrain, unless otherwise directed, from filing any further written submissions until the commencement of the hearing on jurisdiction and liability.

47. On 6 January 2006, prior to the commencement of the hearing and as previously ordered, the Tribunal heard the parties with respect to the Respondent's request for a postponement or a stay of proceedings and, at the conclusion of arguments, took the matter under advisement. The request was later denied by the Tribunal. In its Procedural Order No. 21 dated 6 January 2006, the Tribunal stated, in part, as follows:
14. In support of its present Request for a Postponement, the Respondent avers that ‘the record is incomplete without the relevant and material PIATCO documents that [...] [t]he ICC Tribunal has ordered PIATCO to produce [...] by January 12, 2006’.

15. The Tribunal notes that there has been an ongoing debate between PIATCO and the Republic of the Philippines before the ICC Tribunal in respect of the production by PIATCO of documents sought by the Respondent. This Tribunal cannot in any way influence the timely outcome of the document production process in the ICC arbitration. The Tribunal further notes that documents may soon be produced. If they are, the Respondent will have the opportunity of seeking permission from this Tribunal to produce any such document which it considers relevant and material. In any event, the Tribunal will not postpone the present hearing until a date uncertain in the future when documents, which may or may not be relevant, become available.

16. The Respondent also invokes in support of its present Request for a Postponement that ‘the record is incomplete without Fraport’s relevant and material documents seized by the German Prosecutor’. The Claimant, exercising a procedural option granted to it under German law, has opposed access by the Respondent to these documents, and such access has been suspended pending a decision of a German court. The Tribunal notes that these documents consist of ‘investigation files’ and that according to the Respondent, ‘[i]n the near future, either the German court will rule that the documents will not be made available, or these documents will be forthcoming’. In answer to a question from a member of the Tribunal in this regard, the Respondent’s counsel stated that she did not know when the German court was likely to rule on the Claimant’s objection.

17. The Tribunal believes that the record before it is sufficient to commence a hearing on jurisdiction and liability. It thus sees the situation which obtains today as altogether different from the situation which obtained in August 2005 when it issued Procedural Order No. 10. The Respondent’s Request for a Postponement is accordingly denied.

18. The Tribunal would caution the Parties that in its Procedural Order No. 19 dated 22 December 2005, after having noted the Respondent’s allegations regarding the Claimant’s alleged behaviour which forms part of the Request No. 2 (regarding access to the documents seized by the German Prosecutor), the Tribunal ruled that ‘each Party will be at liberty during the merits hearing to invite the Tribunal to draw appropriate inferences from the other Party’s failure to comply voluntarily with its Request’.

19. Before concluding the present Order, the Tribunal wishes to remind the Parties of ICSID Arbitration Rule 38 (Closure of the Proceeding):

(1) When the presentation of the case by the parties is completed, the proceeding shall be declared closed.

(2) Exceptionally, the Tribunal may, before the award has been rendered, reopen the proceeding on the ground that new evidence is forthcoming of such a nature as to constitute a decisive factor, or that there is a vital need for clarification on certain specific points.’

20. As mentioned by the Tribunal during oral arguments on 6 January 2006, in the event that there is an application to the Tribunal by either Party pursuant to a provision of the above-
cited Rule, the Tribunal in exercising its discretion of necessity will be mindful of and take into account the totality of the record since it has been constituted.”

48. The hearing on jurisdiction and liability was held in Washington, D.C. from 6 January to 17 January 2006, i.e. 11 hearing days. In addition to opening and closing arguments, the following witnesses were heard during the hearing:

   Called for cross-examination by the Respondent:

   Mr. Salih Samim Aydin
   Mr. Dietrich F. Stiller Mr.
   Manfred Scholch Mr.
   Wilhelm Bender Mr.
   Peter Henkel Mr. Thomas W. Golden

   Called for cross-examination by the Claimant:

   Secretary Gloria L. Tan Climaco
   Mr. Reynaldo S. Libutan
   Mr. Norbert Losch
   Secretary Maria Merceditas N. Gutierrez
   Mr. Edgar Navales
   Mr. Juan Jose Rodom T. Fetiza
   Mr. F. Arthur L. Villaraza
   Mr. Victor C. Fernandez
   Secretary Alberto G. Romulo
   Secretary Avelino X. Cruz, Jr.

49. On 1 March 2006, the parties, simultaneously, filed post-hearing briefs.

50. At this point, the parties’ written submissions had totaled approximately 1300 pages, and their witness and expert statements had totaled collectively over 2300 pages, in addition to several hundred exhibits.

51. The Tribunal further notes that, at the request of the Respondent, in view of the ongoing related proceedings and investigations, the proceeding was not closed at the end of the January 2006 hearing on jurisdiction and liability. In fact, as will be seen later, after 17 January 2006, the
Tribunal received numerous letters from the parties, as well as additional requests and applications.

52. Thus, on 10 May 2006, the Claimant wrote to the Tribunal and made the following application:

"Fraport hereby requests that if Respondent is going to request leave to make any further submission to the Tribunal with respect to any new information currently in its possession, that Respondent be directed to so request the Tribunal by close of business on Friday, May 19. If the Tribunal grants the application, a suitable briefing schedule should be worked out."

53. On 19 May 2006, the Respondent responded to the Claimant's letter with the following application:

"For all of the foregoing reasons, the Respondent anticipates that it will request leave within the next two to four months to file an additional submission. Given the uncertainty in timing of the ongoing dispute over document production with PIATCO and the ongoing efforts in Germany, the Respondent submits that it is premature to require that a briefing schedule be established now, as Claimant contends. Instead, in the interest of efficiency, the Respondent requests that it be allowed to notify the Tribunal at the earliest time when a precise date can be set for the filing of an additional submission."

54. On 30 May 2006, the Claimant responded to the Respondent's application as follows:

"Having failed to request leave to make any further submission 4 months after obtaining the PIATCO documents, Respondent should be precluded from making any further submission based upon those documents. Further, Respondent should be ordered, again, to abide by the Tribunal's repeated orders that it provide Fraport on an ongoing basis all documents and submissions in the ICC arbitration. The Tribunal should accept the Respondent's communication to the German authorities as further unlawful treatment of Fraport and its executives in violation of the BIT. Respondent's baseless demands and threats for delay of the Tribunal's deliberation and issuance of an award on liability and jurisdiction in this bifurcated Arbitration should be rejected."

55. On the same date, the Respondent wrote to the Tribunal seeking the following:

"The Republic will continue to update the Tribunal of any new significant developments in these matters. Beyond providing factual updates, it is critical that the Parties be allowed to brief the Tribunal on the legal implications of these developments. As such, the Republic requests that it should be permitted to address the legal implications of recent developments in the expropriation proceedings in a later written submission."

56. On 31 May 2006, the Respondent wrote a further letter to the Tribunal:

"Claimant has submitted a 14 page single-spaced letter addressing matters beyond those mentioned in our May 19 submission. Claimant's letter is effectively a supplemental submission on the merits that is calculated to impact the Tribunal's deliberations and should be disregarded."
Alternatively, if the Tribunal plans to read and consider Claimant's submission, then the Republic must be permitted to respond before any consideration is given to the issues addressed therein. [...] 

Accordingly, we ask that the Republic be permitted to respond to Claimant's extensive and substantive May 30, 2006 submission, that came in the guise of a response to the Republic's discussion of a potential supplemental submission, before the Tribunal considers Claimant's submission. We are prepared to file a response by June 21, 2006. That response is not meant to supplant the requested supplemental submission based on PIATCO documents and any others obtained from Hong Kong or Germany in the interim.

57. On 6 June 2006, the Tribunal issued Procedural Order No. 22, ordering as follows:

"(i) the Respondent shall file an additional submission on 19 June 2006 for the purpose of addressing the Claimant's letter of 30 May 2006, the PIATCO documents, any other documents obtained from Hong Kong or Germany, as well as recent developments in the expropriation proceedings in the Philippines;

(ii) the Claimant shall file its response thereto on 3 July 2006 and

(iii) the Respondent shall be entitled to submit a reply to the Claimant's response of 3 July 2006 on 10 July 2006." (emphasis in original)

As part of its Procedural Order No. 22, the Tribunal also reminded the Respondent of its directions that it provide to the Claimant on an ongoing basis all of its documents and other submissions in the related ICC arbitration.

58. On 14 June 2006, the Respondent sought a revision of the timetable established under Procedural Order No. 22. By letter dated 16 June 2006, the Tribunal informed the parties that this timetable was temporarily suspended pending the Claimant's response and the Respondent's reply.

59. On 23 June 2006, the Tribunal, after deliberating, issued Procedural Order No. 23, directing as follows:

"the Respondent shall file an additional submission on 15 August 2006 for the purpose of addressing the Claimant's letter of 30 May 2006, the PIATCO documents, any other documents obtained from Hong Kong or Germany, as well as recent developments in the expropriation proceedings in the Philippines;

the Claimant shall file its response thereto on 15 September 2006; and

the Respondent shall be entitled to submit a reply to the Claimant's response of 15 September 2006 on 29 September 2006." (emphasis in original)

60. On 27 June 2006, the Claimant made an application requesting that the Tribunal reconsider its ruling under Procedural Order No. 23.
On 18 July 2006, the Tribunal issued Procedural Order No. 24 dismissing the Claimant’s application requesting that the Tribunal reconsider its ruling under Procedural Order No. 23. As part of its Procedural Order No. 24, the Tribunal also stated:

"7. With respect to the production by Respondent to Claimant of all documents and submissions in the ICC arbitration between Respondent and PIATCO, Respondent is reminded yet again that it has been ordered to provide these documents to Claimant on an ongoing basis, i.e. as soon as they are available.

8. With respect to documents which Respondent, or indeed Claimant, may receive from ongoing Hong Kong or German criminal investigation, both Parties are minded of their obligations to update the Tribunal and report any new development in a timely manner.

9. Finally, with respect to the Philippine expropriation proceedings, the Tribunal notes that Respondent has offered to update the Tribunal (and Claimant) on all developments in these proceedings and it is so ordered." (emphasis in original)

On 15 August 2006, the Respondent filed its Additional Submission consisting of 80 pages, numerous exhibits and supplementary witness statements.

On 7 September 2006, the Respondent filed an additional submission.

On 15 September 2006, the Claimant filed its Observations to Respondent's Additional Submission consisting of 76 pages.

On 2 October 2006, the Respondent filed its Reply to Claimant’s Observations consisting of 132 pages as well as further exhibits and witness statements.

On 25 October 2006, in accordance with Rule 38 of the ICSID Arbitration Rules, the Tribunal stated:

"The Tribunal is of the view that the presentation of their case by both parties is now completed and the instant proceedings are hereby declared closed.

Nevertheless, the Tribunal's Procedural Order of 18 July 2006, as it pertains to the ongoing expropriation proceedings in the Philippines, remains in effect and Respondent is accordingly directed to keep the Tribunal (and Claimant) informed of the status of those proceedings."

On 5 January 2007, the Claimant informed the Tribunal that the Philippine Department of Justice had dismissed an ADL complaint made against PIATCO and Fraport officials (the "ADL complaint").

On 8 January 2007, the Respondent wrote to the Tribunal, taking issue with the Claimant's characterization of the Philippine Department of Justice's dismissal of the ADL complaint.

On 10 January 2007, at the Tribunal's request, the Claimant provided the Tribunal with certain

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2 This matter is addressed in more detail in Chapter V of this Award ("Analysis and Findings on jurisdiction").
documents forming part of the evidentiary record in the ADL complaint.

70. On 11 January 2007, the Respondent made further submissions to the Tribunal regarding the ADL complaint, alleging that although the ADL complaint was dismissed, certain "critical documents" had not been before the Department of Justice. The Respondent contended:

"These critical documents were unavailable to the DOX, not for lack of effort or interest, but (1) because of the confidentiality designation in this arbitration under the ordered confidentiality agreement; and (2) because Fraport, through German courts, blocked the Philippine DOX's request for mutual legal assistance in Germany. Having denied the Philippine DOX the crucial and relevant evidence, Fraport cannot celebrate the DOX's dismissal as evidence of its innocence."

71. In a letter dated 12 January 2007, the Claimant took issue with this contention of the Respondent. The Claimant reiterated that it did not have the full record regarding the ADL complaint.

72. On 14 February 2007, the Tribunal requested that the Respondent produce *in extenso* the documents having formed part of the record in the ADL complaint. The Tribunal added:

"The present request is not a decision by the Tribunal to reopen the proceeding under ICSID Arbitration Rule 38. The Tribunal merely seeks to complete the evidentiary record which the Parties have constituted with their attachments to Respondent's letter of 5 January and Claimant's letter of 10 January.

Until further notice, the Tribunal does not wish to receive any submissions with respect to this material from either Party."

73. The requested documents regarding the ADL complaint, consisting of over 1900 pages, were produced by the Respondent on 14 March 2007. The Respondent's document production regarding the ADL complaint was subsequently supplemented, *inter alia*, by additional documents provided by the Claimant on 26 March 2007.

74. By letter dated 13 June 2007, the proceeding was declared closed in its entirety. The Tribunal wrote:

"[T]he Tribunal is of the view that the presentation of their case by both parties is completed and accordingly, pursuant to Arbitration Rule 38, the proceeding is now declared closed in its entirety."

75. As a final observation, the Tribunal wishes to emphasize that the above account of the procedural history of this arbitration is not meant to be exhaustive. As noted earlier, this has been a bitterly fought case since the constitution of the Tribunal on 11 February 2004. The mere fact that, more than 14 months after the end of the oral hearing on jurisdiction and liability, the parties were still exchanging letters and submitting reports and documents to the Tribunal attests to the unusual nature of the present arbitration and explains why the Tribunal's decision has only been made now.

76. Throughout this arbitral proceeding, the Tribunal has been required to address a plethora of
procedural requests and applications, in addition to those reviewed in the present chapter of its Award. They were all extensively and diligently briefed by the parties, resulting in literally thousands of pages of submissions and exhibits. The Tribunal considers it unnecessary to describe these submissions beyond the account set forth above. The Tribunal wishes to acknowledge, however, the dedication and professionalism of counsel for both parties who, often in trying circumstances, have always sought to assist the Tribunal.

II. FACTUAL BACKGROUND

A. Introduction

77. For reasons set out in more detail later in this Award, the Tribunal has decided that it does not have jurisdiction to rule on the Claimant's allegations of breaches by the Respondent of certain provisions of the BIT, because the Claimant's investment is not protected by the Treaty.

78. In order to fully understand the Tribunal's analysis and findings on jurisdiction, it is necessary to set out at some length the factual matrix of this case as disclosed by the evidence, written and oral, presented by the parties and thereby review the history of Fraport's investment in the Philippines Terminal 3 project. The Tribunal will now proceed to do so.

B. The Terminal 3 Project

1. The Original Proposal

79. The project to construct an international passenger terminal at Ninoy Aquino International Airport ("NAIA") in Manila, otherwise known as Terminal 3, dates back to 1990 when, as part of a report ("Master Plan Review") commissioned by the Philippine Department of Transportation and Communication ("DOTC"), it was recommended that NAIA continue to be the principal airport for Metro Manila, with construction of Terminal 2 for domestic passengers and Terminal 3 for international passengers.

80. In April 1993, the then-President of the Philippines, President Fidel V. Ramos, met with a group of six Philippine business leaders and asked them to submit a bid to develop Terminal 3. These business leaders, known collectively as the Six Taipans, were led by Lucio Tan, Chairman of Philippine Airlines ("PAL"), the national flag carrier; the other five were Alfonso T. Yuchengco, Henry Sy, Sr., George S.K. Ty, John Gokongwei and Andrew L. Gotianun.

81. On 15 September 1993, the Six Taipans incorporated a company known as Asia's Emerging Dragon Corporation ("AEDC") for the purpose of constructing, operating and maintaining Terminal 3. Approximately one year later, on 5 October 1994, AEDC formally submitted its bid to the DOTC in the form of an unsolicited proposal for the construction and operation of Terminal 3.
The AEDC Terminal 3 proposal called for a US$369 million terminal that would be financed entirely by AEDC, i.e. at no cost to the Philippine Government. Under the proposal, AEDC would construct a world-class passenger terminal with a design capacity of up to 10 million passengers annually. AEDC would operate and collect revenues from the terminal over a 25-year concession period, which could be renewed for an additional 25 years. During the construction and concession period, AEDC would also pay to the Philippine Government a series of fixed annual guaranteed payments.

In the period during which AEDC was preparing its Terminal 3 proposal, the Philippine Congress passed Republic Act No. 7718 on 5 May 1994, entitled “An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector and for Other Purposes”, better known as the Philippine “BOT Law”. The BOT Law regulates, inter alia, project proposals that are not publicly solicited by the Philippine Government. Under the BOT Law, the incentive for private investment is the concessionaire’s ability to earn revenues from operation of the concession on agreed terms and conditions for a given period of time.

The BOT Law lists three conditions that must be met before a government agency or unit may accept an unsolicited proposal: (a) the project must involve a new concept or technology and/or is not part of the list of priority projects; (b) no direct government guarantee, subsidy or equity is to be required; and (c) the agency or unit concerned must have subsequently invited by publication, for three consecutive weeks, in a newspaper of general circulation, comparative or competitive proposals. In the event that another project proponent submits a lower price proposal, the original proponent has the right to match it within thirty working days. If the original project proponent matches the submitted lowest price within the specified period, it is immediately awarded the project; otherwise, the contract is awarded to the one tendering the lowest price.

The BOT Law and Implementing Rules and Regulations of the BOT Law (“IRR”) provide the criteria for selecting the winning proposal: “[T]he contract shall be awarded to the bidder who, having satisfied the minimum financial, technical, organizational and legal standards required by this Act, has submitted the lowest bid and most favourable terms for the project, based on the present value of its proposed tolls, fees, rentals and charges over a fixed term for the facility to be constructed, rehabilitated, operated and maintained according to the prescribed minimum design and performance standards, plans and specifications.”

The BOT Law and the IRR further set forth various legal, credential, and financial requirements for project bidders. In the event of a public utility franchise, the proponent and facility operator must be Filipino or if a corporation, it must be duly registered with the Securities and Exchange Commission (“SEC”) and owned and controlled up to at least sixty percent (60%) by Filipinos, as further required by the Philippine Constitution. In addition, the project proponent, by itself or through the member-firms in case of a joint venture/consortium or through the contractor(s) engaged for the project, must have successfully undertaken a project similar or related to the project at issue.

The BOT Law also requires that an unsolicited proposal be approved by the Philippine National Economic Development Authority (“NEDA”). More particularly, pursuant to the IRR, the NEDA Investment Coordination Committee (“ICC”) is tasked with leading the approval process in connection with projects “involving substantial government undertakings”. As part of this process, the BOT contract is reviewed by the ICC Technical Board, and on a line-by-line basis by the ICC Technical Working Group (“TWG”, or ICC Contract Review Committee), which recommends
approval or disapproval to the ICC Cabinet Committee.

88. In the present case, the evidence discloses that AEDC’s proposal for the Terminal 3 project, as submitted in October 1994, was endorsed six months later on 27 March 1995 by the DOTC Secretary to NEDA-ICC, as required by the BOT Law and applicable IRR. In May 1995, however, President Ramos publicly approved the simultaneous development of both Terminal 3 and a second airport which was known then as Clark Field Airport (“Clark”), a former United States Air Force Base. In light of this development, a revised proposal was forwarded by the DOTC to NEDA on 13 December 1995.

89. Thereafter, on 19 January 1996, as required by the BOT Law and IRR, the ICC Cabinet Committee reviewed and recommended approving the Terminal 3 project proposal upon the terms formulated by AEDC.

90. On 13 February 1996, the NEDA Board approved the Terminal 3 project in NEDA Board Resolution No. 2 along the terms and conditions imposed by the ICC, but added certain conditions concerning appraisal of the land valuation of the site and other clauses for negotiations. AEDC and the DOTC then held a "Project Launching Ceremony" for Terminal 3 in February 1996. The parties also signed a memorandum of agreement to fast-track the implementation of the Terminal 3 project.

91. The only challenge to AEDC’s unsolicited proposal came on 20 September 1996 from Paircargo Y Associates, Inc. (which would later incorporate as Philippine International Air Terminals Co. or PIATCO). Paircargo Y Associates was a joint venture composed of People’s Air Cargo Y Warehousing Co, Inc. (“Paircargo”), Philippine Airport Y Ground Services, Inc. (“PAGS”), and Security Bank Corporation (“Security Bank”). Paircargo operated a cargo warehouse facility at NAIA and was owned by Cheng Yong and his son, Jefferson Cheng (the “Chengs”). PAGS was a joint venture between Paircargo and GlobeGround, the latter a wholly-owned subsidiary of Lufthansa. Security Bank is a Philippine commercial bank.

92. On 20 September 1996, the Paircargo group thus submitted its proposal to the Prequalification Bids and Awards Committee (“PBAC”). On 23 September 1996, the PBAC opened an envelope containing the requalification documents of the Paircargo group. The next day, on 24 September 1996, the PBAC determined the Paircargo group to be financially capable under the BOT Law and the IRR.

93. Two days later, the PBAC’s determination prompted AEDC to make its first official objection to the Paircargo group’s bid, alleging that the Paircargo group did not have sufficient capital to meet the prequalification requirement. The basis for AEDC’s challenge was the contention that the total net worth of Security Bank, one of the Paircargo group’s consortium members, should not have been considered in evaluating whether the Paircargo group had the ability to raise 30% of the project cost equity. AEDC argued that the Philippine General Banking Act limited Security Bank’s equity investment to no more than 15% of the total net worth of Security Bank, as opposed to its entire net worth.

94. On 2 October 1996, the PBAC rejected AEDC’s challenge and informed AEDC that the Paircargo group had been correctly pre-qualified. The PBAC wrote: “Based on the documents submitted and established criteria for prequalification the PBAC found that the challenger pre-qualified to undertake the NAIA 3 project.” The PBAC further stated that the DOTC Secretary had approved the PBAC’s findings.
95. On 16 October 1996, despite further objections raised by AEDC, the PBAC thus opened the Paircargo group’s envelope containing its financial proposal. Subsequently, AEDC received a letter from the PBAC stating that it had accepted the Paircargo group’s financial proposal, attaching Paircargo Y Associates’ schedule of annual guaranteed payments to the Government during the construction and 25-year concession period. At this point, AEDC had 30 working days to match the proposal of the Paircargo group or the contract would be awarded to Paircargo Y Associates.

96. On 29 October 1996, AEDC’s counsel asked the PBAC to provide it with official copies of the Paircargo group’s financial proposal in order for AEDC to evaluate what it was being asked to match. The PBAC rejected AEDC’s request. Consequently, on 2 December 1996, AEDC’s lawyers, Villaraza Y Cruz, informed DOTC Secretary Lagdameo that AEDC could not make a decision on whether or not to match the competing bid due to a lack of sufficient data, which DOTC officials refused to provide. AEDC never submitted a bid to match the Paircargo group’s bid and the latter was accordingly selected for the Terminal 3 project.

97. Subsequently, on 16 April 1997, AEDC filed a civil suit in the Regional Trial Court of Pasig City against DOTC officials, PBAC Chairman Cal, Vice-Chairman Atayde, Technical Committee Chairman Alvarez, and PBAC voting members Ceser Valbuena, Herminia Castillo, and Wilfredo Trinidad. AEDC’s petition requested a declaration that Paircargo Y Associates (which by then had incorporated as PIATCO) was not properly prequalified, a declaration of nullity of the award of contract to PIATCO, and an injunction against proceeding with its bid.

2. The Concession Agreement

98. The Concession Agreement was executed on 12 July 1997 by PIATCO (which had been incorporated on 27 February 1997) and DOTC Secretary Enrile, on behalf of the Government of the Republic of the Philippines. Its core terms included the following:

(i) The exclusivity for international passengers at Terminal 3, whereby the Government committed to relocate international passenger operations for Terminals 1 and 2 once Terminal 3 opened, with the result that the older terminals were to be used for domestic passengers and cargo. The development of Clark as a facility for international passengers was also restricted.

(ii) Various concession fees and payments to the Government, as well as a distinction between “public utility revenues” and “non-public utility revenues”.

(iii) A concession period of 25 years, which could be extended by another 25 years at the Government’s request. At the end of the concession period, PIATCO was to transfer Terminal 3 free of charge.

(iv) The Government was given several options in the event of the concessionaire’s default under the concessionaire’s agreements with its lenders. Specifically, the Government had the option of allowing the concessionaire’s creditors to be substituted, if qualified, as the concessionaire and operator of Terminal 3, or to designate an operator. In the event the Government were to designate an operator pursuant to this election, the Government would be obligated to assume attendant liabilities to the concessionaire’s creditors.
(v) A separability clause providing that "[t]he invalidation of any of the terms, conditions, stipulations, covenants, conditions, or restrictions, or any part hereof by a final judgment of a court of competent jurisdiction shall not affect the other provisions hereof.

(vi) A conflict clause providing that, "[i]n case of conflict between any of the provisions of this Agreement and any provision of any document or instrument relating to the Project (whether or not forming part of the Bid Documents), the provisions hereof shall prevail".

(vii) The Concession Agreement expressly permitted amendments, changes, modifications or supplements, provided that they were in writing and executed by both parties.

99. Simultaneously with the signing of the Concession Agreement, a separate agreement (the "Side Agreement") was executed by the Parties to address the various possible outcomes following resolution of the ongoing legal challenge to the bid process raised by the AEDC lawsuit. If the AEDC challenge was resolved in favour of the PBAC (i.e. in favour of PIATCO), the Side Agreement would become void and of no effect. If, however, the challenge was successful and the Concession Agreement terminated as a consequence, the Side Agreement provided that PIATCO would be released unconditionally from any obligations under the Concession Agreement without liability and the Government would have to reimburse PIATCO fully for all its expenses.

100. The Concession Agreement, like all contracts in the Philippines for infrastructure and development projects, went through the process of being submitted by the DOTC to the ICC and NEDA "for clearance on a no-objection basis, specifically on the extent of the final government undertaking to be provided to the project". On 16 April 1997, the Concession Agreement negotiated between PIATCO and the PBAC members was thus sent to the ICC for approval. PIATCO's contract was required to meet the same conditions as AEDC's unsolicited proposal previously approved by NEDA in February 1996; any changes would require review and approval by the ICC and NEDA.

101. On 17 April 1997, the ICC Cabinet Committee held a meeting, the minutes of which reflect that an ad referendum was conducted. However, only four of the requisite six signatures were obtained to approve or clear the contract on a "no objection" basis as required by the IRR. The contract, therefore, was merely noted. The minutes at issue do not reflect that additional signatures were subsequently forwarded. In any event, on 9 July 1997, the DOTC issued a Notice of Award to PIATCO, and the parties proceeded to execute the Concession Agreement on 12 July 1997.

3. The Amended and Restated Concession Agreement

102. By 1998, the terms of the Concession Agreement were being renegotiated to allow PIATCO to obtain financing from certain international lenders. The loan PIATCO was depending upon had not materialized and the international lenders were requiring changes to the Concession Agreement prior to committing financing. The renegotiations to effect these changes culminated in the Amended and Restated Concession Agreement ("ARCA"), ultimately signed by PIATCO and Secretary Rivera of the DOTC on 26 November 1998.

103. The core terms of the ARCA included the following:
(i) The concession payments, *i.e.* the basis thereof, would be established when operations were started by the MIAA. In addition, a passenger fee of US$20, as opposed to 500 pesos, would be collected.

(ii) In the event of default by PIATCO, the lenders had the right to designate a qualified nominee to operate the Terminal or transfer the Terminal to a qualified transferee. If the lenders were unable to designate a nominee or transferee, the Terminal was to be transferred to the Government or its designee, with the Government being required to make a payment to PIATCO “equal to the Appraised Value of the Development Facility or the sum of the Attendant Liabilities if greater”. The Concession Agreement had specified only that, in the event of a PIATCO default, the Government would have the option to take over the Terminal and to assume all attendant liabilities.

(iii) If the ARCA was terminated because of a default by the Government, it was to pay liquidated damages to PIATCO.

(iv) The ARCA added a special warranty as to the legality of the ARCA as well as of the actions of the DOTC and the MIAA in accordance with the contract to PIATCO. The Government further warranted that it was entitled to enter into the agreement and to guarantee that all of the procedures of the DOTC/MIAA in connection with the Terminal 3 project, including the order of award of the concession to PIATCO, were legal, valid and binding and in accordance with all applicable regulations.

(v) The ARCA was to take precedence over the Bid Documents in the event of any conflict.

104. The same day that the ARCA was signed, DOTC Secretary Rivera forwarded it to NEDA. In his cover letter, Secretary Rivera informed the Director General of NEDA that the ARCA was the result of negotiations to address the concerns of international lenders. The cover letter also stated that although there were seventeen substantial changes:

“A great majority of the amendments, however, were for consistency of reference, adherence to defined terms, brevity, precision, and in some cases a mere matter of writing style. Rest assured that the so-called substantial changes do not contravene the minimum requirements of the Terms of Reference and do not put the government to a disadvantage.”

105. The letter also attached a matrix prepared by PIATCO's counsel showing the section-by-section changes from the Concession Agreement to the ARCA, and the reasons for the change. After looking at the 135-page matrix comparing the changes from the Concession Agreement to the ARCA, Technical Board member Undersecretary of Finance for Corporate Affairs Lily Gruba suggested to the Technical Board that the ARCA be reviewed by the ICC Contract Review Committee, also known as the TWG.

106. During this period, on 12 February 1999, President Estrada issued a Memorandum “Affirming the Government’s Commitment to Extend Full Assistance to the Ninoy Aquino International Airport [NAIA] Terminal 3 Project in order to Ensure its Completion and the Commencement of its Commercial Operations by 2001”. The memorandum, which President Estrada signed, was directed to the heads of 16 government agencies and "all other pertinent Government Agencies and
Officers”. President Estrada stated in the memorandum as follows:

“The Government of the Republic of the Philippines (GRP) has committed to the fulfillment of all its obligations under the Concession Agreement dated 12 July 1997 (as amended and restated on November 26, 1998) with the Philippine International Air Terminals Co. In support of this commitment, you are hereby directed to engage your full cooperation in ensuring into completion of the said project within the timetable set.”

107. Meanwhile, the TWG, which was headed by Department of Finance Assistant Secretary Juan Jose Rodom T. Fetiza, proceeded with the ARCA review. Undersecretary Gruba assigned to him the task of reviewing the matrix of changes in the ARCA and preparing a memorandum for the Chairman of the Technical Board, NEDA Deputy Director-General Ruperto Alonzo. In a letter dated 12 March 1999 to Mr. Alonzo, Mr. Fetiza specifically summarized approximately eighty substantive changes in the ARCA that required further study and recommended that the ARCA be scrutinized by the TWG to determine its effect on the Terminal 3 project. At a meeting on 15 March 1999, the ICC Technical Board decided to refer the amendments to the TWG for further review.

108. The TWG met over the following months to review and resolve objections to the ARCA raised by Mr. Fetiza and others. When negotiations broke off, the ARCA was elevated to the ICC Cabinet Committee with a statement that most of the issues were resolved except for the direct guarantee language in ARCA section 4.04(c)(vi). On 25 June 1999, the ARCA was thus presented to the ICC Cabinet Committee and the only issue the Cabinet Committee discussed was the language in section 4.04(c)(vi).

109. Section 4.04(c)(vi) of the ARCA addressed the Government's rights in the event of default on the part of PIATCO. It provided that in such circumstances, the lenders had the option to designate a qualified nominee to operate Terminal 3 or transfer it to a qualified transforee. Otherwise, Terminal 3 was to be transferred to the Government or its designee, with the Government being required to make a payment to PIATCO “equal to the Appraised Value of the Development Facility or the sum of the Attendant Liabilities if greater.” The Bangko Sentral ng Philippines (“BSP”), i.e. the central bank of the Philippines, had viewed this as a "buy out" that would not be a direct guarantee provided it were optional, i.e. if the Government was not required to make a termination payment and that payment was limited to PIATCO's verifiable expenses, and not the amount of PIATCO's attendant liabilities to its creditors.

110. The ICC Cabinet Committee ultimately adopted BSP's view and conditioned its approval of the ARCA on BSP's review, approval, and monitoring of the credit agreement between PIATCO and the lenders to ensure the buy-out was optional and the termination payment limited. The ICC's conditional approval was accordingly contained in NEDA Board's Resolution that approved the ARCA, subject to "the understanding that the credit agreement between the concessionaire and the Senior Lenders shall be subject to the approval and monitoring by the Bangko Sentral ng Pilipinas". In this regard, the Tribunal further notes that Annex A of the ARCA (the required certificate from the Department of Finance) and Annex B (the required opinion from the Minister of Justice) both required a sovereign guarantee, but were never attached nor is there evidence that they were ever executed.
4. The ARCA Supplements

111. Three supplements to the ARCA were also executed. The First Supplement, executed on 27 August 1999, addressed the Government's obligation under the Concession Agreement to deliver clean possession of the project site to PIATCO so that construction could proceed as scheduled. The ARCA had mandated that this obligation be performed by 30 September 1998, but the Government requested an extension of time. Pursuant to the First Supplement to the ARCA, the date for delivery of clean possession of the project site was accordingly extended to 31 December 1998, with corresponding changes to the rest of the contractual timetable. The First Supplement also made express that PIATCO would have responsibility to construct a surface access road rather than an access tunnel because a tunnel was deemed neither economically viable nor technically feasible. Finally, the First Supplement also amended provisions of the ARCA defining "Revenues" or "Gross Revenues", as well as provisions regarding "Terminal Fees".

112. The parties executed a Second Supplement to the ARCA on 4 September 2000, by virtue of which PIATCO agreed to take on the clearing of the site of subterranean structures. The Second Supplement also contained detailed provisions for determining compensation for PIATCO's performance of this task.

113. Finally, the Third Supplement, executed on 22 June 2001, dealt with the surface access road between Terminal 2 and Terminal 3, and imposed on PIATCO the additional obligation to build and finance the road. Four months later, on 16 October 2001, the Third Supplement was presented to the ICC Technical Board for approval. Submission of the Third Supplement raised questions at the ICC about the prior supplements that had not been approved, but which were submitted about ten days later. The ICC ultimately decided to defer discussing the Third Supplement until DOTC and MIAA explained why they executed three Supplements to the ARCA "neither with justification nor prior ICC approval".

114. The parties subsequently negotiated two additional supplements, i.e. the Fourth Supplement in 2001 and the Fifth Supplement in 2002. Neither one of these supplements was ever executed. The Tribunal will revert later in the present Award to these two Supplements.

C. Fraport's Investment In The Terminal 3 Project

115. As indicated earlier, Fraport is a leading company in the international airport business and owns and operates the Frankfurt Airport, one of the busiest and most successful in the world. Fraport is also the owner, operator or shareholder, either directly or through affiliated companies, of a number of other airport facilities, both in Germany and elsewhere.

116. Fraport's investment as a financial participant in the Terminal 3 project spans a period of several years, starting in 1999 and ending in 2002-2003, when, as the evidence discloses, Fraport progressively wrote off its investment. Fraport's investment was both directly in PIATCO and, indirectly, in a "cascade" of Philippine companies that have ownership interests in PIATCO. In addition to its equity investments, Fraport has extended loans and loan and payment guarantees to PIATCO, the cascade companies and PIATCO's lenders and contractors.
117. Fraport directly and indirectly owns 61.44% of PIATCO. Its ownership of PIATCO and the cascade companies is set forth on the following chart submitted in evidence. As will be seen, the PIATCO shareholders, beside Fraport, are Jefferson G. Cheng, Paircargo, PAGS, and PTI, all of which are controlled by the Cheng family, as well as Sojitz and SB Airport.

1. The Initial 1999 Investments

118. In mid-1998, Stephan M. Bauchspiess, a member of PIATCO's Board of Directors who was also a manager of GlobeGround, a wholly owned subsidiary of Lufthansa, and the managing director of PAGS, a joint venture between the Cheng family and GlobeGround, approached Fraport on behalf of PIATCO and invited Fraport to join the Terminal 3 project as a consultant. Fraport, then known as Flughafen Frankfurt Main AG ("FAG"), agreed to become involved in the Terminal 3 project in that capacity.

119. A short time thereafter, Fraport contemplated initial equity and loan infusions into PIATCO and affiliated companies. To this end, a Philippine KPMG affiliate, Laya Mananghaya Y Co., conducted a financial due diligence review of the proposed investment. In addition, Quisumbing Torres (sometimes referred to as "QT"), a local Philippine affiliate of Baker Y McKenzie, conducted a legal due diligence and issued to Fraport a preliminary report on 28 December 1998.

120. This report which, as will be seen later, addressed important provisions of the Philippine Constitution and other pertinent legislation, indicated, inter alia: (1) the need to consider carefully any shareholder arrangement other than an equity investment in PIATCO, in view of the Philippine constitutional requirement that foreign nationals can own no more than 40% of the capital of a public utility, and the prohibitions of the ADL that prevent foreign nationals from intervening in the management, operation, administration or control of a company that is a public utility; (2) the need to obtain ICC/NEDA approval for the ARCAm and (3) the need to obtain from the President of the Philippines a certification attesting to the authority of the government signatories to sign on behalf of the Philippines, because the BOT Law does not contain an express delegation of authority from the President of the Philippines as required by the Administrative Code.

121. Fraport was also advised to seek termination or resolution of the AEDC lawsuit (raising the issue whether PIATCO had been prequalified properly as a bidder) because "court cases involving high profile infrastructure projects for policy reasons can be politically sensitive".

122. An event worthy of note, in this regard, which occurred prior to Fraport's Supervisory Board's consideration of the PIATCO investment, is AEDC's dismissal of its court challenge to the award of the Terminal 3 concession to PIATCO. In fact, approximately six months earlier, on 14 September 1998, AEDC had withdrawn its pending challenge to the award of the concession to PIATCO (including its contention that PIATCO was not properly prequalified) at the express request of then-President Estrada, who had summoned AEDC to meet with him and his Executive Secretary Ronaldo Zamora shortly after taking office. The record discloses however that AEDC withdrew its challenge with continued misgivings, which AEDC expressed to President Estrada, as to PIATCO's ability to meet minimum equity requirements and to finance the bid.

123. During the month of March 1999, Fraport's Supervisory Board ultimately determined that the investment would be made. The discussions leading to the decision to invest were recorded in the
minutes of the Supervisory Board meeting of 12 March 1999. While the views of those involved in making the decision to invest will be considered in more detail later in this Award, the following excerpts from the meeting of 12 March 1999 are reproduced here:

"Mr. Schmidt reports that the information given [to] the employees' representatives is contradictory, so that it is difficult for him to make a decision. Moreover, the facts certified by the auditor are now being portrayed as no longer relevant. In order to take the decision requested in the submission, he needs reliable information that he does not possess today. Dr. Bender points out that it is very difficult for FAG to get projects if the discussion is conducted in this manner. He reminds of the joint statement according to which this company needs outside growth. During the latest strategy retreat, it was stated that FAG, over the next several years, has a strategic revenue gap of about DM 3 billion. This revenue cannot be achieved through increased activity in the Frankfurt market - even if the EWP already provides for an increase from DM 2.5 billion to DM 3.5 billion DM next year - but must be achieved outside. True, in part the Manila project is considered to be very risky, but FAG was asked to participate in it by a German company - GlobeGround. Even though the returns of this project are already taking [sic] into account the country risks, they are still far above the margin jointly agreed upon as any project's minimum return. He points out that it will be difficult to present again a similar project having this kind of returns and this degree of maturity.

[...] Mr. Struck reports that on February 12, 1999 the President of the Philippines instructed all government agencies to proceed immediately with the construction of Terminal 3 at the Manila airport as the international airport of the Philippines. This decree had not yet been taken into account by the K.PMG report. Now, the risk of the airport being built anywhere else must be assessed more cautiously. Also, the support of PIATCO as the airport operator is now certain. As to the question of the Chairman of the Supervisory Board which would be the consequences of a failure to reach a decision today, Mr. Struck explains that the equity contributed by PIATCO is nearly exhausted. Without the professional leadership of FAG, none of the current shareholders is willing to invest more funds into the project. Furthermore, the banks have asked PIATCO to make room for a competent airport operator; only then can the lending be finalized." (emphasis in original)
consist of critical evidence establishing that Fraport sought to exercise managerial control over PIATCO and thereby knowingly orchestrated its investment in flagrant violation of the ADL.

2. The Subsequent 2000 - 2001 Investments

126. In early 2000, PIATCO, with substantial assistance from Fraport, concluded a competitive bidding process and selected the Takenaka Corporation as the contractor for the Terminal 3 project. Takenaka, PIATCO, and Takenaka's wholly owned offshore procurement supplier, Asahikosan Corporation, entered into several contracts that collectively are referred to as the "EPC Contract". The EPC Contract effectively transferred to Takenaka PIATCO's design, construction, supply, commissioning, defects liability and related obligations under the concession arrangements.

127. Construction commenced under the EPC Contract on 15 June 2000 to be completed in 30 months in late 2002. Regular meetings with the MIAA were held throughout construction to ensure that the MIAA was fully informed and that construction-related issues were properly addressed, including security, design, subterranean structure demolition, and utilities issues.

128. Payments under the EPC Contract were to be made from proceeds from long-term finance agreements. In order to facilitate timely commencement of the work, the EPC contractors and PIATCO agreed to an interim works procedure whereby they could suspend work if their entitlement to payments exceeded or was likely to exceed US$70 million. In this connection, Fraport entered into several contracts that effectively made Fraport the guarantor of up to US$127.4 million of PIATCO's payment obligations to Takenaka and Asahikosan. In addition, Fraport supported as guarantor a term loan facility made available to PIATCO by a group of German banks. This term loan facility was eventually increased to US$165 million, US$138.5 million of which were available to PIATCO for utilizations. This available amount was fully drawn by PIATCO, in large part to make payments to the general contractor, 52.4% of which payments were deducted from Fraport's maximum liability under the US$127.4 million guarantee until Fraport's guarantee was reduced to US$86.7 million.

129. The Tribunal notes that at the time when it began contemplating further investments, Fraport had anticipated raising equity from PIATCO's other minority investors. To that end, in September 2000, Fraport had dispatched its financial adviser, Dr. Georg Braune of Dresdner Kleinwort Wasserstein ("Dresdner Bank"), to the Philippines to "win[] the additional support needed from the shareholders". PIATCO's other shareholders, however, were unable or unwilling to invest additional money into the Terminal 3 project. Nissho Iwai, for instance, was still reeling from the effects of the Asian financial crisis, and thus declined to make its equity call. Paircargo, too, was "unable even to make its basic contribution". Like PIATCO's other shareholders, SB Airports also refused to make its required equity contributions, noting that "its funds are currently tied-up in different projects".

130. In short, Fraport was the only shareholder in PIATCO willing to invest further funds. Dr. Braune explained that "[a] decision has to be made as soon as possible whether to implement the project with the full support of all shareholders (if need be, to be exchanged) or to abandon it". Fraport accordingly decided to increase its shareholdings pursuant to two agreements dated 5 May 2000 (the "2000 Share Purchase Agreements"). Under these two agreements, Fraport acquired an additional 5% of PIATCO, and PTI acquired another 24% of PIATCO.
131. In 2001, Fraport acquired a 40% stake in PAGS, which resulted in Fraport having an additional 9.04% indirect interest in PIATCO. The Tribunal notes that, as of this point, Fraport had acquired 61.44% direct and indirect ownership of PIATCO.

132. The Tribunal further notes that, during this time, Fraport needed to secure longterm financing for PIATCO to ensure sufficient funds were available to complete the Terminal 3 project and recoup the bridge loans and loan guarantees to PIATCO. For this purpose, Dresdner Bank formed a lending consortium with Kreditanstalt fur Wiederaufbau ("KfW"), the Asian Development Bank ("ADB") and the International Finance Corporation ("IFC"). On 27 July 2001, KfW, ADB and IFC (collectively, the "Senior Lenders"), among others, accordingly entered into an "Omnibus Agreement" with PIATCO as Borrower for the purpose of financing the Terminal 3 project. The Omnibus Agreement included a "Common Terms Agreement", which in turn identified various "conditions precedent" (referred to, by the Respondent, as the 77 conditions precedent) that required resolution before the Senior Lenders would permit a drawdown of the loans, including:

- Approval of the project, the ARCA, and the three Supplements by the cabinet-level ICC.
- A shareholding structure acceptable to the Senior Lenders, which required reducing the Chungs' shareholding to less than fifty percent.
- A legally binding commitment letter from Duty Free Philippines agreeing to: (1) close its flagship store, the Fiesta Mall; (2) relocate all duty-free operations in Metro Manila to Terminal 3; and (3) pay PIATCO fifteen percent of duty-free revenues at Terminal 3.
- A Fourth Supplement to the ARCA in a form that was acceptable to the Senior Lenders and that, among other things, expanded the Government's obligations as regards attendant liabilities, force majeure, incremental and consequential costs, and other "special obligations".
- An agreement with the Philippine Economic hone Authority ("PEhA") concerning PIATCO's obligation to make full use of the land allocated by the Government for the Terminal 3 project, in order to take advantage of certain tax advantages.
- A certified copy of "Presidential Full Powers Authority", ratifying the DOTC's authority to have entered into agreements (such as the ARCA) on behalf of the Government.
- A legal opinion from the Philippine Department of Justice approving the ARCA, its Supplements and the Government's Direct Agreement.
- A legal opinion from the Philippine SEC attesting to the legality of PIATCO's shareholder arrangements.
- Approval of the Government Direct Agreement by Government departments and agencies, including the Department of Finance and the Central Bank.

133. Section 2 of the "Common Terms Agreement", entitled "Conditions Precedent", states as follows:

"2. CONDITIONS PRECEDENT

2.1 Initial Conditions Precedent"
2.1.1 The Borrower may not submit a Notice of Drawdown in respect of the Initial Advance unless the Intercreditor Agent has notified the Borrower and each of the Senior Creditors that all of the Initial Conditions Precedent are in form and substance satisfactory to, or have been waived by, each of the Senior Lenders.

2.1.2 The Intercreditor Agent will promptly give the notification in Clause 2.1.1 above upon receipt from each of the Senior Facility Agents of written confirmation that all of the Initial Conditions Precedent have been satisfied or waived (such confirmation to be given promptly by the Senior Facility Agents upon such satisfaction or waiver).

2.2 Conditions Precedent to each Advance

The obligation of each of the Senior Lenders to participate in an Advance under a Senior Facility (including the Initial Advance) is subject to the further conditions that, on both the date of the Notice of Drawdown and the Drawdown Date of that Advance:

2.2.1 (in the case of the Initial Advance only) the Senior Facility Agents are satisfied that the Initial Conditions Precedent remain satisfied or waived;

2.2.2 the conditions set out in Part B of Schedule 3 (Conditions Precedent to each Advance) are in form and substance satisfactory to the Senior Facility Agent under that Senior Facility;

2.2.3 all conditions precedent specifically set out in the relevant Senior Facility Agreement are in form and substance satisfactory to the Senior Facility Agent under that Senior Facility.

2.3 Waiver of Conditions Precedents

2.3.1 The initial Conditions Precedent may be waived only by all of the Senior Lenders.

2.3.2 Conditions under Clause 2.2 (Conditions Precedent to each Advance) may be waived by each Senior Facility Agent in relation to the relevant Senior Facility Agreement.”

134. Many of the changes that the Senior Lenders were requesting as preconditions for the drawdown of long-term financing that Fraport had arranged were reflected in the draft Fourth Supplement (in addition to the DOTC's issuance of a letter to all airlines informing them that all international flights would have to go through Terminal 3 after the in-service date, and the relocation of Duty Free Philippines to Terminal 3). The Fourth Supplement was never executed.

135. Finally, the Tribunal notes that, on 8 June 2001, Fraport proceeded with an important IPO in Germany and that the Offering Circular, in a section entitled "Risk Factors", includes the following pertinent information regarding, inter alia, the issue of long-term financing:

"Risks in connection with the NAIA International Passenger Terminal IPT 3 project in Manila

Due to legal restrictions, Fraport AG has only limited commercial influence over the main project for the construction and operation of the new passenger terminal IPT3 at Ninoy Aquino International Airport ("NAIA ") in Manila, Philippines; moreover, the time frame, costs and effects of pending changes of the project's shareholding structure cannot presently be estimated in detail."
The NAIA IPT 3 project is currently one of Fraport's most capital-intensive projects and includes the financing, construction and operation of a new passenger terminal at NAIA. The main project company is the Philippine International Air Terminal Corporation Inc. ("PIATCO"), in which Fraport AG participates both directly and, through other companies, indirectly. According to Philippine law, the direct shareholdings of all foreign investors in PIATCO may not exceed 40 percent in the aggregate. Fraport AG's direct as well as indirect shareholdings in PIATCO currently amount to 52.4 percent in the aggregate. Thus, in spite of its substantial capital investment, Fraport AG can only exert limited influence over PIATCO's commercial decisions. The project is based on complex corporate legal and contractual structures. Discussions and negotiations are currently being held to secure the overall project, including, without limitation, the shareholding structure. There can be no assurance that these negotiations will be concluded successfully within the intended timeframe and without additional costs for Fraport AG or PIATCO. This could have a material adverse effect on Fraport's business activity, financial condition and results of operations.

The profitability of the overall project is dependent on obtaining business partners for the operation of the airport terminal and on resolving certain customs and tax issues affecting the legal status of PIATCO and PTI

The profitability of the entire terminal project rests upon PIATCO's cooperation with competent and commercially viable business partners on appropriate terms. In terms of profitability, it is particularly important that duty-free outlets be operated exclusively in the new IPT 3 terminal and that all international flights be transferred to this terminal. However, there can be no assurance that these two goals will be achieved. Additionally, the customs and tax status of PIATCO and the future operating company Philippine Airport Ground Services Terminal, Inc. ("PTI") /sic/, for which individual issues still require resolution, has a significant impact on the results of operations of the entire project. To the extent that these prerequisites for the profitability of the project cannot be met, this could have a material adverse effect on Fraport's business activity, financial condition and results of operations.

The success of the entire project depends on the granting of permits from relevant public authorities

The success of the entire project depends upon the granting of a large number of permits, concessions, consents and similar authorizations from governmental bodies, including the consent of the Philippine government for PTI to operate the terminal. A few of these permits are also important for the project's financing. Some of the required permits and similar authorizations are still outstanding. There can be no assurance that all required permits will be granted in the timeframe anticipated by Fraport, if at all. If the required permits and similar authorizations are not granted or are only granted after considerable delay, the project could fail or its results of operations could be materially diminished. This could have a material adverse effect on Fraport AG's business activity, financial condition and results of operations.

The timely and complete implementation of the terminal project depends substantially on obtaining financing and sponsor support

PIATCO presently needs considerable bridge financing to secure the entire Project until long-term financing arrangements have been concluded. Fraport AG may be required to assume
this bridge financing or a significant portion thereof. Furthermore, the provisions of the concession contract require that PIATCO maintains an equity ratio of 30 percent (without taking subordinate shareholder loans into account as either equity or debt). Other government agencies may impose even more stringent capital ratio requirements, which would increase further Fraport's financing burden. Declines in the value of the Philippine peso against the U.S. dollar, which in turn have led to changes in other currency exchanges rates, have occurred in the past. These changes have created additional funding risks for PIATCO shareholders, and it is possible that these risks could reoccur in the future. Moreover, the banks financing the project are likely to require the shareholders to contribute additional equity capital to PIATCO.

PIATCO's long-term external financing has not been secured and is contingent on its strengthening its shareholding structure. This restructuring must take into account restrictions on foreign shareholdings in PIATCO and PIATCO's direct and indirect shareholders and ensure the profitable operation of the terminal through corresponding agreements. If it is not possible to achieve the prerequisites for long-term bank financing, Fraport AG will have to continue to carry or assume disproportionate economic risks from the loans it has granted and the collateral it has provided, without being able to participate to the same extent in the project's dividends. Even if long-term bank financing can be secured, Fraport AG may have to provide disproportionate financial support (so-called sponsor support) for the equity capital and liabilities of PIATCO. In either case, Fraport may have to provide substantial additional financing that could have a material adverse effect on its business activity, financial condition and results of operations. If long-term financing is not obtained, PIATCO may become insolvent. This would lead to a loss of the investments made up to that time and could thus have a material adverse effect on Fraport's business activity, financial condition and results of operations."

136. That section of the Offering Circular concluded prophetically as follows:

"Political developments in the Philippines could jeopardize the success of the project

Recently, political relations within the Philippines have become unstable. Because of the project's significance to Philippine air traffic infrastructure, political relations are also of considerable significance to the project. Unforeseen changes in political relations, unrest or similar developments could have a negative impact on the project's completion. This could have a material adverse effect on Fraport's business activity, financial condition and results of operations."

D. Opposition To The Terminal 3 Project

1. The Transfer of International Operations to Terminal 3 and PAL's Emergence from Bankruptcy
137. In the late 1990s, PAL had suffered major financial losses and entered rehabilitation following then-President Ramos’ liberalization of the Philippines’ domestic and international airline industry. PAL thus introduced severe cost-cutting measures and reduced international destinations from 30 to 4 and domestic destinations from 39 to 14. But PAL’s troubles continued and it was forced to cease all operations in September 1998 due to a breakdown in negotiations with its creditors and employees.

138. By this time, PAL’s emergence from rehabilitation depended heavily upon renewed pledges of commitment by the Government, which the Government acknowledged in rehabilitation proceedings:

“The Government of the Republic of the Philippines has committed, and will continue to commit itself to the rehabilitation of PAL. In demonstration of such commitment, the government has undertaken a review of the air rights granted to certain competing regional airlines to ensure that PAL will no longer be unfairly disadvantaged and can operate profitably under the Amended Plan as the National Flag Carrier.”

139. One important feature of PAL’s rehabilitation plan was for all operations of PAL at NAIA, both domestic and international, to be relocated to Terminal 2. On 10 August 1999 - one day after the inaugural opening of Terminal 2 - PAL moved its operations exclusively to the new Terminal 2. Mr. Lucio Tan said the opening of the new terminal indicated that “PAL is well on its way to reclaiming its accustomed place among the leaders of Asian aviation”. By late 2000, just three years after being grounded by bankruptcy and forced into receivership, PAL had gained back many of its lost routes.

140. Within weeks of the 11 September 2001 terrorist attacks, however, PAL announced that it had “suspended all expansion plans” until the impact of the terrorist attacks became clearer. PAL announced in November 2001 that it expected to suffer a quarterly loss for the first time in two years. Throughout the next several months, PAL continued to report that it expected to lose money for its fiscal year ending in March 2002. In May of 2002, PAL announced that it had unaudited losses of US$30.3 million dollars.

141. Under the Concession Agreement, PAL’s international operations were to be relocated prior to the Terminal 3 in-service date. Even before September 11, the aviation press had described the award of the contract for the construction of Terminal 3 to the PIATCO group as a “setback for PAL”. In post-September 11 testimony to the Philippine Congress, Mr. Perfecto Yasay, the former chairman of the Philippine SEC at the time when PAL’s rehabilitation plan was approved, who by this time had become a spokesperson for a group of businesses known as MASO (“MIA-NAIA Association of Service Operators”), was more direct, stating that the relocation of international operations to Terminal 3 would “signal the start of PAL’s collapse”.

2. The MASO Campaign

142. Opposition to the Terminal 3 project was voiced by MASO which, as noted earlier, comprised a

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3 These businesses include Cargohaus Inc., Dnata-Wings Aviation System Corp., MacroAsia-Eurest Catering Services Inc., MacroAsia-Ogden Airport Services Corp., the Miascor Group of Companies and PAL.
group of businesses, including PAL, that had contracts to provide airline-related services in Terminals 1 and 2. In essence, the MASO members feared their companies would be prohibited from operating in Terminal 3 because of the exclusivity clause of the concession arrangements in favour of PIATCO with respect to international passenger operations. In particular, PAL did not want to move to Terminal 3 because it had consolidated operations in Terminal 2 and was reportedly not charged fees for use of the terminal. Ostensibly because of these concerns, the Tribunal notes that MASO launched a vigorous and unrelenting campaign to keep Terminal 3 from entering into service or to cause significant amendments to the concession arrangements which PIATCO held.

143. MASO began its campaign in late June 2001, the month before the planned execution of PIATCO's long-term finance arrangements pursuant to the Omnibus Agreement referred to earlier in this Award. The Tribunal notes that MASO wrote to the lenders alleging that PAGS had been inducing MASO's clients to enter into service agreements with PAGS by promising to deliver certain favours or concessions when PAGS took over operations at Terminal 3, and attempted to dissuade the lenders from loaning money to PIATCO. MASO referred in this letter to the allegedly "onerous and illegal provisions" of the concession agreements and vowed PAL would "go to the highest court of the land" in order not to leave Terminal 2. After tying the concession agreements to the disgraced Estrada administration, and without recognizing that the concession had been awarded to PIATCO under President Ramos and that the Third Supplement had been executed under President Macapagal-Arroyo, MASO asked whether it was in the banks' "charter to lend money to companies that take advantage of poorer countries by exploiting the weaknesses of some of its public servants, who, in the end, feel no remorse for selling their own country down the drain". MASO emphasized that the 25-year concession would outlast several Philippine administrations and asked the lenders: "Do you really want to be worrying about the contract every time there is an election?"

144. MASO also wrote a letter to President Macapagal-Arroyo in the summer of 2001, asserting "this Concession Agreement was suspiciously, if not surreptitiously, amended once and supplemented two times by the Erap Administration, through former DOTC Secretary Vincente Rivera, Jr., to further favour PIATCO and place the government at the losing end". In this letter to the President, MASO said it was prepared to go to court, but that "will create a public spectacle that could put the country in a bad light", and pleaded with her to have the agreements "reviewed by your new anti-graft body and rectify this onerous contract immediately before this becomes a national embarrassment that the entire world will see".

145. In addition, MASO began a public relations attack on the Terminal 3 project by taking out advertisements in four major Manila newspapers. MASO's advertisements were essentially "open letters" to DOTC Secretary Alvarez, stating on the purported behalf of the "Filipino people, the local companies operating in the airport, and the airlines", that the PIATCO concession arrangements should be invalidated.

146. Fraport expressed concern to the highest levels of the Philippine Government about the efforts on the part of MASO and others to dissuade the lenders from financing the project. In particular, on 30 November 2001, Fraport wrote to President Macapagal-Arroyo. Fraport wrote:

"We are deeply concerned that this ambitious Project, which is designed to serve 13 million passengers annually with its state-of-the-art facilities at no cost the Philippine Government, has become the subject of political disputes which are paralysing the honest efforts of all
parties involved to achieve the conditions precedent for a first draw-down of the credit facilities in the near future. It makes us particularly concerned that the validity of the Amended and Restated Concession Agreement of PIATCO, which forms the legal basis of the whole Project, and the legality of which had been confirmed, *inter alia*, by the Committee on Transport and Communication, is now being put in question again.

One of the political arguments raised against this Project is the allegation that the development and prosperity of the Diosdado Macapagal International Airport ("DMIA") and of the whole province of Pampanga would be adversely affected by this Project. Presently, DMIA serves around 50,000 passengers per year, and it is evident that the development of DMIA will take its time until the design capacity of 850,000 passengers per year has been reached. By then, however, it appears that NAIA IPT 3 will already have reached its design capacity for three consecutive years so that the restrictions to the further upgrade of the facilities at DMIA will no longer be applicable.

We do not have any doubts that the Philippine Government will act in accordance with the constitution and the law, and that the Philippine Government will always follow the principle of ‘pacta sunt servanda’. Nevertheless, we would like to ask you, Madam President, for all possible political support for this Project, which support is urgently needed by the Project and PIATCO to overcome the present standstill in relation to various aspects of the negotiations with the Philippine Government.

Not only international investors, but also the credit institutions from all over the world look closely on this Project and place their confidence on a reliable climate for foreign investment in the Philippines to foster the prosperity of the people and for the mutual benefit of all parties concerned.

We therefore pray for your support for this Project and for a reliable environment for foreign investment in your great country.”

One of the PIATCO’s long-term lenders, Kreditanstalt fur Wiederaufbau, also expressed its concerns to President Macapagal-Arroyo in a letter dated 3 December 2001:

"Kreditanstalt fur Wiederaufbau (KfW) is willing to support the long term financing of the Ninoy Aquino International Airport (NAIA) International Passenger Terminal III project (the "Project"), based on its financial viability. KfW forms part of a bank consortium of leading international and multilateral financing institutions comprising Asian Development Bank (ADB), International Finance Corporation (IFC) as well as Dresdner Bank. As you know, KfW - like the other development banks involved in the Project - has been financing successfully projects over decades within the Philippines and in the region, both through financial co-operation and through commercial export and project finance.

As the Project is providing state-of-the-art facilities to serve 13 million passengers annually at NAIA, it is a major contribution to the transportation infrastructure of the Philippines. It fosters mobility throughout the region, thereby adding valuable economic benefits to the Philippines. With Fraport as major sponsor, the Project will benefit from the know-how of one of the world’s leading airport operators. All of this is especially remarkable in the world’s and South East Asia’s current economic situation. The macro-economic benefits of the Project for
your country and the involvement of a highly qualified private sponsor such as Fraport are a major consideration for KfW to participate.

Unfortunately, we have noted with concern that certain issues - which are outlined in a separate letter of Fraport to you — have arisen that may cause delays to the completion of the Project. As we all share the same goals, namely the successful conclusion of the Project, we would highly appreciate your support to resolve the open issues in a joint effort.”

148. Not surprisingly, the need for a solution in light of the circumstances obtaining in the Philippines was referred to by Fraport in its 2001 Annual Report to its shareholders:

“Our BOT (build, operate, transfer) project for a new international terminal at the Ninoy Aquino International Airport in the Philippine capital of Manila presented difficulties in 2001. Construction is on target and the opening is scheduled for November 2002. Because of a changed forecast of future profitability, we made a write-down. In addition, political difficulties have arisen in connection with this project, which were not expected when we first undertook the commitment. We are vigorously working on a solution.”

E. The Collapse of Fraport’s Investment

1. Early Discussions with Secretary Climaco

149. Late in 2001, in the midst of MASO’s public campaign against the Terminal 3 project, President Macapagal-Arroyo appointed Gloria L. Tan Climaco as a presidential advisor on strategic projects. Pursuant to Executive Order No. 79, President Macapagal-Arroyo formally elevated Ms. Climaco to full cabinet rank in March 2002. Her presidential mandate included the express authority to review the Terminal 3 concession.

150. Shortly after her appointment, on 10 December 2001, Secretary Climaco held meetings with Fraport and PIATCO representatives, namely Mr. Bernd L. Struck (Executive Vice-President of Fraport and PIATCO’s Chairman of the Board), Mr. Johannes Endler (Fraport's Chief Financial Officer), Dr. Dietrich F.R. Stiller (Clifford Chance Punder) and Mr. Hans-Arthur Vogel (PIATCO’s Finance Director). The Fraport attendees reported that this first meeting with Secretary Climaco had been “friendly” and “cooperative”. The minutes of meeting reveal that the parties discussed, inter alia, the following:

"1. Sec. Climaco opened the discussion by mentioning that a number of concerns have been raised with respect to the agreements relating to the Ninoy Aquino International Airport Terminal 3 (NAIA 3), among which is the lack of NEDA-ICC approval for the Amended and Restated Concession Agreement and its 3 supplements. Apparently a 4th supplement [is] pending before DOTC Sec. Pantaleon Alvarez.

3. Fraport, through Mr. Struck, said they acknowledge the necessity for approval of these
documents by the NEDA-ICC. However, the Terminal is 60% complete with outside structures finished and work continuing on the structures within the Terminal. The approval for these amendments to the original Concession Agreement, as well as the 4th supplement, is necessary for their senior lenders to release the loans needed to finance the Project. [...] Fraport hopes to comply with its conditions precedent for financial drawdowns soon so that it can recover its advances to PIATCO. It has been advancing funds because its local partners have not been able to invest more than US$50 Million to the Project because of restrictions imposed by local laws. [NB: figures subject to verification]

4. Sec. Climaco assured Fraport that the government will be fair, and this was acknowledged by Fraport. It would after all be to the best interests of both parties to settle pending issues expediently.

5. There are MASO contracts whose validity extend beyond the targeted InService Date in 2002. Mr. Struck gave his views that MASO is being sponsored by Messrs. Tan and Delgado for their respective business considerations.

10. Mr. Struck mentioned that in their view, an approval by President Gloria Macapagal-Arroyo and by the NEDA-ICC of the Amended and Restated Concession Agreement and the supplements thereto would be ideal.

11. Mr. Struck said that they have discussed the exclusivity provision with respect to the Clark Terminal with their senior lenders and the latter are amendable to relinquishing that right. In return, however, they would want to be given the right to operate the Clark Terminal.”

151. The Fraport executives attending the meeting of 10 December 2001 also reported:

"We have noted that shortly after the meeting with Hon. Gloria Tan-Climaco there appeared certain articles in the German and Philippine press, according to which the Concession Agreement would need to be substantially renegotiated. We do not know from which sources such misleading information originated. However, the truth is that the issues raised by the Philippine Government might lead to certain amendments of the Concession Agreement, as the issues raised by the Senior Lenders which should lead to certain other amendments of the Concession Agreement as set out in the draft Fourth Supplement to the Concession Agreement. This appears to us as a normal bargaining situation where one party agrees to certain changes in consideration of the agreement of the other party to other changes. We do not have any reasons to believe that the Philippine Government would not comply with its obligations under the existing contracts, or bring forward unreasonable demands which might jeopardize the commercial and legal basis of the concession.”

152. On 19 December 2001, in a memorandum entitled “Expression of Concern by Frankfurt Airport Services Worldwide and Kreditanstalt for Wiederaufbau on the NAIA Terminal 3 Project” addressed to Executive Secretary Romulo, Secretary Climaco described her first meeting with Fraport as follows:

"The concerns of Fraport were mutually discussed in a meeting held with their representatives on 10 December 2001. A copy of the minutes of said meeting is attached
for your perusal. We proposed that the open issues concerning Fraport and the Philippine Government be discussed in further detail in order to resolve the same at the soonest possible time and Fraport agreed to commence discussions in January 2002. We gather that Fraport subsequently referred its concerns and the discussions in this meeting to Philippine International Air Terminals Co. Inc. (PIATCO), the concessionaire for the NAIA Terminal 3 Project, and in a letter of PIATCO dated 11 December 2001 to the undersigned. PIATCO expressed its concern that matters relating to the Project be discussed with PIATCO directly."

153. During this time, Secretary Climaco also met with PIATCO representatives. During the first of these meetings on 7 January 2002, Secretary Climaco indicated that, although the Government planned to honour the concession agreements, it wanted revisions to be made to address the concerns of MASO; she stated that certain provisions in the concession agreements were too onerous.

154. At a further meeting held on 21 January 2002 at which Fraport and PAL representatives were invited, Dr. Georg Braune of Dresdner Bank, Fraport's financial adviser for the Terminal 3 project, made a presentation. Dr. Braune sought to demonstrate to Secretary Climaco that the changes to the concession arrangements she had proposed on 7 January 2002 would be unacceptable to the Senior Lenders. In her first witness statement to the Tribunal, Secretary Climaco stated:

"Dr. Georg Braune of Dresdner Kleinwort Wasserstein made a presentation explaining from the lenders' view the Project's unsatisfactory situation. Dr. Braune raised concerns about the lack of an agreement with Duty Free Philippines ("DFP") to move to Terminal 3; PAL's reluctance to move to Terminal 3; and that the Project's internal rate of return at the PIATCO level was dropping. Mr. Braune said that he would show me the financial model. At the same meeting, Mr. Struck also discussed the possibility of having PIATCO operate Terminal 2 and the Government becoming a PIATCO shareholder."

155. Further discussions were held the next day, on 22 January 2002. PIATCO handed a document to Secretary Climaco entitled "List of Action Items Involving the Philippine Government". This list set forth 18 key items, including 13 items identified as the "conditions precedent in loan documents" and 5 items identified as "other issues". The Tribunal considers that this list should be reproduced:

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Conditions Precedent in Loan Documents</td>
<td>4th Supplement Other amendments and supplements, Draft given to DOTC</td>
</tr>
</tbody>
</table>
This Agreement is being negotiated with the DOTC. This Agreement is between GRP, PIATCO, IFC, ADB, KfW, and Dresdner Bank A.G. Through this Agreement, GRP directly confirms to the Senior Lenders certain terms and conditions in the ARCA (i.e. Enforcement of Security, Payments by GRP, Termination of Concession Agreement, Step-in and Step-Out rights, Transfer of Facility).

1. Land Direct Agreement Other related documents and internal approvals, resolutions (board/shareholder). This Agreement is being negotiated with BCDA. This Agreement is between BCDA, MIAA, PIATCO and Deutsche Bank A.G. This Agreement confirms PIATCO’s rights in respect of the Land Lease Contract between BCDA as Lessor and MIAA as Lessee and for BCDA to give consent to the mortgage in favor of the Senior Lenders. 2. Written confirmation re: PIATCO’s right to possess and use the Site.

Under this Agreement, PEhA undertakes to grant certain consents and to acknowledge the legality and validity of the Security.

Under this Agreement, QAI confirms its obligations to the Senior Lenders. Japan Airport Consultants, the QAI, prior to any negotiation on the Direct Agreement, gets clearance or consent from MIAA Related issue: QAI Agreement Extension - parties are JAC, MIAA, PIATCO

Purpose: to ratify that the DOTC Secretary, who entered in to the
<table>
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<tr>
<th></th>
<th>Description</th>
<th>Details</th>
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<tbody>
<tr>
<td>7</td>
<td>Duty Free Philippines: 1. Legally binding commitment letter 2. Other related documents (i.e. board and shareholder resolutions)</td>
<td>Full Powers Authority ARCA on behalf of GRP was duly authorized. PIATCO is currently negotiating a Heads of Terms Agreement (i.e. Commitment Letter) with DFP.</td>
</tr>
<tr>
<td>8</td>
<td>Register of Deeds 1. Payment of DST and other amounts by MIAA on the Land Lease Agreement so that PIATCO’s rights under the Land Lease Agreement can be annotated on BCDA’s land titles 2. Written confirmation from MIAA re: availability of the site and other land required for purposes of NAIA T3, including all necessary easements, rights of way and access roads 3. Confirmation of MIAA on revised tender design</td>
<td>Annotation of Land Lease Agreement Registration of all Security Documents, including but not limited to the Mortgage</td>
</tr>
<tr>
<td>9</td>
<td>MIAA 1. Written confirmation from owner of additional land required and registration of the right of PIATCO to sue additional land</td>
<td>Owners: BCDA, MIAA, DPWH, PAF</td>
</tr>
<tr>
<td>10</td>
<td>DOX 1. The DOJ legal opinion will opine on the ARCA, including the amendments and supplements</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>OGCC (counsel to MIAA and BCDA) 1. This OGCC legal opinion will opine on the Land Lease Agreement, Land Direct Agreement and the GRP Direct Agreement</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>SEC</td>
<td>Opinion confirming legality of shareholder arrangements of PIATCO</td>
</tr>
</tbody>
</table>
II. Other Issues

14  PEhA

1. Denial of duty free importation of construction materials 2. Certificate stating compliance by PIATCO of all reportorial requirements imposed by RA 7916 (PEhA Law) and its implementing rules and regulations 3. PTI (Pags Terminals, Inc.) will apply for registration with PEhA

15  ICC-NEDA

Approval of all amendments, supplements.

16  BSP

1. Approval of all loans and conversions for repayment (daily or monthly conversions) 2. Comfort letter confirming that the approval would not be withdrawn due to breach of the ratio caused by Peso devaluation 3. Registration of BOT Scheme and all versions of the Concession Agreement

17  PAL

Agreement re transfer to NAIA T3

18  Ombudsman Case

Pending

156. In response to PIATCO's presentation of this list on 22 January 2002, Secretary Climaco indicated that she would shortly be sending what she described as a “Fifth Supplement” to the ARCA reflecting the revisions that she would like to see made to the concession arrangements.

157. Later on 22 January 2002, PAL joined the meetings because Secretary Climaco said she wanted to assist PAL and PIATCO in finding an amicable solution to PAL's refusal to move to Terminal 3. PAL submitted its "shopping list" and presented demands that would have to be met if it was to operate out of Terminal 3, principally a simultaneous transfer of its domestic operations as well as its international operations from Terminal 2 to Terminal 3. PAL also stated that, if it relocated to Terminal 3, it wanted to incur no greater charges or fees for the first five years than it paid in Terminal 2. PAL also stated that it expected to perform its own ground handling operations.

2. Secretary Climaco's Negotiations with Fraport and PIATCO

158. On 23 January 2002, negotiations began in earnest when Secretary Climaco submitted the proposed Fifth Supplement to the ARCA which, according to her witness statement, contained "the necessary changes to the ARCA that would make it to the fullest extent possible accord with the Bid Documents and, therefore, acceptable for the Government". One of the main provisions of the draft Fifth Supplement required that PIATCO surrender the exclusivity of Terminal 3 for international passenger operations at NAIA.

159. The Tribunal recalls that the “Exclusivity” provision in the ARCA read as follows:
"Section 3.02 Exclusivity.

(a) During the Term of this Agreement, GRP undertakes and guarantees that Concessionaire shall have the exclusive right to operate a commercial international passenger terminal within the Island of Luzon, with the exception of those already existing at the time of the execution of this Agreement, specifically, the airports at the Subic Bay Freeport Special Economic Zone (SBFSEZ), Clark Special Economic Zone (CSEZ) and Laoag City. With regard to CSEZ, GRP shall ensure that no new terminal facilities shall be operated therein until such time as the Development Facility Capacity shall have been consistently reached or exceeded for three (3) consecutive years during the Concession Period. 'Development Facility Capacity' refers to the ten million (10,000,000) passenger capacity per year of the Development Facility."

160. The draft Fifth Supplement envisaged that this provision would be replaced by the following:

"Section 3.02 Exclusivity.

(a) On the In-Service Date, GRP shall cause the closure of the Ninoy Aquino International Airport Passenger Terminals I and II as international passenger terminals. Neither shall GRP, DOTC or MIAA use or permit the use of Terminals I and/or II under any arrangement or scheme, for compensation or otherwise, with any party which would directly or indirectly compete with Concessionaire in the latter’s operation of and the operations in the Terminal and Terminal Complex, including without limitation the use of Terminals I and/or II for the handling of international traffic; provided that if Terminals I and/or II are operated as domestic passenger terminals, the conduct of any activity therein which under the ordinary course of operating a domestic passenger terminal is normally undertaken, shall not be considered to be in direct or indirect competition with Concessionaire in its operation of the Development Facility."

161. After having reviewed the draft Fifth Supplement, PIATCO wrote to Secretary Climaco on 4 February 2002 and concluded categorically that “we are not in a position to agree on a reopening of the ARCA”. PIATCO said:

"On behalf of Philippine International Air Terminals Co., Inc. (PIATCO), we wish to thank you for meeting with us on several occasions to find a workable and acceptable solution to all the issues raised in connection with the construction, development and operation of the NAIA IPT3 Project.

We wish to stress that the Amended and Restated Concession Agreement (ARCA) dated 20 November 1998 between PIATCO as Concessionaire and the Government of the Republic of the Philippines (GRP) is a valid and legally binding document signed in good faith by the representatives of PIATCO and the Philippine Government, and approved by ICC-NEDA on 25 June 1999. The ARCA has long been in implementation, with both parties mutually exercising their rights there under. We respectfully submit that we are not in a position to agree on a reopening of the ARCA.

Moreover, a reopening of the ARCA will be unacceptable to the Senior Lenders of PIATCO who have structured the credit facilities and their financial projections around the current..."
provisions of the ARCA.

A review of the proposed 5th Supplement to the ARCA have [sic] led us to believe that such 5th Supplement is tantamount to a renegotiation and reopening of the ARCA and if agreed to, will definitely have a negative impact on the financing arrangement between PIATCO and the Senior Lenders. This may then lead to the inability of PIATCO to draw from such credit facilities.

We were hoping that the proposed 5* Supplement would have contained the 'win/win' solution for PIATCO and GRP that we were discussing.

Nevertheless, we are prepared to discuss with GRP the issue related to the development of the Diosdado Macapagal International Airport (formerly Clark International Airport), which, we understand, is a major political concern to the present Administration.

As also discussed during our previous meetings and in the spirit of our mutual cooperation, we would like to request your invaluable assistance in obtaining certain consents and documents from GRP, which are required by the Senior Lenders of PIATCO. These consents and documents are listed in Annex ‘A’ hereof.”

162. The Tribunal notes that the Senior Lenders’ conditions precedent for long-term financing were expressly discussed with Secretary Climaco from the outset. In this regard, the Tribunal further observes that Fraport’s financial adviser for the Terminal 3 project, Dr. Georg Braune of Dresdner Bank, participated in the early discussions with Secretary Climaco, PIATCO and Fraport. In a letter dated 26 January 2002, Dr. Braune of Dresdner Bank wrote to Fraport in order to convey his assessment of these discussions, indicating that there were problems, but they were not insurmountable from the Dresdner Bank’s point of view.

163. On 27 January 2002, i.e. the day after Fraport received Dresdner Bank’s assessment of the Project’s profitability, Dr. Hippe of Fraport circulated an internal memorandum addressed to Mr. Endler and copied to Mr. Struck, Dr. Baune and Dr. Stiller. This memorandum summarized, inter alia, the January meetings with Secretary Climaco, and indicated that Fraport had made it clear to her that “the results achieved to date are not enough to prevent a massive write-off. Dr. Hippe referred expressly to Dresdner Bank’s assessment and the scenarios discussed therein, and went on to conclude that “[i]f however the likelihood increases that the above mentioned scenarios come into play in the further negotiations, a considerable valuation adjustment for Fraport must be assumed, which would impact the 2001 financial statements totally. This would require a further injection of capital by Fraport.”

164. Against this background, on 1 February 2002, Fraport wrote to PIATCO as follows:

“We write to you in our capacity as one of the Project sponsors of Philippine International Air Terminals Co., Inc. (‘PIATCO’) in relation to the Project.

After the signing of the long-term financing agreements for the Project on 27 July 2001 and after the release from escrow of the said agreements on 26 August 2001, Fraport AG Frankfurt Airport Services Worldwide, as Project sponsor, has continuously exerted its best efforts
to cooperate and coordinate with PIATCO to enable PIATCO to comply with the conditions precedent for draw-down under its long-term financing agreements. However, supervening events in the political and economic environment of the Project has made compliance with the conditions precedent an extremely complicated and volatile process. You are already no doubt aware of the substantial change in international passenger traffic projections following the September 11 events and the resulting dismal projections on the project’s economics including without limitation duty-free spendings. We also note the extremely political situation of the Project that has required considerable effort and attention from you and your management team. The collective effect of these factors is to make compliance with the conditions precedent extremely difficult and to make any draw-down in 2002 highly uncertain. Without interim financing, which should be in place by February 2002, PIATCO will have an untenable financial condition and defaults in its contractual obligations is [sic] highly foreseeable. Another foreseeable consequence is that PIATCO would not be in a position to enter into contracts which give rise to new obligations, and this would inevitably lead to a standstill and most probably to a failure of the Project.

The amount of the required additional interim financing for the period from February 2002 to December 2002 is estimated at USD 162.5 million. This amount

● Already includes a possible bridge financing in the form of an accelerated set-off of advance payments made to the EPC Contractors against progress payment claims of the EPC Contractors in the amount of USD 45 million which is presently negotiated with the EPC Contractors,

● but it is in addition to a USD 39 million increase of a Fraport-guaranteed bank bridge loan facility, which we hope will push through during the course of the next days.

As we continue to give our full support to the Project, and as we continue to have interest in the success of the Project, we are however unable to extend any form of further financial support pending compliance with all the conditions precedent to draw-down under PIATCO's long-term financing agreements. Our Board of Directors and our Supervisory Board are, under the present conditions, no longer in a position to approve any further financial exposure for our company in the Project in addition to the already tremendous financial support that Fraport has extended to the Project, and in addition to the support granted to increase the Fraport guaranteed bank bridge loan facility from USD 126 million by USD 39 million to USD 165 million, subject always to the overall limits set out in the Additional Agreement dated December 21, 2001. Our company therefore exhorts and urges the management of PIATCO to exert its best efforts to obtain interim financing or other form of alternative financing for PIATCO to enable it to comply with its payments obligations this fiscal year 2002 and to operate on a more solid financial basis. We urge you to seek the financial support of the other Project sponsors, whether in the form of direct financing or other form of sponsor support.

We can not emphasize enough the urgency of putting this interim financing in place as soon as possible. We look forward and hope that the management of PIATCO will receive firm commitments of financial support from the other Project sponsors.”
financial model, including the Project’s "soft costs". Referring to meetings held on 2 and 4 February 2002 in this connection, Secretary Climaco wrote to PIATCO’s President on 5 February 2002. She said:

"As you are aware, some members of my project team met with your Messrs. Hans-Arthur Vogel and Georg D. Braune last Saturday, 02 February 2002, to discuss certain queries regarding the Financial Model which Mr. Braune furnished us previously. This is to provide us with a clearer understanding of the economics of the NAIA Terminal 3 Project which, in turn, will help the government fairly address the issues PIATCO is now facing. Unfortunately, most of the questions posed by my project team members were left unanswered, and instead, we were requested to provide a list of these queries so that the same may be replied to point by point."

166. On 6 February 2002, Secretary Climaco again wrote to PIATCO in connection with the latter’s letter of 4 February 2002 regarding the draft Fifth Supplement. She stated that "[i]t is disappointing that at this late stage of our negotiations, Philippine International Air Terminals Co., Inc. (PIATCO) has taken the stance it has in this letter, as if it was caught unaware that its concession agreement with the Government requires the changes which the Government has proposed in the draft 5th Supplement to address infirmities which its concession has sustained because of changes initiated by PIATCO every year since the time it was awarded the concession for the NAIA Terminal 3 Project in 1997". She went on:

"Changes to the original Concession Agreement of 1997, which itself appears to be a departure from the draft concession agreement in the Bid Documents, were proposed yearly by PIATCO - in 1998 through the Amended Y Restated Concession Agreement (ARCA); in 1999 through the First Supplement; in 2000 through the Second Supplement; and in 2001 through the Third Supplement; and in 2001-2002 ; with a draft Fourth Supplement pending before the Department of Transportation and Communications (DOTC), all of which are being questioned on legal, political, economical, and moral grounds by several sectors, and not without reason. Even grievances on PIATCO’s manner of implementing its concession, at this stage where Terminal 3 is not even in its operational phase, has [sic] been raised before the Government. Government’s draft 5th Supplement was one of several actions we deem necessary to address these issues, and this was explained to you and your local and foreign lawyers on different occasions.

Nonetheless, we shall address each of the points raised in your 04 February letter.

First, PIATCO claims that it is ‘not in a position to agree on a reopening of the ARCA’. Without prejudice to legal objections to the ARCA, we believe PIATCO is not in a position to say it is not in a position to reopen the ARCA since it has constantly done so in 1999, 2000, and 2001. In fact, the first action which you requested us to address in Annex A to your 04 February letter is your draft Fourth Supplement now pending before the DOTC, which would have been the change to the ARCA for 2002, tantamount to the fourth reopening of the ARCA. Neither does it appear to be your intention to let these annual changes end with the draft Fourth Supplement, since the first item of said annex likewise speaks of other amendments and supplements, including clarifying letters to the Concession Agreement.’ Thus far, reopening the ARCA appears to be an annual activity. Your actions appear inconsistent with your statement."
Second, PIATCO claims that ‘a reopening of the ARCA will be unacceptable to the Senior Lenders of PIATCO who have structured the credit facilities and their financial projections around the current provisions of the ARCA. A review of the proposed 5* Supplement to the ARCA have [sic] led us to believe that such 5* Supplement is tantamount to a renegotiation and reopening of the ARCA, and if agreed to, will definitely have a negative impact on the financing arrangement between PIATCO and the Senior Lenders. This may then lead to the inability of PIATCO to draw from such credit facilities.’ Have the Senior Lenders been apprised of the three supplements and the pending draft fourth supplement which have reopened the ARCA? We see no difference in the action to be taken by PIATCO on its proposed draft Fourth Supplement and Government’s draft 5th Supplement. We believe that the effect of the 5th Supplement, on the whole and in the long run, is to strengthen the concession granted to PIATCO. PIATCO's Senior Lenders only stand to benefit from a strengthened concession. From the undersigned’s very first meeting with you, and time and again thereafter, we informed you that the concerns of PIATCO’s Senior Lenders will be met provided all pending issues relating to PIATCO’s concession and its implementation thereof are suitably addressed. The latter should take precedence over the former.

Third, PIATCO expressed its sentiment ‘We were hoping that the proposed 5th Supplement would have contained the ‘win/win’ solution for PIATCO and GRP that we were discussing.’ The 5th Supplement is one of several actions proposed to be taken to solve the issues surrounding the NAIA Terminal 3 Project. The undersigned has stressed that given all that has transpired, a ‘win/win situation’ may be difficult to conceive at this point, although we are nonetheless constantly exerting efforts to arrive at other legal acceptable solutions. The issues concerning the Diosdado Macapagal International Airport and consents and documents which you listed in Annex A of your letter, have always been part of these discussions.

It is only in the spirit of cooperation, fairness, and good faith that all issues besieging PIATCO and the Project may be resolved. We trust that this spirit shall govern our relations.”

167. Secretary Climaco and representatives of PIATCO met again on 7 February 2002. PIATCO then submitted a presentation regarding the Project’s financial model in response to Secretary Climaco’s queries. Secretary Climaco also continued to meet with Fraport representatives during this time.

168. On 15 February 2002, Fraport met with President Macapagal-Arroyo and raised with her, as with Secretary Climaco, the possibility that the Chings’ share participation in PIATCO be diluted and that the Government eventually become a shareholder in PIATCO.

169. Two weeks later, on 1 March 2002, Secretary Climaco wrote to Mr. Endler indicating that “[i]t does not appear feasible to obtain a written consent between the Government and Fraport on further proceedings”, and also indicated that discussions with PIATCO had been “hampered”, in part due to her "project cost" inquiries.

170. On 7 March 2002, Mr. Stiller wrote to Mr. Endler and Mr. Struck. He warned his colleagues:

“I believe that we have to rethink our strategy. For the known legal concerns a Memorandum of Understanding (or a similar document) will not be achievable within the next future. We therefore have to focus on
negotiating with our local partner whatever changes in the shareholding structure and / or the relevant agreements we want to achieve from them,

making sure that our local partner co-operates with the Philippine Government in all respects where such co-operation is required or advisable to solve the existing problems (one difficulty in this respect will be that not all members of the government speak with one voice),

cooordinating a joint approach in all relevant negotiations with the government and third parties,

convincing our local partners [sic] to move where he has to move to rescue this project (including without limitation to increase its flexibility in the areas of ground handling and warehousing),

working out which conditions precedent (milestones) need to be achieved from our side before any additional financing could be made available to PIATCO, if any

being prepared that pressure from congress (investigations) and MASO will further increase, and that senior officers of Fraport will be directly made subject of suspicions and investigations; Mr. Struck seems to be the first target, but others might follow,

protecting the interests of Fraport and of all representatives of Fraport in a hostile environment,

continuing to talk to the government in a way where their and Fraport's representatives' face can be saved to bring this project forward, because we do not have influence on the government, but the government has strongest influence on the project.

In addition, we need to monitor the situation with respect to Fraport's obligations as a public listed corporation (WPHG etc.)."

171. While Secretary Climaco continued to meet with Fraport in March 2002, President Macapagal-Arroyo held a news conference. The President addressed the restrictions on the development of Clark Airport, which by then had been re-named Diosdado Macapagal International Airport ("DMIA") in honour of President Macapagal-Arroyo's father. During the press conference, President Macapagal-Arroyo announced that she had signed a memorandum order authorizing Secretary Climaco to renegotiate the contract with PIATCO so that her government would be able to "freely undertake efforts to fully develop the DMIA as an international airport". President Macapagal-Arroyo quoted from the memorandum:

"As Presidential Advisor for Strategic Projects, you are hereby instructed to pursue the negotiations, among others, to revise the restrictions on the development of the Diosdado Macapagal International Airport under the provisions of the amended and restated concession agreement between the Philippine government and the Philippine International Air Terminals Co. Inc. in order that the government may freely undertake efforts to fully develop the DMIA as an international airport."

172. Approximately one month later, on 11 April 2002, Secretary Climaco provided President
Macapagal-Arroyo with a written "update" regarding the Terminal 3 project. She stressed that the "issues pending with the Government may be divided into legal, commercial, and legal-commercial issues. It was made clear to [Fraport representatives] that the legal issues are non-negotiable, while the commercial and legal-commercial issues are negotiable to the extent permitted by law."

173. Since, in the opinion of Fraport, little progress was being made, Fraport decided to change the leader of its Manila team and dispatched the Vice Chairman of its Executive Board to make a personal assessment of the situation. The new team leader was Peter Henkel, Senior Vice-President of Fraport's Special Projects Division. A meeting between Mr. Henkel and Executive Board Vice Chairman Manfred Scholch, among others, with Secretary Climaco was scheduled for 17 April 2002.

174. This meeting between Fraport and Secretary Climaco was followed by an internal memorandum within Fraport, signed inter alia by Mr. Henkel. Under the heading "Options for action", the memorandum concluded:

"The long-term financing depends on the guaranteed profitability. This is not assured either on the basis of the CA 1997 or the basis of the ARCA 1998 without adding the 4th Supplement. However, the Government can successfully stymie the latter. What is more, it insists on the 5th Supplement, which jeopardizes the profitability of the project even more.

Result: The project is doomed without a willingness to cooperate on the part of the Government. According to the way things are, cooperation with the Government is only possible if we succeed in convincing the Cheng family to give up their shares in PIATCO, if need be against payment of a reasonable amount, or to prove their criminal behavior and take court action against them. It remains to be seen whether we could pull it off. It is difficult to conceive that we can without the Government’s help."

175. On 14 June 2002, evidencing the on-going discussions, Secretary Climaco provided Fraport with another list containing a series of "Commercial Items", 27 "Legal Matters" and 14 "Other Matters". A few days later, as part of a further update dated 19 June 2002 to President Macapagal-Arroyo, Secretary Climaco characterized this list as a "Term Sheet" of "pertinent renegotiating points". As part of this same update, Secretary Climaco briefed President Macapagal-Arroyo as follows:

"5. Fraport's immediate concern involves the coming shareholder's meeting on 26 June 2002. It is the first time for Fraport to have a large shareholder's meeting since it was only made a public company in 2001. They anticipate several contentious issues to be raised involving the investment in Terminal 3, and hence have requested for the following:

● A letter from the undersigned which could be read in their shareholder's meeting, assuring their shareholders that the Government will continue to assist Fraport in its investment in the Philippines. A copy of the letter of the undersigned dated 19 June 2002 is attached as Annex 2.

● A call from Executive Secretary Alberto G. Romulo to Fraport's Chairman Roland Koch informing him that a new DOTC Secretary has been appointed, but despite said appointment, all matters concerning NAIA Terminal 3 should be referred to the undersigned.

6. On international political matters, Fraport's representatives informed us that should
Fraport be constrained to write off its investment in PIATCO, information on the scandal will be made worldwide to cause detrimental political repercussions on the current administration. Fraport also wanted to convey to Her Excellency their desire to deal on all matters regarding the Project with the undersigned.

7. On domestic political matters, the undersigned is of the opinion that to allow her reports to be made public or subject to congressional scrutiny at this point in time would be inappropriate, premature and would impede the ongoing negotiations with Fraport, which is to continue beginning 01 July 2002. It is therefore requested that all her reports on this Project be classified as Top Secret in accordance with memorandum Circular No. 78, series of 1964, as amended by Memorandum Circular No. 196, series of 1964, or such classification as Her Excellency may deem appropriate.

8. The undersigned has made it very clear to Fraport that the final deadline for the conclusion of the negotiations should be on 10 July 2002 to give the President and Congress time to review and approve the final revised agreement."

Concurrently, Fraport in its Interim Report to Shareholders as at 30 June 2002, wrote:

"Our current discussions with the Philippine government are aimed at establishing negotiating positions for PIATCO. A major aspect continues to be the concession agreement made between PIATCO and a previous government. Our most important objective is to limit the changes to this agreement sought by the Philippine government in order to obtain a customary market return from the BOT project. Achievement of this objective is a pre-condition for our continued involvement in Manila. More recently, we have also discussed with the government alternatives to the present project structure. For us, one alternative is a transfer of the project from PIATCO back to the Philippine state. In this case, Fraport would aim to recover the amounts invested and ensure a professional operation of the terminal as part of a management agreement to be made between a future operator and the government. This alternative also requires the Philippine government to buy the terminal for a reasonable price which is acceptable to PIATCO and its shareholders and that the conditions set out in the management agreement are in line with international standards.

Following our decision to provide no further financing, PIATCO has substantially used up its available liquid funds. PIATCO is currently trying to obtain additional financing. However, Fraport does not consider the current state of the negotiations far enough advanced to provide further liquid funds.

Due to the financial constraints at PIATCO, in contrast to the original plan there are not enough personnel hired to operate the terminal, which makes adequate training by the end of November 2002 questionable. The start of operations will thus probably also be delayed for this reason. Despite these difficulties, construction of the terminal will be substantially completed in August 2002.

Despite the slow progress of discussions over the past few months, Fraport continues to assume that it will be possible to continue the Manila project successfully. This requires that current discussions will be successful. Otherwise, risks could arise which could lead to considerable negative effects on the results for 2002."

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The Tribunal notes that Fraport's auditors, KPMG, subsequently issued Fraport's financial statements for the year ended 31 December 2001. KPMG's Audit Report included Fraport's Management Report which set forth an account of the negotiations with the Government in 2002. Fraport disclosed to its shareholders that a 60 million write-down had been made. Fraport's explanation for this write-down is detailed as follows:

"By the date of the 2001 balance sheet, the financial exposure to this project - through equity interests, loans and other receivables amount to 234.7 million, plus the securities provided, namely: 26.3 million to the general contractor of the construction work, 118.3 million to banks in connection with bridge loans and to the group of banks which is to provide the long-term financing, as well as a 22.7 million contribution to the increase of PIATCO's equity by US$ 70 million - was much greater than the influence in terms of corporate law. After the 2001 balance sheet date, additional securities amounting to 38.7 million were provided.

This disproportionate financing exposure of Fraport AG to the Manila project was caused by the necessity to obtain interim financing for the terminal construction and by the inability of the fellow shareholders to contribute to this interim financing. True, on July 27, 2001, the long-term financing was concluded with an international group of banks led by the Asian Development Bank, the Kreditanstalt fur Wiederaufbau, and the International Finance Corporation, but in order for this financing to be disbursed, various conditions must have been fulfilled, which up to now is not the case, and their fulfillment depends to a large extent on decisions and declarations of intent of the Philippine government and its agencies. For this reason, mainly in the past few weeks, the Executive Board and other executives of Fraport AG had numerous talks with members of the government and their advisors, with government agencies and business partners, in order to create the conditions for disbursement of the loans. By the end of our audit, Fraport AG had not yet succeeded in this, but based on the progress of these talks up to now, especially after involvement of a special representative of the Philippine President, the Executive Board is confident that they will continue the Manila project, provided the BOT project achieves an acceptable profitability and the Fraport AG Supervisory Board releases the additional funds to cover PIATCO's short-term financing need amounting to US$ 80 million (roughly 90.7 million).

From today's perspective, it seems inevitable that the project will be much less profitable that initially planned, which is reflected in the Executive Board's risk assessment of the Manila project. Even though a concession agreement was entered into with the previous Philippine government, the present government attempts to re-negotiate — for instance, the amount of the concession fees - so that by now there is the 5* amendment of the concession agreement. The Manila project is accompanied by allegations of corruption against members of the government, employees of government agencies, and Fraport AG's Philippine business partners, and by investigations of PIATCO because of the exclusive concession for ground transportation services. Final decisions on factors crucial for the project's profitability, such as, for instance, the move of Philippine airline PAL into the new terminal are still outstanding. The present estimate of the duty free revenue is far below the assumptions made when Fraport AG joined the project. In addition, after a January 2002 expert opinion of the Halcrow Group Ltd., London, the forecast of the traffic volume had to be reduced, reflecting among other things, the business climate after the September 11 terrorist attacks and the weakness of economic activity in East Asia.

Up to now, the delays in disbursing the loans of the long-term financing have created severe
liquidity squeezes for PIATCO. The construction company threatened to stop the work if PIATCO does not meet its payment obligations according to contract. Since the project partners are not willing or able to make a greater contribution to the interim financing, up to now all these loans were made available by Fraport AG. Until disbursement of the long-term loans, PIATCO will need additional loans to prevent its insolvency, which would mean for Fraport AG the loss of all the investments it has made up to now.

In preparing the financial statements for the year ended December 31, 2001, the Executive Board had to assess the total exposure to Manila and the related risks. Against the background of the good progress of construction and the - in the Board's view - constructive talks with the Philippine government and its advisors, on the one hand, and the numerous unresolved problems, on the other hand, the financial investments related to the Manila project were written down by nearly €60 million, so that total investments of €234.7 million were written down by a total of €67.7 million including the previous year's adjustments, i.e. by 28.8 % of the gross value of the assets."

3. Secretary Climaco's "Null and Void" Assessment

178. In early September 2002, during the on-going discussions regarding a potential takeover plan with Fraport, President Macapagal-Arroyo directed a seven-member interagency Cabinet Review Committee to look into the various issues raised by the Terminal 3 project. In this connection, Secretary Climaco submitted to the Cabinet Review Committee, on 10 September 2002, a "Chronology Y Assessment of the NAIA Terminal 3 Project" outlined by reference to (i) background, (ii) commercial assessment, (iii) legal assessment, and (iv) proposed directions. In terms of "commercial assessment", Secretary Climaco stated that the "Project will not survive under original bid terms". In terms of legal assessment, Secretary Climaco concluded inter alia: "[m]ust get court to declare contract is void". The directions suggested by Secretary Climaco were:

   "A. DOX/OGCC Opinion saying award Y contracts are void

   B. Declaration of nullity

   C. Negotiate on mutual termination/amicable settlement

   D. Possible options to Government"

179. The Tribunal notes that, while Secretary Climaco had concluded that court nullification of the concession agreements was one of the Government's options, the Cabinet Review Committee was still recommending negotiations with PIATCO in line with Fraport's takeover proposal. Indeed, on 25 September 2002, the Cabinet Review Committee recommended the following to the President:

   "1. Her Excellency directed on 09 September 2002 a seven-member interagency Cabinet Review Committee (hereinafter, "Review Committee") to look into various issues that have been raised about the Ninoy Aquino International Airport (NAIA) International Passenger Terminal (IPT) 3 build-operate-transfer (BOT) project, and to assess the Fraport offer conveyed
by Roland Koch. The Review Committee was tasked to recommend alternative courses of action to the President within two weeks.

2. The Review Committee is composed of the National Economic and Development Authority (NEDA) as chairman, and the following agencies as members: Department of Justice (DOX), Department of Transportation and Communications (DOTC), Department of Trade and Industry (DTI), Department of Finance (DOF), Department of Tourism (DOT) and Office of the Presidential Adviser for Strategic Projects (OPASP).

25. The Review Committee took into consideration the concern that, as a matter of public interest, the timely completion of Terminal 3 must be pursued.

26. The Review Committee agreed to recommend to Her Excellency the following courses of action:

   a. The President to designate the negotiating team composed of DOTC as lead negotiator, the DOX, and MIAA. The NEDA and other agencies may be called upon for assistance. The negotiating team shall initiate informal consultations with PIATCO pending the clarification on the legal position of the government. In relation to this, the DOX pointed out the "separability principle" in dealing with any legal infirmity in the contract. An interpretation that could be adopted is that if any of the provisions in the contract were found void, it would not necessarily nullify the contract. It could be instead be a point for renegotiation.

   b. The legal agencies of the government, composed of DOX (as head), OGCC, and, OSG to be instructed by Her Excellency to formulate the legal position of the Executive particularly in response to the contract nullification lawsuit filed before the Supreme Court. Meanwhile, all officers of the executive department shall be enjoined to refrain from making any public pronouncements through any media regarding sub judice matters pertaining to the suit.

   c. Once the legal position of the Executive has been formulated, DOTC, MIAA, and DOX may start the formal negotiations with PIATCO."

180. On 30 September 2002, five days after the Cabinet Review Committee's recommendation for "formal negotiations with PIATCO", Secretary Climaco wrote to President Macapagal-Arroyo recommending "that the Government proceed with obtaining a declaration of nullity" of the concession agreement. With her letter of 30 September 2002, Secretary Climaco attached her Memorandum to the Senate Committee on Accountability of Public Officers and Investigations ("Blue Ribbon Committee") on the NAIA International Passenger Terminal 3 project. Secretary Climaco had determined that the concession arrangements were null and void and could accordingly not be renegotiated. She stated and recommended very clearly:

"Being null and void, these agreements cannot be re-negotiated. Novations are void if the original obligations are void. Further, void contracts cannot be ratified, nor does the action or defense for the declaration of their inexistence prescribe. Neither can the Government be held in estoppel for the mistakes or errors on the part of its officials or agents, nor the erroneous application and enforcement of the law by public officers.

It is therefore recommended that the Government proceed with obtaining a declaration of
nullity of the above agreements. Parallel thereto, the Government must determine whether PIATCO was a builder in bad faith or a builder in good faith in order to ascertain whether the structures constructed on Government land should be acquired. Should the Government determine that PIATCO is a builder in good faith, and should the Government deem it feasible to acquire the structures built on its property, then it may consider the offer of Fraport AG in its letter dated 06 August 2002."

181. On 2 October 2002, Secretary Climaco also transmitted a copy of her Memorandum to Secretary Dante B. Canlas, then Director General of the National Economic Development Authority. In her transmittal letter, she wrote:

"Pursuant to the undersigned's membership in the committee created by Her Excellency President Gloria Macapagal-Arroyo to review the NAIA Terminal 3 Project and the proposal of Fraport AG in its letter dated 06 August 2002, the undersigned is transmitting herewith, to yourself and to all the members of said committee and others concerned, a copy of the undersigned's memorandum to the Senate Committee on Accountability of Public Officers and Investigations (Blue Ribbon Committee) dated 26 September 2002.

Based on a review of the Project, the following conclusions may be made:

First, the award of the Project to Philippine International Air Terminals Co., Inc. (PIATCO) [then a joint venture composed of People's Air Cargo Y Warehousing Co., Inc. (Paircargo), Philippine Air (sic) Y Ground Services, Inc. (PAGS), and Security Banking Corporation] was void, since the joint venture did not possess the financial prequalification requirements at the time the bidding was conducted. The provisions of the General Banking Act which restricted the equity investment of Security Bank in a non-allied undertaking to not more than 15% of Security Bank's net worth could not be overlooked nor waived by the Prequalification Bids Y Awards Committee (PBAC).

The BOT Law was violated when the unsolicited proponent was required to match the bid on an entity not prequalified. Further, the unsolicited proponent was not provided with an opportunity to match the bid due to a mis-application by the PBAC of the 1994 Implementing Rules Y Regulations (IRR) of the BOT Law.

Second, the 1997 Concession Agreement executed between the Department of Transportation and Communications (DOTC)/Manila International Airport Authority (M1AA) and PIATCO on 12 July 1997 was null and void.

While the sanctity of contracts is enshrined in the Civil Code, it is also a basic rule of law that contracts whose cause, object or purpose is contrary to public policy are inexistent and void from the beginning. These contracts cannot be novated nor ratified. Neither can the defense of their illegality be waived.

The Supreme Court has held that contracts which require public bidding affect public interest. To alter these contracts without another public bidding runs counter to public policy, and makes the contract null and void. The Department of Justice (DOX) considers this good law as it continues to cite said rulings in the opinions which it renders.
Since the 1997 Concession Agreement was altered in material respects, and was not subject to another public bidding, the 1997 Concession Agreement was null and void.

Third, the 1998 Amended and Restated Concession Agreement (ARCA) executed between DOTC/MIAA and PIATCO on 26 November 1998 is likewise void for being contrary to public policy, applying the Supreme Court rulings which even the DOX cites.

In addition, the ARCA, constitutes a novation of the 1997 Concession Agreement, and a novation is void if the original obligation is void.

Fourth, the 1999 First Supplement, 2000 Second Supplement, and 2001 Third Supplement are likewise invalid and void. They are invalid pursuant to the 1999 IRR of the BOT Law for not having been approved by the NEDA-ICC prior to execution and implementation. They are likewise void, applying the principles laid down by the Supreme Court.

Fifth, the Government is not precluded from having the above contracts declared null and void. It is hornbook law that the principle of estoppel does not operate against the Government for the acts of its agents. Nor is it estopped by mistake or error on the part of its officials or agents. The erroneous application and enforcement of the law by public officers does not prevent a subsequent correct application of the statute.

Sixth, the Constitutional provision on non-impairment of contracts does not apply in this instance since, pursuant to the rulings of the Supreme Court, the provision applies only to contracts legally-executed. Since the above contracts did not comply with the requisite public bidding, then legally-speaking, there is no contract abrogated because the contract was void and inexistent.

The undersigned hopes that the attached Memorandum, which discusses each of the above points in great depth, will be of assistance to her fellow Cabinet members in their review of the Project.

Moving forward, after the determination of the legal status of the Project, the undersigned suggests that a declaration of nullity for the above contracts be obtained. Thereafter, our committee should determine whether PIATCO was a builder in good faith or a builder in bad faith. Parallel thereto, we must determine whether it is feasible for the Government to acquire the structure built on its property. Should this be the case, then the Fraport proposal contained in its letter of 06 August 2002 may be considered.

The undersigned looks forward to working with the committee at the earliest time possible."

182. The Tribunal notes that notwithstanding Secretary Climaco’s conclusions regarding the illegality of the concession arrangements, it was reported at that time in the media that President Macapagal-Arroyo had ordered the “soft opening” of Terminal 3 for 15 December 2002. On 10 October 2002, Secretary Climaco wrote to Executive Secretary Romulo and Chief Presidential Legal Counsel Cruz to express her disagreement in this regard and concluding that “the statement has caused confusion and directly and indirectly pre-empted and prejudiced Government’s position”. She wrote:
1. Soft Opening - The statement of Press Secretary Ignacio R. Bunye that Her Excellency President Gloria Macapagal Arroyo has ordered the soft opening of Terminal 3 on December 15, 2002, which was printed in daily newspapers starting 03 October 2002, has resulted in effects deleterious to the Government, which could have been prevented had that statement not been made.

First, the term ‘soft opening’ is being equated with ‘In-Service Date’ which, as will be explained below, is being used by the Philippine International Air Terminals Co., Inc. (PIATCO) to compel Government to comply with stipulations favorable to PIATCO and to compel the airlines to transfer to Terminal 3 despite it being untested for operational readiness. With the In-Service Date declared in their favor, PIATCO effectively holds a Sword of Damocles over Government as it has been preparing to call Government in default, given the excessive Liquidated Damages Government has to pay after In-Service Date.

Second, the Executive Branch is widely perceived to have foregone studying the legality of the contracts involving Terminal 3 since the signal from the Palace is to open the terminal even before any finding is made, and to prematurely re-negotiate the onerous provisions of the contracts. This has been reinforced by the statements of NEDA Director-General Dante B. Canlas, as printed in the October 8, 2002 issue of Business World, page 11 (copy attached), despite his self same Memorandum to the President dated 25 September 2002 enjoining all members of the Cabinet, the Presidential Review Committee, and their subordinates from issuing statement on the matter because this controversy is sub judice.

Third, the Senate Committee on Accountability of Public Officers and Investigations (Blue Ribbon Committee) is due to render its report on the legality of the contracts of the Project, and this apparent eagerness to open Terminal 3 from the Executive Branch does not further Government’s interest, given the lengthy discussions on the onerous and apparent illegal provisions of the Project agreements in the Blue Ribbon Committee hearing, which Sec. Canlas is privy to.

Fourth, this has prompted the House of Representatives Committee on Transportation to conduct a hearing on 09 October 2002, effectively criticizing the Manila International Airport Authority (MIAA), Air Transportation Office (ATO), and Philippine Economic house Authority (PEhA) for not cooperating with PIATCO. We have been informed that members of the House Committee were reprimanding MIAA and ATO for not acceding to PIATCO’s requests which would lead to the opening of Terminal 3 on December 16, 2002. We were also informed that PEhA was criticized for not fully granting PIATCO the tax exemptions it claims are due to it.

In sum, the statement has caused confusion and directly and indirectly pre-empted and prejudiced Government’s position. It is therefore strongly recommended that this statement, if not be retracted, be clarified to refer to a blessing, a site visit, or similar activity NOT EQUIVALENT TO IN-SERVICE DATE.

The undersigned is in favor of opening Terminal 3, but only:

- Under legal terms acceptable to and favorable to the Government, unlike the terms of the Project agreements as they stand;

- Once Terminal 3 is certified by independent appraisers to be structurally-sound and
operational under international standards;

- When the requirements of the airlines and MIAA employees are addressed; and
- If its operations do not pose a security risk, given international standards.

## 4. Secretary Climaco's Appearance before the Senate "Blue Ribbon Committee"

183. As noted earlier, in the period during which discussions involving Fraport, PIATCO and Secretary Climaco were being held, a Philippine Senate Blue Ribbon Committee was conducting hearings as part of an investigation instituted in response to a resolution filed in late 2001 by three senators calling for the investigation of the alleged "grossly anomalous agreement entered into by the Republic of the Philippines and PIATCO involving the construction, operation and maintenance of the NAIA T3 [Terminal 3 project]". The resolution was referred to three Senate Committees, which jointly conducted an investigation. The Blue Ribbon Committee heard witnesses.

184. In August and September 2002, Secretary Climaco appeared before the Senate Blue Ribbon Committee and testified that the concession contracts should be declared null and void. This appears to be the first time that Secretary Climaco took the position that the contracts which she had been busy re-negotiating were null and void. More particularly, Secretary Climaco testified that, after reviewing the Terminal 3 concession arrangements, she had presented to President Macapagal-Arroyo two options: (1) to declare the agreements null and void; or (2) to renegotiate the contract. She informed the Committee that her effort to renegotiate the contract had failed. Secretary Climaco also addressed what she alleged had been corruption by the Cheng family in connection with the Terminal 3 project, stating unequivocally that she had information that PIATCO's controlling shareholder took "kickbacks" and received "under-the-table" payments.

185. At the end of the hearing, on 26 September 2002, at the request of the Chairman of the Committee, Secretary Climaco provided an extensive Memorandum ("Climaco Memorandum") in which she advocated that all five of the project contracts, and the award of the concession to PIATCO, be declared null and void.

186. More particularly, in her Memorandum, Secretary Climaco expressly stated that there would be severe negative financial consequences for both the Government and PAL if the Concession Agreement was performed and its invalidation and nullification not obtained. According to the Climaco Memorandum, "[t]he financial and operational issues of NAIA Terminals 1, 2 and 3 and the proposed international cargo terminal must be rationalized". The Climaco Memorandum explained as follows:

"It appears that when the Project was accepted as an unsolicited proposal, a study on the financial impact thereof to MIAA's capacity to absorb the financial impact of the requirements for Terminals 1 and 2 was not made. Neither was the impact of the proposed construction of an international cargo terminal on the site currently occupied by Nayong Pilipino conducted."
187. The Climaco Memorandum referred to PAL's expressed desire to continue to operate its domestic and international operations on a consolidated basis and concluded as follows:

"In any event, if PAL’s requests will be accommodated, this will result in:

1. The under-utilization and loss of revenues for Terminal 2, should PAL’s integrated operations be moved to Terminal 3. This will result in MIAA's inability to pay the JICA loan for Terminal 2.

In the alternative, should PAL's integrated operations be retained in Terminal 2, then the Government may be called in default for not transferring all international passenger terminal operations to Terminal 3 upon In-Service Date.

2. If PAL’s integrated operations will be transferred to Terminal 3, PIATCO will have to construct and [sic] extension of Terminal 3 to be used for domestic flights, which shall cost around US$15M."

188. The Climaco Memorandum further emphasized that, whether in Terminal 2 or Terminal 3, PAL would want "to be permitted to enjoy privileges/exemptions which it is now enjoying in Terminal 2". It also expressly stated that PAL's relocation to Terminal 3 would have negative financial consequences for the Government as well. According to the Climaco Memorandum, Terminal 2 was "now operating at a loss because of low traffic volume, low domestic passenger terminal fee, and non-payment of fees by some end users", giving the Government, as creditor to the Japanese lenders of Terminal 2, concern about the additional negative revenue consequence of a PAL move to Terminal 3. The Climaco Memorandum explained:

"If Philippine Airlines, which currently uses Terminal 2 as it hub for its domestic and international operations, transfers to Terminal 3 on In-Service Date, the loss of revenue will greatly impact upon the ability of MIAA to service its loan for Terminal 2 to JICA. It should be noted that payments for the principal to JICA are due beginning 2003, and this amounts to approximately P700M."

189. Ultimately, after seven separate hearings and testimony by witnesses representing, inter alia, PIATCO and Fraport, the Blue Ribbon Committee issued its Report on 10 December 2002. The report concluded that: (1) the PIATCO contracts are intrinsically void because the required six signatures of the ICC members were not obtained; (2) the contracts were also void because there were substantial deviations from the Bid Documents; (3) the contracts contained onerous and disadvantageous provisions contrary to public policy and to the BOT Law; (4) the payment to Alfonso Liongson for buying favours from the Government was condemned; (5) the contract provides for a direct government guarantee which is prohibited by the BOT Law; and (6) the condition of the terminal facility raised serious security concerns. The Committee recommended the investigation and prosecution of those responsible for the violation of laws and irregularities at issue.
5. President Macapagal-Arroyo’s Declaration That Her Government Would Not Honour the Terminal 3 Contracts

190. A few days prior to the Senate Blue Ribbon Committee’s Report, President Macapagal-Arroyo delivered a public condemnation of the Terminal 3 project and PIATCO. These remarks were made on 29 November 2002 before a group of Filipino exporters in the Ceremonial Hall at Malacanang Palace during the 16 Annual "Golden Shell Awards". In her speech, the President raised the "PIATCO issue" as a disreputable example of the hold of "vested interest" on the Philippine State. After recognizing the importance of PIATCO’s concession to build a world-class airport for international travelers, the President stated that "the Solicitor General and the Justice Department have determined that all five agreements covering the NAIA Terminal 3, most of which were contracted in the previous administration, are null and void".

191. The President then said that the contracts would henceforth not be honoured and declared: "I cannot honour contracts which the Executive Branch’s legal offices have concluded are null and void." The Tribunal notes that these remarks were delivered ten days before oral argument in the Supreme Court in the cases brought by petitioners identified with PAL to prevent the opening of Terminal 3.

192. The President declared that there had been illegality during the procurement and subsequent negotiations of the Concession Agreement, the ARCA, and its supplements. She stated that the PIATCO concession was "emerging as a test-case" of her administration’s "commitment to fight corruption" and "to free the state from the hold of any vested interest". She added that she was ordering "the Department of Justice and the PAGC (Presidential Anti-Graft Commission) to investigate any anomalies and prosecute all those found culpable in connection with the NAIA contract". The following day, on 30 November 2002, the President reiterated her declaration in another speech and said that the “Solicitor General has submitted to the Supreme Court the government position that all five agreements covering NAIA 3 are null and void”.

193. On 28 November 2002, i.e. the day before President Macapagal-Arroyo publicly declared that the Terminal 3 concession agreements would not be honoured, the Department of Justice had concluded in a memorandum addressed to the Executive Secretary that the concession agreements were null and void, mainly because they contained material deviations from the Bid Documents and the draft Concession Agreement.

194. The Tribunal notes that this memorandum is strikingly different from the Department of Justice's prior written advice to the President on 21 May 2002 that had identified several provisions of the ARCA which "may be possible subjects of renegotiation" but neither stated that the ARCA was null and void nor questioned the validity of the original Concession Agreement.

195. The conclusion in this memorandum is also diametrically different from "Contract Review No. 434" dated 30 September 2002, in which the Office of the Government's Corporate Counsel concluded that the concession arrangements were valid, and added that "[r]ecords attest to the fact that the negotiation, drafting, execution and signing of the Concession Agreement were strictly in accordance with Republic Act No. 6957, as amended by Republic Act No. 7718 k(the BOT Law)l and its Implementing Rules and Regulations". Accordingly, the Office of the Government's Corporate Counsel recommended that "[s]ubject to the regulatory powers of the government through MIAA,
the parties continue with the implementation of the contract but in the process the onerous provisions thereof, if any, be negotiated/re-negotiated”.

196. The Tribunal also notes that as part of President Macapagal-Arroyo’s speech on 30 November 2002, she expressly addressed the shareholders involved in the Terminal 3 project: “Let me, however, assure the shareholders: Your legitimate claims will be honored to the last peso and the Terminal will open early next year.” On 4 December 2002, Fraport wrote to the Government seeking a written confirmation along the same lines:

“Now we are at a critical junction. We need for internal reasons and in particular for auditors, a written confirmation along the lines that President Gloria Macapagal-Arroyo announced publicly.

The key point is, Fraport can only continue to negotiate with Government and continue the same supportive level if a written confirmation is given to us that under Philippine Law, our investment is acknowledged and protected. Therefore, it is urgent that we have someone we can deal with to achieve the goal.”

6. Fraport's Continued Efforts to Find a Solution

197. On 12 December 2002, Mr. Henkel met with representatives of the Government including Executive Secretary Romulo and Chief Presidential Legal Counsel Cruz. During this meeting, Fraport expressed its concern regarding the "turn of events". The minutes of the meeting reveal the following:

"1. Mr. Lauk stated that Fraport was now very concerned with the turn of events. The Department of Justice rendered an opinion saying that the PIATCO concession agreements were void. Her Excellency President Gloria Macapagal Arroyo delivered a speech quoting said opinion, and that of the Solicitor General, and said that she could not enforce a void contract. The Senate Blue Ribbon Committee had rendered Senate Report No. 130 which, among others, stated that the concession agreements of PIATCO were void. Further, third parties have initiated proceedings before the Supreme Court to confirm that PIATCO's concession agreements are void.

2. Fraport believes that the Chengs were the ones who originated the problems PIATCO now faces. Fraport is nonetheless bound to the Chengs as fellow-shareholders in PIATCO. Mr. Lauk stated that Fraport will be coming out with a press release soon stating these matters.

3. Given the above, Fraport seeks assurance from the Philippine Government that Fraport, as the primary funder of Terminal 3, will receive compensation.

4. Secretary Cruz stated that President Arroyo stated in her speech that all legitimate claims shall be paid to the last centavo, provided the same are legitimate and valid. The Solicitor General likewise mentioned the same in its pleading before the Supreme Court.

5. Mr. Lauk requested for Executive Secretary Romulo's indulgence that he speak with Fraport Chair Roland Koch to inform him of what President Arroyo and the Solicitor General had
Mr. Lauk also requested that these be reduced to a letter which Fraport can show to its shareholders and other interested parties, such as Fraport's auditors who are currently in the process of auditing the books of Fraport. Fraport's auditors are considering a total write-off of the amounts infused by Fraport into the NAIA Terminal 3 project. Mr. Lauk said that if that is done, then Fraport can no longer join hands with the government, which has been his recommendation.

6. Executive Secretary Romulo replied that these requests shall be given due consideration.

7. Secretary Cruz reiterated that Philippine laws amply protect local and foreign investors provided their claims are legitimate and valid.

On 27 December 2002, Secretary Romulo wrote to Fraport. Some of the extracts from this letter are quoted at length since they are not irrelevant to the aftermath of the Tribunal's decision in respect of jurisdiction:

"This refers to your letter to Her Excellency President Gloria Macapagal-Arroyo dated December 18, 2002.

Philippine laws protect legitimate investments and arm's length transactions.

Accordingly, Her Excellency President Gloria Macapagal-Arroyo, during her speech for the Bonifacio Day Celebration on November 30, 2002, assured the stakeholders that 'your legitimate claims will be honored to the last peso'. Her statement was reiterated by Solicitor General Alfredo L. Benipayo in a Supplemental Comment dated December 9, 2002 filed before the Supreme Court wherein it was stated: 'To disabuse PIATCO of its apprehension that a government takeover will send a wrong signal to foreign investors, President Gloria Macapagal-Arroyo has made it plain in a speech on November 30, 2002 that 'legitimate claims of stakeholders in PIATCO will be honored to the last peso'.

During our meeting on December 11, 2002, Secretary Avelino X. Cruz and I reiterated that all legitimate investments shall be protected and honoured in accordance with the Philippine Constitution and laws.

Rest assured that our Administration intends to implement fairly and justly the law as the Constitution mandates."

Notwithstanding these assurances, there were no discussions between Fraport and the Government. On 17 January 2003, Mr. Henkel wrote to Executive Secretary Romulo to express Fraport's disappointment:

"With disappointment I have noted that, despite several attempts through various channels, it was not possible to get any appointment with your goodself or with any other representative of the Philippine Government who is responsible for the NAIA IPT 3 Project during my stay in Manila from 7 January 2003 through 17 January 2003. Unfortunately I have to travel back to Germany on 18 January 2003 to report the status of the NAIA IPT 3 Project to my Board."
Bearing in mind that the discussions with the Philippine Government on several open issues on this ambitious Project have now been pursued for more than one year, and that a world class and state of the art terminal has been materially completed and ready for operations since December 2002, but despite of this is not allowed to enter into operations and earn revenues for an unforeseeable period, we believe that the present status of the Project leads to a tremendous waste of resources and unnecessary costs and risks.

We therefore urgently request you that the talks about the future of our investment are resumed as soon as possible, and I am pleased to assure you that I will be available again, together with my team, here in Manila from 27 January 2003 to meet with your goodself or any other duly authorized representative of your Government who is responsible for this Project.

Please allow me to suggest that a final solution for the various pending issues should be achieved until the mid of February of 2003.”

On 10 February 2003, Mr. Henkel again wrote to Executive Secretary Romulo reiterating Fraport’s request for an amicable settlement:

"We hereby reiterate our appeal to the Philippine Government to finally come to an expeditious solution for our investment in the NAIA IPT 3 Project either through an economically viable concession or through an amicable settlement.

Based on the bilateral Agreement for the Promotion and Reciprocal Protection of Investments between your Country and the Federal Republic of Germany, we repeat our numerous requests for a counterpart to seriously and actively discuss a mutually acceptable solution on the future of our investment in the Philippines.

With disappointment we have noted that we have neither received any reply to our letter dated January 17, 2003 nor have we been advised of who is the duly authorized representative of the Philippine Government for discussions with us about our investment. We would be grateful if such nomination could be notified to us by February 13, 2003, and it should be our joint goal to reach an agreement in principle, subject to further detailed negotiations, by February 28, 2003.

Without feedback from Government’s side, we have no other recourse but to initiate the commencement of arbitration proceedings before World Bank in Washington D.C. in order to protect our investments in the event that no agreement in principle has been reached by February 28, 2003.”

By letter dated 14 February 2003, Fraport repeated its desire to settle the issue amicably through negotiations and stated its position as follows:

"Please understand that it is completely unacceptable for Fraport if Fraport's investment is questioned only after the NAIA International Passenger Terminal 3 Project has been almost completed, and the government has received benefits under the relevant agreements without raising any objections, and without assurance that Fraport shall receive compensation in
accordance with the Agreement between the Federal Republic of Germany and the Republic
of the Philippines for the Promotion and Reciprocal Protection of Investments ('Bilateral
Investment Treaty') in the event the concession agreements are deemed by your national
courts to be null and void as announced by your government.”

202. On 18 March 2003, Dr. Wilhelm Bender, Fraport's CEO, wrote to Secretary Cruz in his capacity as
Chief Legal Counsel of the Office of the President:

"Over the last week, the Executive and the Supervisory Board of Fraport AG had the
impression that a mutually acceptable solution for the problems of the NAIA IPT 3 Project had
been agreed upon in principle. This impression was confirmed by the conversations between
Executive Secretary Romulo and Prime Minister Koch. It was confirmed that the Government
of the Republic of the Philippines is willing to cooperate to come to an amicable settlement,
which would secure Fraport’s investments in the Philippines.

On this basis, and with the explicit support of our shareholders, I decided to come personally
to Manila to discuss with the authorized representatives of the Philippine Government the
major issues to come to an acceptable solution. It was always very clear to me from our
previous discussions with the Philippine Government that you sought a solution involving an
exit for Fraport and thereby securing the value of the NAIA IPT 3 Project, in which we invested
in good faith.

It is evident that such solution has to recognize the value of our commitment either through
the economic viability of the Project or through a fair compensation of Fraport in the amount
of at least 300 Mio. USD. The draft memorandum of understanding distributed to us and
discussed with Secretary Tan Climaco still has significant gaps and unresolved critical issues.

However, we would be very pleased to continue fruitful negotiations with the Philippine
Government, in which the following key issues should be addressed:

● Minimum compensation for Fraport's investment in 2003
We would be willing to receive a compensation which is determined by an internationally
renowned auditor, which both sides agree upon. Based on the size of our investment, we
expect that this will result in a compensation to Fraport not less than 300 Mio. USD.

● Appropriate financing terms and conditions
We could agree to a financing agreement reflecting market conditions, which will not result
in further write-off for Fraport upon the determination of the value of the project on market
conditions.

According to the requirements of German law, we could sign such an agreement immediately
to take effect after approval by the Supervisory Board of Fraport AG."

203. On the same day, Dr. Bender also wrote to President Macapagal-Arroyo requesting a meeting with
her and indicating that he was "optimistic that we will be signing an agreement with your
Government on a mutually beneficial solution within the next day".

204. On 25 March 2003, Secretary Climaco responded to Fraport's letter of 18 March 2003. She wrote:
“It was pursuant to the numerous requests of Fraport and its claim that it has a proposed amicable solution which prompted the undersigned to meet with its representatives. The following communications may be referred to: the letter of Mr. Peter Henkel to Executive Secretary Alberto G. Romulo dated 17 January 2003; the facsimile transmission of Mr. Henkel to Executive Secretary Romulo dated 03 March 2003; and the facsimile transmission of Mr. Henkel to the undersigned dated 06 March 2003. Copies of these are attached for immediate reference.

Fraport likewise requested for meetings through diplomatic channels. Accordingly, the undersigned met with German Ambassador to the Philippines Herbert D. Jess on 07 March 2003.

It was likewise these requests which prompted Executive Secretary Romulo to call your Mr. Roland Koch and inform him that the undersigned would meet with Fraport’s representatives to listen to Fraport’s proposed amicable solution.

During the undersigned’s meetings with Fraport, the undersigned emphasized that the issues on the validity of the award of the NAIA Terminal 3 Project to Philippine International Air Terminals Co., Inc. (PIATCO), and the five (5) contracts executed thereafter, have been submitted to the Philippine Supreme Court before any discussions could be commenced with PIATCO.

Nonetheless, since Fraport claimed that it had an amicable solution for all parties concerned, the undersigned met with your representatives. The undersigned reiterated in said meetings that any amicable solution should be made on the basis that the award of the Project to PIATCO, and the five (5) contracts executed thereafter, are null and void. This is the same premise which any negotiations with PIATCO was to be made. Further, Fraport’s proposed solution should be in accordance with Philippine laws and further discussions on the issues on the Project should be with the Department of Transportation and Communications (DOTC) headed by Secretary Leandro R. Mendoza, with the assistance of Solicitor General Alfredo L. Benipayo and Government Corporate Counsel Manuel A. X. Teehankoe.

In said meetings, Fraport informed the undersigned that it is in the process of purchasing its local partner’s equity interest in PIATCO, and its proposed solution calls for an agreement between Fraport, PIATCO, and our Government. Fraport’s proposal included the following principal terms: (1) the immediate delivery and turnover of ownership and physical possession of Terminal 3 by PIATCO to the Government; and (2) payment by the Government to PIATCO of an appropriate value for Terminal 3 to be determined by a reputable international auditing firm, subject to the verification and confirmation of the Commission on Audit.

Fraport’s proposed terms also included: (1) a minimum guaranteed payment to Fraport for its financial exposure to the Project; and (2) a Technical Services Agreement (TSA) for the operation of Terminal 3.

The undersigned in her meetings with Fraport representatives has advised them that the minimum guaranteed payment to Fraport may not be allowed under Philippine laws. With respect to the TSA, that is an operational matter best addressed to DOTC Secretary Mendoza and the Manila International Airport Authority, subject to compliance with the Philippine...
procurement laws.

In addition, should PIATCO decide to dissolve its corporate existence, as your representatives have claimed, then the amounts which PIATCO possesses, under our laws, should first be used to pay its creditors. The balance, should there be any, is distributed to its shareholders. We are not privy to the credit agreements of PIATCO, and the shareholder agreements among its shareholders.

The above issues were emphasized by the undersigned in all of her meetings with Fraport. The undersigned trusts that the above narration is a faithful summary of what transpired in her discussions with Fraport and its representatives, and that the same clarifies some misunderstandings in the letter dated 18 March 2003."

205. This would turn out to be Secretary Climaco's last official letter to Fraport regarding the Terminal 3 project. In the end, when the takeover proposal became public, the Manila press presented the plan as evidence of government mismanagement and selfdealing. Secretary Climaco later denounced the takeover plan in testimony before the Senate and the plan was never implemented. In a subsequent press statement, President Macapagal-Arroyo declared:

"Even while the Government was taking the correct position that the concession contracts are null and void, negotiations with both PIATCO and Fraport were being conducted, to explore the possibility of avoiding protracted litigation [...]. Immediately upon assumption of my second term, I directed renewed efforts to arrive at a negotiated solution so that the terminal could be examined, and if it is safe, structurally sound, and conforms to international standards, open it in a way that adheres to law. Two new waves of effort were undertaken, but both failed, not because of any fault of Government, but due to deep reasons that prevent PIATCO and Fraport representatives from coming to a unified, reasonable position vis-a-vis the Republic. Those reasons are beyond the capability of the Republic to address and are internal to the two companies."

206. In his witness statement to the Tribunal, Fraport’s CEO, Mr. Bender, states that as of this point, "Fraport's management decided to write down the value of our investment to zero in accordance with German accounting requirements". Mr. Bender's statement concludes:

"Because of the write-down, Fraport had an annual net loss of 121 million euros, and retained earnings were zero after a release from capital reserves. As a result, no dividend payments were made for fiscal year 2002. This was the first loss that Fraport had experienced since I joined the company in 1993."

7. The Philippine Supreme Court's Decision that the Terminal 3 Contracts Are Null and Void Ab Iaitio

207. Starting in September 2002, several petitions for prohibition were filed with the Philippine Supreme Court against PIATCO and others. Under the Philippine Constitution, the Court has...
original jurisdiction over petitions for writs of prohibition. Rule 65, paragraph 2, of the Philippine Rules of Civil Procedure provides for use of the writ to restrain ministerial acts of a government agency, including the performance of public contracts, when such acts are without or in excess of authority or constitute grave abuses of discretion and when administrative appeal is unavailable or inadequate.

208. In case number G.R. No. 155001, filed on 17 September 2002, the petitioners \(^4\) were employees of international airline service providers operating at Terminals 1 and 2 who claimed that they stood to lose their employment upon the implementation of the Terminal 3 concession contracts. On 15 October 2002, employers of the petitioning workers filed a motion to intervene and a petition-in-intervention. In G.R. 155547, filed on 24 October 2002, Congressmen Salacnib Baterina, Clavel Martinez and Constantino Jaraula filed a similar petition. In G.R. 155661, filed on 6 November 2002, several employees of the MIAA also filed a petition for prohibition seeking to nullify the Terminal 3 concession contracts. On 11 December 2002, another group of Congressmen moved to intervene as Respondents-Interveners seeking to defend the validity of the concession agreements and seeking dismissal of the petitions.

209. PIATCO filed comments in response to the petitions on 7 and 27 November 2002. PIATCO sought as relief a denial of the petitions with an award of costs.

210. The Office of the Solicitor General, on behalf of the public respondents, filed comments on November 11 and 18, 2002 seeking to have the contracts declared null and void, and filed a supplemental comment on 9 December 2002 reiterating its prayer and adding the argument that PIATCO had not been properly qualified. The Office of the Government Corporate Counsel filed comments on behalf of MIAA on 7 November 2002, in which it requested that the ARCA and supplements, but not the 1997 Concession Agreement, be declared null and void.

211. The Supreme Court heard oral argument on the petitions from all parties to the proceedings, including PIATCO, on 10 December 2002. After the oral argument, the Court required the parties to file memoranda in amplification of the issues heard in oral argument within 30 days and ordered the parties to explore the possibility of mediation or arbitration. The Office of the Solicitor General, now joined by the Office of the Government Corporate Counsel, filed a joint memorandum seeking a judgment from the Supreme Court declaring the 1997 Concession Agreement, the ARCA and the Supplements to the ARCA void as contrary to the Constitution, the BOT Law and its Implementing Rules and Regulations.

212. The Tribunal has noted that during the Supreme Court proceedings, the Solicitor General at first had urged that the original Concession Agreement be upheld, and that only certain provisions of the ARCA be struck down. Specifically, on 11 November 2002, then-newly appointed Solicitor General Benipayo filed a comment which was, with a few exceptions, a verbatim restatement of the fact section and other parts of the legal discussion of Secretary Climaco’s Memorandum to the Blue Ribbon Committee. Solicitor General Benipayo’s comment, unlike Secretary Climaco’s Report, however, did not contest the validity of the Concession Agreement itself. Instead, it requested that the parties “reinstate, and comply with the 1997 Concession Agreement, except as regards material deviations therein from the Bid Documents”.

\(^4\) Including one Demosthenes Agan, Jr., hence the subsequent references to the “Agan decision”
213. As indicated earlier, on 18 November 2002, the Office of the Solicitor General also filed a comment in the Agan case. This comment was a major reversal of the Solicitor General's position a week earlier. The Solicitor General was now requesting that all PIATCO agreements be declared null and void, rather than having the original concession agreement reinstated, which he acknowledged "in all candour" to be a reversal of position. The 18 November comment, like the 11 November comment, restated verbatim the facts and some of the legal sections of Secretary Climaco's Memorandum. But for the first time, the Solicitor General argued that a basis for nullifying the concession agreements was the PIATCO group's failure to satisfy the bidding prequalification requirements.

214. The full reformulation of the Solicitor General's position came on 9 December 2002, a week after President Macapagal-Arroyo's public denunciation of PIATCO and the Terminal 3 project. The occasion was the supplemental comment in the Baterina case. The Solicitor General stated that "Paircargo, PIATCO's predecessor, was not validly prequalified, and thus the award to PIATCO is void", concluding that "[c]learly, the award to PIATCO, and consequently, the PIATCO contracts are void". Again, the supplemental comment constituted a mostly verbatim restatement of the relevant passages of Secretary Climaco's Memorandum to the Blue Ribbon Committee. Indeed, the supplemental comment reiterated, with very minor editing, pages 15 to 22 of Climaco's argument, according to which the award of the Terminal 3 concession and each of the concession agreements were considered void because the PIATCO group had lacked the requisite financial capability. The Solicitor General concluded that "since the subject contracts are void, it follows that no irreparable injury will be suffered by PIATCO" in the event of a government takeover of the Terminal, and PIATCO would not be entitled to argue that such a takeover would constitute a confiscation without due process and just compensation, because the "facility is not the private property of PIATCO".

215. The Philippine Supreme Court issued its decision on the Agan and related petitions on 5 May 2003. The Court first decided the question of standing, and determined that the airport employees and concessionaire petitioners had standing because they had a direct personal stake in the outcome of the proceeding. As for the public official petitioners, the Court determined that the case was of "transcendental importance" to the Philippine public and therefore supported a waiver of the technical requirements of standing, consistent, the Court said, with a longstanding and well-established line of Philippine precedents.

216. The Court then determined to take the case as a matter of original jurisdiction under its Rule 65 writ of prohibition procedure because the facts essential to the decision were well-established, a speedy disposition was important, and the parties agreed that the petitions raised issues of transcendental importance.

217. In considering the merits of the issues raised by the petitions, the Court determined that serious violations of Philippine law and public policy in respect of several issues raised by the petitioners compelled it to conclude that the concession agreements in the Terminal 3 project were null and void ab initio. The Court considered the contention that the Terminal 3 project concessionaire (then the Paircargo consortium) had not been properly pre-qualified as financially able to undertake the contract because the PBAC had improperly factored into the net worth of the consortium the entire equity of Paircargo's partner, Security Bank, in disregard of the provisions of the Philippine Banking law that limited Security Bank's contribution to no more than 15% of its equity. The Court

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5 G.R. No. 155001, G.R. No. 155547 and G.R. No. 155661.
determined that it was erroneous to include all of Security Bank's equity, which was never available to Paircargo because of the restrictions of the Banking Law, in deciding the Paircargo consortium's net worth. Had the proper calculation been made prior to the award of the concession, it would have been evident that Paircargo did not qualify, because its equity would have amounted only to 6.08% of the project cost, instead of the 30% required. Because Paircargo was not a qualified bidder, the Court concluded that PBAC's award of the Terminal 3 concession contract to Paircargo was null and void.

218. In addition, among various other findings, the Court found that the 1997 Concession Agreement was "entirely different" from the draft Concession Agreement that had been bidded out, which "directly translates concrete financial advantages to PIATCO that were previously not available during the bidding process". Therefore the 1997 Concession Agreement was void as being contrary to public policy.

F. The Aftermath

219. At the time of the Supreme Court's decision, Terminal 3 was almost fully built. In fact, after the Supreme Court's decision invalidating the PIATCO concession and related contracts, as was noted earlier, the Macapagal-Arroyo administration officials repeated assurances that Fraport would receive due compensation. One day after the Supreme Court's decision, the Philippine Finance Secretary said that investors in the Terminal 3 project would be justly compensated, stating that the "issue of just compensation is one that is respected by this administration. I don't think there's any question of getting it for free. I don't think that's an issue." The next day, President Macapagal-Arroyo repeated that the investors would be "justly compensated". Moreover, President Macapagal-Arroyo instructed the Philippine Ambassador to Germany Minerva Jean Falcon to brief the German government on the options open to the Philippine government and to assure that Fraport would be treated fairly and equitably.

220. Following the "null and void" decision of the Supreme Court, Fraport accordingly continued its discussions with the Government in order to obtain compensation. In June 2003, President Macapagal-Arroyo issued Administrative Order No. 75 establishing a Cabinet Oversight Committee to resolve the various outstanding issues with respect to Terminal 3. The Committee first met with Fraport in a joint session also attended by the other PIATCO shareholders. Committee Chairman Roxas refused to consider separate treatment for individual shareholders. He declared that if a solution could not be found which was satisfactory to all parties, he would recommend that the President dissolve the Oversight Committee. In response to Roxas' statement and in an effort to move the talks forward, the PIATCO shareholders agreed to and did in fact consolidate their requests for compensation. They also appointed a common representative to facilitate negotiations with the Government.

221. However, by year-end 2003, the discussions between the Oversight Committee, on the one hand, and PIATCO and Fraport, on the other hand, had been postponed indefinitely. It is noted that during this period, PIATCO sought reconsideration before the Supreme Court of its decision in Agan, but PIATCO's motions were denied by a Resolution of the Supreme Court dated 21 January 2004. As of this point, the Supreme Court's decision in Agan became final. On 1 March 2004, in Administrative Order No. 96, President Macapagal-Arroyo dissolved the Oversight Committee. In the interim, on 17 September 2003, Fraport had submitted its Request for Arbitration to ICSID.
Shortly after Fraport’s Request for Arbitration was registered by ICSID on 6 August 2004, Attorney F. Arthur L. Villaraza filed a criminal complaint for libel against two of Fraport’s senior executives, Dr. Wilhem Bender and Dr. Manfred Scholch, as well as against two of Fraport’s Philippine lawyers, Cesar Manalaysay and Edgardo Balois, alleging that the Request contained derogatory statements against him and his law firm.

On 19 September 2004, Secretary Climaco also filed a criminal complaint for libel against the same respondents alleging that Fraport’s Request for Arbitration contained malicious and derogatory statements against her.

Although these two complaints were dismissed in the spring of 2006, at the time of writing the present Award, the two complainants have sought leave to appeal these decisions. To the Tribunal’s knowledge, these appeals are presently pending.

Finally, the Tribunal notes that following a lawsuit filed by Takenaka in London’s High Court of Justice against PIATCO claiming substantial sums due pursuant to the EPC Contract for Terminal 3, it obtained a ruling in its favour for the unpaid amount of US$83 million under that agreement.

III. THE PHILIPPINE EXPROPRIATION PROCEEDINGS

A. Introduction

As the Tribunal noted earlier, after the Request for Arbitration had been registered by ICSID and the Tribunal constituted, and while the written phase of the instant arbitration was proceeding, the Republic of the Philippines, in December 2004, took possession of Terminal 3.

At the time of writing the present Award, the expropriation proceedings in the Philippines have not been concluded.

B. The Background to the Philippine Expropriation Proceedings

In December 2004, the Republic of the Philippines instituted court proceedings to take possession of Terminal 3. In a statement issued on 24 December 2004 titled “NAIA Terminal 3 takeover”, President Macapagal-Arroyo explained the Respondent’s action as follows:

"On Tuesday, December 21, 2004, I directed the Solicitor General to file the expropriation complaint to allow Government to acquire the NAIA Terminal 3. We are now in possession of the terminal, and after the necessary inventory and inspection to ensure the safety of the travelling public, we will take steps to complete and operate the Terminal as soon as possible. Public interest requires that the Government take all lawful measures to immediately provide for the increasing demands of international passenger traffic. I am concerned at the unmet need of our overseas Filipino workers, businessmen and tourists who are deprived of a modern, safe and convenient airport terminal."
The expropriation was undertaken only after all reasonable measures to arrive at a negotiated settlement broke down. In November 2002, I announced that after careful study it was my Government's view that the concession contracts to Terminal 3 were null and void ab initio. The position was upheld by the Senate Blue Ribbon Committee in December, and by the Supreme Court in May of 2003. PIATCO moved to reconsider the decision by the Supreme Court twice, and both motions were rejected. The care shown by the three branches of Government, and our careful adherence to law and due process are underscored by the availability of remedies to PIATCO every step of the way. We could not have taken possession of the Terminal until the judgment of the Supreme Court became final in March 2004, at a time when the country was engrossed in the presidential electoral exercise.

Even while the Government was taking the correct position that the concession contracts are null and void, negotiations with both PIATCO and Fraport were being conducted, to explore the possibility of avoiding protracted litigation. While the case was pending before the Supreme Court, both PIATCO and Fraport sued the government before two international arbitration bodies. We are vigorously defending our right to implement our own laws as a sovereign country in those two arbitration proceedings.

This includes the constitutional role of the Supreme Court as the final arbiter of the law. Its decisions must be and will be fully respected and upheld.

Immediately upon assumption of my second term, I directed renewed efforts to arrive at a negotiated solution so that the terminal could be examined, and if it is safe, structurally sound, and conforms to international standards, open it in a way that adheres to law. Two new waves of effort were undertaken, but both failed, not because of any fault of Government, but due to deep reasons that prevent PIATCO and Fraport representatives from coming to a unified, reasonable position vis-a-vis the Republic. Those reasons are beyond the capability of the Republic to address and are internal to the two companies."

The President concluded her statement with the following commitment to, inter alia, Fraport:

"Let me take this occasion to assure everyone that prompt just compensation will be paid in accordance with Philippine law. Existing legal processes will be observed, and due process will be accorded [sic] all genuine parties in interest, including foreign investors and contractors, who will have the full benefit of the observance of law. The Government has deposited the sum required by law into the custody of the expropriation court with the filing of the Complaint." (emphasis added)

The Respondent, in its Rejoinder, addressed the context in which the Terminal 3 expropriation was undertaken:

"In short, following the litigation before the Supreme Court, which finally concluded on January 21, 2004 when the Court issued its decision on reconsideration, PIATCO could not lawfully operate the Terminal. PIATCO, however, retained its rights in the terminal facility and denied government officials any access to it. PIATCO's unpaid contractor, Takenaka, in fact, fenced it off and employed armed guards to exclude the government officials and others from the premises. That is, Takenaka barred entry to MIAA and DOTC and posted armed guards
to physically exclude government personnel from the Terminal, a public utility situated on the Government’s own land. That situation was threatening the safety and security of the airport as a whole. At the same time the public need for the terminal was increasing with increasing passenger traffic, given that the Republic had refrained from improving Terminal 1 expecting that Terminal 3 would be operational by 2002. Finally, expropriation followed numerous serious efforts to resolve the situation amicably, ending with the last failed attempt several days earlier in December.” (emphasis in original) (footnotes omitted)

231. As noted, at the time of writing the present Award, the legal proceedings in connection with the expropriation of Terminal 3 have yet to reach their final resolution. The Tribunal has been informed by the parties that the expropriation proceedings have in fact resulted in literally dozens of related motions and orders which need not be described in extenso for purposes of this Award. The Tribunal nonetheless will summarize the key rulings and procedural milestones regarding the expropriation proceedings thus far, in particular as they relate to the compensation to be made to Fraport as a result of the expropriation of Terminal 3.

C. The Right of Eminent Domain or Expropriation Generally

232. The right of eminent domain is defined as the right of the sovereign to appropriate any property within its territory for a public purpose. Under the Philippine Constitution, this right of eminent domain, or expropriation, is subjected to the requirement to pay just compensation.\(^6\)

233. The Tribunal understands that the process for taking property by eminent domain or expropriation in the Philippines consists of two principal judicial stages: a first stage during which the authority and public purpose for the expropriation are scrutinized prior to the authorization of the expropriation, and a second stage in the course of which the just compensation for the expropriated property is determined.

234. The first stage focuses on the authority of the plaintiff to exercise the power of eminent domain and the propriety of its exercise in the specific case. It ends with an order (if the expropriation complaint is not dismissed) of condemnation declaring that the plaintiff has a lawful right to take the property sought to be condemned for the public use or purpose described in the complaint for expropriation, upon compensation to be determined as of the date of the complaint. The only requisites for judicial authorization of immediate entry upon the property pursuant to a writ of possession are (1) the filing of a complaint for expropriation sufficient in form and substance, and (2) the making of the deposit of an assessed value of the property at issue, also referred to as the “proffered value”.\(^7\) It is observed that the writ of possession is issued by the court seized of the complaint on an ex parte basis.

235. As noted, the second stage is concerned with the determination of the just compensation for the property to be taken. This is done by the court seized of the complaint for expropriation with the assistance of not more than three commissioners. In essence, the commissioners are required to


\(^7\) Revised Rules of Court, Rule 67, § 2.
view and examine the property sought to be expropriated, assess its value and make a full and accurate report to the court of all their proceedings. Thereafter, the court seized of the complaint is required to hold a hearing. A number of outcomes are then possible: the court may accept the commissioners’ report and render judgment in accordance therewith or, for cause shown, recommit the file to the commissioners for a further report of facts; or, set aside the report and appoint new commissioners; or accept the report in part and reject it in part. In any case, the court may make such order or render such judgment as shall secure to the plaintiff the property essential to the exercise of the right of expropriation, and to the defendant just compensation for the property so taken.

236. Finally, the Tribunal observes that just compensation for the expropriated property is based on market value, which is defined under Philippine law as the price which the expropriated property will command when it is offered for sale by one who desires, but is not obliged to sell it, and is purchased by one under no necessity of having it. In this connection, the Tribunal further notes that the provisional deposit upon entry of the order of condemnation, i.e. the proffered value, serves the double purpose of prepayment upon the value of the property, if finally expropriated, and as an indemnity against damages if the expropriation suit fails. The difference between, on the one hand, the proffered value already paid and, on the other hand, the just compensation as subsequently confirmed by the court, is to be paid when the court’s decision on just compensation becomes final and executory.

D. The Initial Expropriation Proceedings Before the Regional Trial Court

237. Expropriation complaints in the Philippines are filed with the Regional Trial Court, which has original and exclusive jurisdiction over such matters. In the circumstances at issue, the complaint was filed on 21 December 2004 before the Regional Trial Court of Pasay City, where Terminal 3 is located. A deposit with the Land Bank of the Philippines in the amount of US$62,343,175.77 was made by the plaintiffs, who were identified as the Republic of the Philippines, the Manila International Airport Authority and the Department of Transportation and Communications. PIATCO, as owner of Terminal 3, was impleaded as an indispensable party to the expropriation proceedings. The complaint for expropriation included a plea for the immediate issuance of a writ of possession of Terminal 3.

238. The Writ of Possession was obtained on the same day that the complaint was filed, i.e. on 21 December 2004, based on an Order issued by Judge Henrick Gingoyon of the Regional Trial Court. More particularly, Judge Gingoyon instructed that the plaintiffs be made “in possession and control of the International Passenger Terminal 3 described above and to eject therefrom all adverse occupants, defendant Philippine International Air Terminals Co., Inc. and all other persons claiming under it”. The Tribunal notes that in his Order directing the issuance of the Writ of Possession, Judge Gingoyon took judicial notice of the Supreme Court’s decision to “set aside the ‘PIATCO Contracts’”. Judge Gingoyon also stated that “IPT 3 is a structure for a well-defined public

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8 Manila Railroad Company v. Caligsihan, G.R. No. L-12484 (29 October 1919) reprinted in 40 Phil. 326. The owner of private property should be compensated only for what he actually loses; it is not intended that his compensation shall extend beyond his loss or injury. And what he loses is only the actual value of his property at the time it is taken (Eslaban v. Vda de Onorio, G.R. No. 146062 (28 June 2001)).
9 Visayan RefiningCo. v. Camus, G.R. No. 15870 (3 December 1919) reprinted in 40 Phil. 550 (1919)
purpose”. He concluded as follows:

“The case record shows that plaintiffs have deposited the assessed value of the IPT3 in the Land Bank of the Philippines, an authorized government depository, as shown by the certification attached to their complaint. This Court adds that due notice to the defendant PIATCO of the instant complaint has been made. Plaintiffs have thus complied with the requisites for the issuance of the writ of possession.”

239. On 4 January 2005, Judge Gingoyon issued a supplemental order ("January 4 Order") that (a) directed the release of US$62,343,175.77 to PIATCO, which would be deducted from the yet-to-be determined amount of just compensation (b) directed the submission of a Certificate of Availability of Funds to cover the payment of just compensation and (c) pending the expropriation proceedings, directed the Republic, through the DOTC and the MIAA, to maintain, preserve and safeguard the Terminal, but prohibited them from performing "acts of ownership such as awarding concessions or leasing any part of the NAIA IPT3 to other parties". In so doing, Judge Gingoyon relied on Republic Act No. 8974 entitled "An Act To Facilitate The Acquisition Of Right-Of-Way, Site Or Location For National Government Infrastructure Projects And For Other Purposes" (R.A. No. 8974) as the applicable law.

240. On 5 January 2005, the Republic filed an Urgent Motion for Reconsideration of the January 4 Order. The Republic challenged the applicability of R.A. No. 8974 to Terminal 3 on the basis this law refers only to acquisition of real property needed as right-of-way, site, or location. The Republic also challenged the January 4 Order to release to PIATCO an amount which exceeded the provisional deposit.

241. On 7 January 2005, Judge Gingoyon issued a further supplemental Order ("January 7 Order") appointing three commissioners to value Terminal 3 and instructing them to take oaths of office within three days. On the same date, the Republic filed a Motion for Inhibition of the Regional Trial Court judge, i.e. Judge Gingoyon, which led to a hearing on both the Urgent Motion for Reconsideration and the Motion for Inhibition. The Republic argued that the January 4 and 7 Orders were issued motu proprio in favour of PIATCO, which had not yet entered its appearance or filed its answer. The hearing of both motions was held on 10 January 2005 and, on that same date, an Omnibus Order denying both the Motion for Reconsideration and the Motion for Inhibition was issued ("January 10 Order").

242. Two days later, on 12 January 2005, the Republic filed a Petition for Certiorari before the Supreme Court of the Philippines. While the outcome of this petition is discussed in greater detail later in this chapter, the Tribunal notes here that pursuant to its petition the Republic sought a temporary restraining order against the Regional Trial Court Judge Gingoyon to (1) cease implementing the January 4, 7 and 10 Orders; and (2) inhibit himself from further actions on the Republic's expropriation complaint. The Republic also sought nullification of the three orders at issue.

243. On 14 January 2005, notwithstanding its Petition for Certiorari before the Supreme Court, the Republic filed in the Regional Trial Court its "Objections to the Appointment of Commissioners". The Republic again objected that the January 7 Order had been issued motu proprio and with none of the interested parties having been notified or given the opportunity to be heard on the matter of appointment of commissioners. The Republic also objected inter alia to the alleged haste with which the January 7 Order was issued.
244. On 17 January 2005, PIATCO filed its Answer in the expropriation proceedings before the Regional Trial Court. More particularly, PIATCO sought the dismissal of the Republic's complaint for expropriation of 21 December 2004 on the basis that, *inter alia*, the Regional Trial Court lacked jurisdiction. PIATCO also raised the pending ICC arbitration between the same parties involving the "same cause" and maintained that the Republic had engaged in forum shopping.

245. The Tribunal observes that the Republic argued in the hearing before the Regional Trial Court on 10 January 2005 that Fraport should be included as an interested party in the expropriation proceedings. The Republic stated that while PIATCO was the named party in the expropriation complaint, Fraport, among others, is a necessary party which, though not indispensable, has a right to join if it so desires. However, to the Tribunal's knowledge, no such action has formally been taken by Fraport in the expropriation proceedings to date.

E. The Republic's Petition Before the Supreme Court

246. As noted earlier, on 12 January 2005 the Republic filed a Petition for Certiorari before the Supreme Court of the Philippines. In essence, with this petition the Republic sought to prevent the implementation of the Regional Trial Court's Orders of 4, 7 and 10 January 2005. In effect, the Republic appealed against these orders. According to the Republic, these orders amounted to grave abuse of discretion and unjustly prejudiced its rights in the expropriation for substantially the reasons argued before the trial judge.

247. On 14 January 2005, the Supreme Court, in an *en bane* Resolution, issued a temporary restraining order instructing the trial judge to cease and desist from executing the assailed orders, thereby allowing the Republic to perform all acts necessary to accomplish the public purpose for which the expropriation was undertaken. PIATCO filed its comment on the Petition for Certiorari on 27 January 2005, and the Republic in turn filed a reply on 11 February 2005. In addition, on 4 April 2005, the Republic filed a Motion for Early Resolution with the Supreme Court, arguing that an expedited resolution of the Petition for Certiorari "would allow the expropriation case before another branch of the Regional Trial Court in Pasay City, other than the present one, i.e. Branch 117, to progress in accordance with law and justice". In a Resolution dated 26 April 2005, the Supreme Court required the parties to submit memoranda and by June 2005, the Petition for Certiorari was ready for resolution.

248. The Supreme Court issued its ruling on the Republic's Petition for Certiorari on 19 December 2005 (the "Gingoyon decision"). In brief, the Supreme Court's decision directed that the implementation of the 21 December 2004 Writ of Possession over Terminal 3 be held in abeyance, pending payment by the Republic to PIATCO of the amount of Php3,002,125,000.00 representing the proffered value of the Terminal.

249. Less than two weeks later, on 2 January 2006, the Republic filed a Motion for Partial Reconsideration of the Supreme Court's *Gingoyon* decision. The Republic's principal argument was that the release of the proffered value solely to PIATCO would deny full and final relief to the Philippine Government and would work an injustice to lawful claimants of the just compensation.

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10 Transcript of Stenographic Notes, 10 January 2005, 8:30 a.m., at page 9.
In its Motion, the Republic referred to various claims against PIATCO such as Fraport’s as well as judgment creditors of PIATCO, namely Takenaka and Asahikosan. The Republic argued that the amount of Php3,002,125,000.00 should not be released until legitimate claims against PIATCO with respect to the Terminal were ascertained and liquidated, and the fair value of the Terminal determined. The Republic also argued against the applicability of Republic Act No. 8974.

Motions for intervention were filed with the Supreme Court after the promulgation of the Gingoyon decision. Takenaka filed a Motion for Partial Reconsideration in Intervention on 5 January 2006, arguing that the Php3,002,125,000.00 amount should not be released to PIATCO pending the determination of its claim against PIATCO and the amount of just compensation. Takenaka pointed out that, after determining the value of the Terminal and the unsettled obligations of PIATCO, the just compensation may not be sufficient to settle PIATCO’s obligations to its creditors. Takenaka informed the Supreme Court of its favourable judgments in the courts of the United Kingdom against PIATCO. In its separate motion of same date, Asahikosan made similar arguments.

The Supreme Court denied all these motions in a Resolution dated 1 February 2006. The interventions were denied as filed after promulgation of the Gingoyon decision, which the Supreme Court considered as contrary to procedural rules. In particular, the Supreme Court emphasized that the directive enjoining payment was in accordance with Republic Act No. 8974, which the Supreme Court again upheld as the applicable law.

On 17 March 2006, the Republic filed a Motion for Clarification and Second Motion for Reconsideration before the Supreme Court, praying that the Court clarify whether the awarding of concessions and leasing airport premises to airport-related operating businesses in Terminal 3 could be undertaken while full payment of the just compensation remained pending. The Republic also requested a reconsideration of the Gingoyon decision and the Supreme Court’s Resolution of 1 February 2006. Alternatively, the Republic also requested that the deposit of the Terminal 3’s proffered value be placed in escrow pending determination of just compensation due to PIATCO. The Supreme Court denied this Second Motion for Reconsideration as a prohibited pleading under the Rules of Court in a Resolution dated 21 February 2006. The Gingoyon decision thus became final and executory, and an Entry of Judgment was thereafter made on 17 March 2006. More particularly, the following rulings in the Gingoyon decision were entered into judgment as final and executory:

11 First, the Supreme Court stated that its 21 January 2004 Resolution denying PIATCO’s motions for reconsideration of the Agan decision was the principal reason why it ruled as it did in respect of the issues raised in the Gingoyon Petition for Certiorari. The Tribunal recalls that in its January 2004 Resolution, the Supreme Court specifically held that the Government had to pay PIATCO just compensation in accordance with law and equity prior to taking over Terminal 3. According to the Gingoyon decision, “[t]his pronouncement contains the fundamental premises which permeate [the Agan] decision of the Court”, and “any disposition of the present petition must conform to the conditions laid down by the Court in its 2004 Resolution”. It is abundantly clear that the Supreme Court of the Philippines was well aware of the close nexus between its Agan decision and the Gingoyon decision.

254. Second, the Supreme Court ruled that Republic Act No. 8974 and its Implementing Rules provided the legal regime which the Government had to follow in the expropriation of Terminal 3, and not Rule 67 of the Rules of Civil Procedure. Accordingly, the amount of payment to PIATCO under R.A. No. 8974 was to include the value of the improvements and/or structures on the land.

255. Third, the Supreme Court ruled that because there was no way to ascertain immediately the value of the improvements, a factual determination, the Republic had to pay PIATCO a provisional amount denominated the "proffered value" of Terminal 3 pursuant to R.A. No. 8974. The Supreme Court refused to accept PIATCO's argument that the proffered value be set at its alleged Terminal cost of "not less than US$ 350 million". Instead, the Supreme Court deemed that the proffered value should be equal to the amount the Republic had deposited to commence the expropriation proceedings, i.e. Php3,002,125,000.00. The Supreme Court ruled that the Republic could not take possession of the Terminal until it paid PIATCO the proffered value.

256. Fourth, the Supreme Court recognized a critical distinction between possession of the Terminal through a Writ of Possession upon payment of the proffered value, and "taking over" the Terminal upon paying PIATCO just compensation, which was the same as exercising full ownership rights over the Terminal. The Supreme Court ruled that the Government is limited under the Writ of Possession "to perform the acts that are essential to the operation of the NAIA 3 as an international airport terminal. [...] These would include the repair, reconditioning and improvement of the complex, maintenance of the existing facilities and equipment, installation of new facilities and equipment, provision of services and facilities pertaining to the facilitation of air traffic and transport, and other services that are integral to a modern-day international airport". However, until the Government paid PIATCO final payment of just compensation, the Government could not "perform[] acts of ownership such as awarding concessions or leasing any part of NAIA 3 to other parties".

257. Fifth, to ensure that PIATCO was promptly paid, the Supreme Court ruled that the Regional Trial Court must determine the amount of PIATCO's just compensation within the 60-day period for paying a property owner just compensation as set forth in R.A. No. 8974. This time period would start to run from the date of the "finality" of the Supreme Court's decision.

258. Sixth, the Supreme Court ruled that the appointment of three Commissioners to hear evidence on valuation under Rule 67 was appropriate under the circumstances and that any objection to the appointments was to be lodged with the Regional Trial Court and not by way of petition to the Supreme Court.

F. The Subsequent Proceedings Before the Regional Trial Court

259. On 27 March 2006, the Regional Trial Court, referring to the "finality" of the Gingoyon decision and without being seized of any motion, ordered the issuance of a Writ of Execution, and the release of Php3,002,125,000.00 to PIATCO.

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12 Section 4(c) of R.A. 8974 provides in relevant part that “in case the completion of a government infrastructure project is of utmost urgency and importance, and there is no existing valuation of the area concerned, the implementing agency shall immediately pay the owner of the property its proffered value”.

13 The Supreme Court suspended the Republic's Writ of Possession to the Terminal until PIATCO was paid the proffered value.
On the same date, the ceiling of the arrival lobby section of Terminal 3 collapsed. This prompted the Republic to file an Urgent Motion to Quash the Writ of Execution of 27 March 2006. Pointing to the supervening event of the collapse of the ceiling, as well as the procedural requirement under the Philippine Rules of Court that writs of execution can only be issued upon motion by the prevailing party, the Republic challenged the issuance of the Writ of Execution. A hearing on the Republic's Motion to Quash was held on 7 April 2006. PIATCO filed its comment on 12 April 2006.

The Tribunal notes that AEDC, which had filed a Motion for Intervention in the expropriation proceedings, filed a Manifestation and Motion dated 8 May 2006 praying that the resolution of the Republic's Motion to Quash be held in abeyance pending resolution of its Motion for Intervention. This Manifestation and Motion were promptly met with PIATCO's Opposition on 16 May 2006. The Tribunal further notes that throughout the valuation proceedings, AEDC attempted to prevent the payment of the Terminal's proffered value to PIATCO.

In an Order dated 15 June 2006, the Regional Trial Court denied the Republic's Urgent Motion to Quash the Writ of Execution. The Court, upholding the arguments in PIATCO's comment, concluded that collapse of the ceiling could not be considered as a supervening event that would warrant quashing the Writ of Execution. The Court opined that the collapse of the ceiling did not have a direct effect on the matter already litigated and settled by the Supreme Court in Gingoyon, as it did not create a substantial change in the rights or relations of the parties. The Court directed immediate compliance by the Republic with the Order of 27 March 2006.

Following the denial of the Urgent Motion to Quash, the Republic filed an Urgent Manifestation and Motion on 21 June 2006 declaring that it would comply with the order of payment, but requested that, in anticipation of the operation of the Terminal, the Court issue an order granting plaintiffs an effective writ of possession authorizing them to implement the Terminal 3 project by performing acts essential to the operation of an international airport passenger terminal, such as the awarding and execution of lease contracts and concession agreements. PIATCO opposed this Motion on the basis that it was identical to the Motion for Clarification and Second Motion for Reconsideration which the Republic had filed previously in the Gingoyon case.

In an oral hearing before the Regional Trial Court on 23 and 28 June 2006, the Republic reiterated its commitment to pay the proffered value as required under Philippine law while requesting confirmation of its rights under the Writ of Possession. During the hearing, EPC contractors Takenaka and Asahikosan requested that the release of payment be held in abeyance pending a determination of the amount of just compensation and the identification of the rightful claimants. In order to determine what action needed to be taken in view of Takenaka's interest as a judgment creditor of PIATCO (now judgment creditor for the unpaid US$83 million on the EPC Contract) and also in the interest of orderly procedure, the Court declared on 28 June 2006 that it would resolve the remaining pending motions in an Omnibus Order before it ordered the actual release of the Republic's deposited proffered value.

Thus, by Order dated 7 August 2006, the Regional Trial Court denied the Republic's Urgent Manifestation and Motion. This Order was followed by an Order on 8 August 2006 denying all motions of the Republic.

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14 For example, in a brief filed with the Supreme Court on 5 September 2006, AEDC asserted that it had a legal right as “original proponent” of the Terminal to obtain the concession to operate the facility and accordingly argued that the Republic cannot assume ownership of the Terminal or transfer it to third parties without AEDC's consent.
motions for intervention from third parties, including those of Takenaka, and another Order on 9 August 2006 directing the Manila International Airport Authority and the Land Bank of the Philippines to cause the release of the Php3,002,125,000.00 to a duly authorized PIATCO representative. The Board of Directors of the Manila International Airport Authority accordingly issued a Board Resolution where it “approved the payment to PIATCO of the proffered value of NAIA Terminal 3” and authorized its General Manager “to take the necessary steps in order to effect immediate payment of the said proffered value to PIATCO”. The second stage proceedings for the valuation of the Terminal for payment of just compensation could then commence.

G. The Valuation Proceedings by the Court-Appointed Commissioners

266. Under Rule 67 of the Philippine Rules of Court, which is suppletory to Republic Act No. 8974, upon payment of the proffered value by the Republic and issuance of the order of expropriation (already issued), just compensation is determined by three competent and disinterested commissioners in order to ascertain and report to the court the just compensation for the expropriated property. Evidence may be introduced by either party to the proceedings who may also examine the property sought to be expropriated.

267. As noted earlier, the determination of just compensation and the transfer of title to the Republic is the last stage of the expropriation proceedings. As also noted earlier, on 7 January 2005, the Regional Trial Court had already issued an order appointing three commissioners for the determination of just compensation, to which the Republic had filed its objections on 14 January 2005, questioning the competence of the appointees. The resolution of this matter had been held in abeyance pending resolution of the Gingoyon case. On 5 April 2006, the Regional Trial Court issued an Order denying the Republic's opposition and set the oath-taking of the commissioners for 11 April 2006. The Regional Trial Court ordered the commissioners to submit their report on the valuation of the Terminal on or before 22 May 2006.

268. The Republic filed a Motion for Reconsideration on 11 April 2006, on the grounds that (1) the appointed commissioners did not appear to be competent for the task; and (2) there was no showing that the appointed commissioners were disinterested. Of particular relevance to the present arbitration, the Republic of the Philippines submitted that since the determination of the valuation of the Terminal and the just compensation for its taking would impact inter alia on the ICSID arbitration proceedings, the valuation should be made by a disinterested, competent and respected international airport engineering construction expert. Only in this way would the valuation be respected by international tribunals. PIATCO took issue with these arguments in its comment of 26 April 2006. In the interim, on 12 April 2006, the Regional Trial Court ordered a valuation conference to be held between the parties and the appointed commissioners on 18 April 2006. On 19 April 2006, the Regional Trial Court ordered an “ocular inspection” of the Terminal to be held on 25 April 2006.

269. The Republic filed a Manifestation and Motion on 24 April 2006 praying that the Regional Trial Court resolve all pending motions, including a number of motions filed by various intervenors, before continuing with the valuation proceedings. In light of the unresolved objections to the appointment of commissioners, the Republic also objected to the “ocular inspection” and submitted
that it should not be considered part of the valuation proceedings but should merely be a "visit" to the Terminal. The viewing of the Terminal nonetheless proceeded on 25 April 2006, with all parties present.

270. In a Request for Extension of Time by Court-Appointed Commissioners, filed on 5 May 2006, the commissioners asked the Regional Trial Court to allow them "to determine the appropriate appraised value unilaterally by engaging an internationally accepted professional entity that would perform the actual technical work of appraisal of the Terminal in question". The commissioners also asked for an extension of three months to complete the task of determining just compensation.

271. The Tribunal observes that Section 4 of R.A. No. 8974 provides that in the event the owner of the property contests the implementing agency's proffered value, the Regional Trial Court shall determine the just compensation to be paid to the owner within sixty (60) days from the date of the filing of the expropriation case. It will be recalled that the Supreme Court in its decision in Gingoyon directed the Regional Trial Court to determine just compensation within the same period. However, consistent with the Court's inherent power to control its own processes, the commissioners' Motion for extension of time was granted by the Court in its Order of 17 May 2006. This Order was silent on the matter of the commissioner's proposed engagement of an "internationally accepted professional entity".

272. On 22 May 2006, the Republic filed a Manifestation stating that it had retained the international engineering firms of TCGI Engineers, Ove Arup Consulting, and Gleeds Management Services for the assessment of the safety, operability and value of Terminal 3. The Republic informed the Regional Trial Court that notwithstanding its continuing objection to the appointment of the commissioners, it would submit the final report of these engineering firms for use in the expropriation proceedings. Three days later, on 25 May 2006, the Republic filed a Motion for Production and Inspection of Documents and Things.

273. On 11 September 2006, while the valuation proceedings were pending, the Government of the Philippines made a provisional payment to PIATCO representing a proffered value for the Terminal of Php3,002,125,000.00. The Tribunal notes that PIATCO transferred approximately half of this amount, i.e. US$29 million, to Fraport during the month of September. On that same date, i.e. on 11 September 2006, the Regional Trial Court issued an Order memorializing payment of the proffered value to PIATCO and stated that the Republic had complied with the Supreme Court's Gingoyon decision and the Regional Trial Court's Orders directing payment. The Regional Trial Court thus reinstated the Republic's Writ of Possession over Terminal 3 dated 21 December 2004.

274. The commissioners subsequently held a valuation conference with the Republic and PIATCO on 21

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15 In a press release dated 25 September 2006 posted on Fraport's website (www.fraport.com) under the heading "Fraport Receives First Payment for Manila Terminal Project", the following is stated: The Philippine government has made a first partial compensation payment of 3,002,125,000 Philippine pesos (about US$60 million) to PIATCO terminal company, in which Fraport AG holds a 30-percent share. Of this amount, some US$29 million were transferred to Fraport AG's account in Frankfurt today. Part of this amount is the redemption of a loan which Fraport granted to PIATCO. The remainder of this initial payment was used for the reduction of other PIATCO liabilities. The definitive total amount of compensation shall soon be determined with the help of independent experts. This is a first success in our efforts to get appropriate compensation for our investment in the Philippines,' said Fraport AG's executive board chairman Dr. Wilhelm Bender. The sum remitted can therefore only be a down payment for PIATCO. We are still vigorously pursuing the arbitration procedure before the World Bank in Washington.' The full amount of the payment made will have an effect on earnings in the current business year so that Fraport will show additional non-recurring income of about €22.6 million.
September 2006, during which the commissioners stated that the quantitative determination of just compensation could be simplified if the parties could agree on the valuation. The parties were invited to confer and consider whether they were willing to engage in negotiations. In a conference on 19 October 2006, the commissioners again proposed setting aside a period of time to negotiate and attempt to reduce the issues in dispute. The commissioners nevertheless stated that they would simultaneously seek presentations for a formal valuation in the event negotiations were not fruitful.

275. The Tribunal notes that a subsequent commissioners' conference on 30 October 2006 was attended by representatives of the Republic and PIATCO, as well as by Fraport official Peter Henkel and legal counsel for Takenaka.

276. The next valuation conference took place on 24 November 2006, during which the commissioners stated that the informal negotiations between the parties had failed. The formal valuation would accordingly proceed and, to this end, an independent appraiser would be appointed.

277. The parties to the valuation proceedings were subsequently requested to provide the commissioners with various documents, including the Tender documents, the Terminal-related contracts between the Republic and PIATCO as well as the EPC Contract. The commissioners' request for documents resulted in a production Order dated 5 January 2007. As of the date of the present Award, the parties had yet to fully comply with this Order, and an independent appraiser had yet to be appointed to proceed with the formal valuation of Terminal 3.

278. As a final observation, it is noted that on 17 March 2007, the Regional Trial Court modified its Order of 8 August 2006 and allowed the intervention of Takenaka and Asahikosan in the expropriation proceedings. The Court held that the two firms, as PIATCO's construction contractor and procurement supplier, are in the best position to elucidate actual construction costs, which is the most important consideration facing the commissioners and the Court.

279. The valuation phase of the expropriation proceedings regarding the Terminal continues as of the date of the present Award. As they progress, the Tribunal recalls the commitment made by President Macapagal-Arroyo on 24 December 2004 when Respondent instituted the expropriation proceedings to take possession of Terminal 3:

"Let me take this occasion to assure everyone that prompt just compensation will be paid in accordance with Philippine law. Existing legal processes will be observed, and due process will be accorded [sic] all genuine parties in interest, including foreign investors and contractors, who will have the full benefit of the observance of law. The Government has deposited the sum required by law into the custody of the expropriation court with the filing of the Complaint."

IV. THE RESPONDENT'S JURISDICTIONAL OBJECTIONS

A. The Treaty
280. Before addressing the Respondent's jurisdictional challenge, it is essential to reproduce those provisions of the Treaty which the Tribunal is called upon to interpret and analyze in this regard.

281. The relevant provisions of the Preamble to the Treaty, as well as part of Article 1, read as follows:

"The Federal Republic of Germany and the Republic of the Philippines hereinafter referred to as the Contracting States,

Desiring to intensify economic co-operation between both States;

Intending to create favorable conditions for investments by nationals and companies of either Contracting State in the territory of the other Contracting State, and to increase prosperity in their respective territories;

Recognizing that encouragement and protection of such investments will benefit the economic prosperity of both States -

Have agreed as follows:

**Article 1 Definition of Terms**

For the purpose of this Agreement:

1. The term 'investment' shall mean any kind of asset **accepted in accordance with the respective laws and regulations of either Contracting State**, and more particularly, though not exclusively:

(a) movable and immovable property as well as other rights in rem, such as mortgages, liens, pledges, usufructs and similar rights;

(b) shares of stocks and debentures of companies or interest in the property of such companies;

(c) claims to money utilized for the purpose of creating an economic value or to any performance having an economic value;

(d) intellectual property rights, in particular copyrights, patents, utility-model patents, registered designs, trademarks, tradenames, trade and business secrets, technical processes, knowhow, and good will;

(e) business concessions conferred by law or under contract, including concessions to search for, extract or exploit natural resources;

any alteration of the form in which assets are invested shall not affect their classification as an investment." (emphasis added)

282. Paragraph 1 of Article 2 of the Treaty further contains the following relevant provisions regarding jurisdiction:

"**Article 2 Promotion and Acceptance**
(1) Each Contracting State shall promote as far as possible investments in its territory by investors of the other Contracting State and admit such investments in accordance with its Constitution, laws and regulations as referred to in Article 1 paragraph 1. Such investments shall be accorded fair and equitable treatment.” (emphasis added)

Also of significance to the issue of jurisdiction are the following provisions from the Protocol to the Treaty:

"Protocol to the Agreement between the Federal Republic of Germany and the Republic of the Philippines concerning the Promotion and Reciprocal Protection of Investments

(2) Ad Article 2

(a) As provided for in the Constitution of the Republic of the Philippines, foreign investors are not allowed to own land in the territory of the Republic of the Philippines. However, investors are allowed to own up to 40 % of the equity of a company which can then acquire ownership of land.

(5) Ad Article 5

(a) With respect to the Republic of the Philippines it is understood that duly registered investments are assets of any kind as defined in Article 1, admitted in accordance with Article 2 (1) and reported to competent governmental agencies at the time the investment was made. It is further understood, that the transfer guarantee is not limited to the capital values of the investments that have been duly registered. The Republic of the Philippines will relax as soon as possible existing reporting requirements." (emphasis added)

With these Treaty provisions in mind, the Tribunal now turns to the parties' respective positions regarding the issue of jurisdiction. As the Respondent is the moving party, the Tribunal will consider its arguments in this regard first. The Tribunal will then review the Claimant's arguments regarding jurisdiction.

B. The Respondent's Position

In essence, the Respondent challenges the Tribunal's jurisdiction in this arbitration on the basis that the protections afforded by the BIT at issue do not extend to investments made in violation of Philippine law. The premise to this challenge is that the BIT entered into between the Philippines and Germany provides the only possible basis for the Tribunal's jurisdiction over the Claimant's BIT claims. In this regard, the Respondent refers to the "limited nature" of the BIT's application and contends that the Claimant's investment falls outside of the BIT's expressly limited scope because it was not made in compliance with Philippine law. In brief, the Respondent avers that the Claimant's investment was not "accepted" in accordance with the laws of the Philippines, in the words of Article 1(1) of the BIT.

It is in this connection that the Respondent emphasizes that "even once 'admitted' an investment may fall outside the scope of the BIT's protections where it is implemented in a manner that
materially violates the host State’s laws that directly regulate the investment or the investment activities”. In other words, the duty to comply with the host State’s law is an ongoing one which must be respected throughout the period in which the investment is made. It is also in this connection that the Respondent posits that “[t]he burden is on the investor to ensure that its investment complies with host State law if the investor wishes to avail itself of the rights and benefits of the BIT”.

287. More particularly, the Respondent contends that the Terminal 3 concession is a public utility subject to the nationality restrictions of the Philippine Constitution and the prohibitions imposed by the ADL, and that both have application to Fraport’s investment in PIATCO. It is the Respondent’s contention that Fraport openly sought to evade the nationality requirement limiting foreign ownership of the capital of a public utility to 40% through the device of “indirect” ownership coupled with the secret shareholder agreements referred to earlier in this Award. The Respondent argues that Fraport sought de facto control of the Terminal 3 project and/or of PIATCO as the corporate vehicle of Fraport’s investment because its Supervisory Board would not otherwise permit the flow of its funds into the Terminal 3 project.

288. The Respondent expands on its argument that the BIT’s protections extend only to investments made in accordance with Philippine law by referring to, inter alia, the decision in the ICSID case of Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco. Where a BIT contemplates, as it allegedly does here, a threshold analysis of the legality of the investment as a jurisdictional matter, such an analysis must be conducted. According to the Respondent, broad and general statements in the preamble to a BIT to the effect that it is meant to promote investments cannot serve as grounds to circumvent the duty to conduct this analysis. The Respondent argues that “interpreting the provisions of a BIT requires a balanced approach that takes into consideration that States seek to create favourable environments for the promotion of investment, but not at the cost of other legal and regulatory imperatives that must be respected in order to promote and sustain governments based on the rule of law”.

289. In terms of the applicable standard regarding jurisdiction, the Respondent refers to the Claimant’s argument that the Tribunal must dismiss the Respondent’s jurisdictional objection if it is satisfied that the Claimant has “alleged facts” that if proven would be “capable of falling with the provisions of the treaty”. According to the Respondent, the Claimant’s argument confuses the general standard of proof for establishing jurisdictional elements with the standard applied to assessing the sufficiency of claims that the substantive terms of the BIT have been breached. The Respondent further adds that it is not challenging whether the causes of action alleged by the Claimant are capable of constituting violations of the BIT. Rather, the Respondent’s jurisdictional objection focuses on whether a basic element necessary to establish jurisdiction is present, i.e. the existence of an investment covered by the BIT.

290. Finally, according to the Respondent, it is precisely because the Claimant’s capital investments, loans and guarantees to PIATCO were made in violation of the Philippine Constitution and ADL that they do not benefit from the BIT’s protection. In particular, the Respondent contends that, starting in 1999, the Claimant structured its investment in PIATCO in a manner that was intended to evade Philippine nationality and anti-dummy laws. It devised a series of arrangements designed to assure

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16 Supra at paragraph 125.
17 ICSID Case No.ARB/00/4 (23 July 2001).
that it could exert influence and control over PIATCO, including authority to make additional appointments to PIATCO's board, veto rights over decisions of the terminal operator, pooling arrangements to permit it to influence areas of terminal operations and retail management, as well as contractual arrangements through which it had the exclusive authority to determine the financial arrangements for the Terminal 3 project. The Respondent further states that the Claimant had been advised that "arrangements, other than mere equity investments between FAG [i.e. Fraport] and the Company [i.e. PIATCO], must be considered carefully".

291. From a broader perspective, the Respondent's jurisdictional challenge, to the extent that it relates to the Claimant's alleged non-compliance with Philippine law (with emphasis on ADL prohibitions), is based on the following statement: "The point is not that Fraport controlled PIATCO, but that Fraport tried but failed to control PIATCO, and in so doing violated the Philippine Anti-Dummy Law." According to the Respondent, the Claimant's (failed) attempt to control PIATCO is conclusively evidenced by the secret shareholder agreements produced by the Claimant in December 2005 and during the hearing in January 2006.

C. The Claimant's Position

292. The Claimant's central position on jurisdiction is that its investment, which allegedly totals more than US$425 million, was made in accordance with Philippine law. In the Claimant's own words:

"Fraport's indirect investment in PIATCO by means of the cascade companies allowed funds to be provided to the Terminal 3 project in compliance with Philippine law, including Philippine restrictions on foreign ownership of public utilities. The members of the Cheng family are citizens of the Philippines and control PIATCO. Fraport is a 30% non-controlling shareholder of PIATCO notwithstanding its 61.44% direct and indirect ownership of PIATCO through the cascade companies."

293. In terms of general observations, the Claimant maintains that the "Respondent's arguments based on Fraport's non-compliance with the 'anti-dummy' and nationality laws should also be understood as inventions for this arbitration", and states that the Philippines has not "ever taken any action under its own laws to charge Fraport with any violation of those laws".

294. Regarding the manner in which its investment was structured, the Claimant makes this further general observation:

"An obvious fundamental flaw of Respondent's argument is its failure to distinguish between economic participation and management control. Fraport is a minority shareholder in PIATCO. Control is in the hands of the majority shareholders of PIATCO, the Cheng family. Fraport is also a minority shareholder in the cascade companies, and Fraport does not have control over any company owning stock in PIATCO. This was the structure by which Fraport complied with the Philippine law's prohibition against its having control over a public utility while also achieving an economic interest commensurate with its investment. Fraport should not be viewed with suspicion for having structured its investments on the basis of legal advice so as to have the influence in the project that Philippine law permitted." (emphasis in original)
As a theme running through its arguments on jurisdiction, the Claimant emphasizes that the Respondent has long known the details of PIATCO’s shareholding structure, and never charged the Claimant in the Philippines with violating its foreign ownership laws. In particular, the Claimant maintains that its investment(s) has always been fully disclosed to the Philippine SEC, and furthermore that the Respondent was aware of the Claimant’s investment(s) at the highest levels of government. The Claimant also makes the point that although it was provided with a chart of PIATCO’s shareholder structure, the Philippine Supreme Court did not address this issue in its May 2003 Agan decision. The Claimant stresses that it asked for and followed legal advice to ensure it respected the law while achieving permissible influence in the Terminal 3 project.

In addition, the Claimant maintains that the Philippine SEC and DOX have rendered opinions to the effect that “companies that are at least 60% owned by Philippine nationals are considered Filipino-owned irrespective of minority ownership”. Similarly, it submits that the Respondent’s own description of facts and the statements of its witnesses foreclose the argument that the Claimant controlled PIATCO in violation of Philippine law and that, furthermore, none of the Respondent’s experts on Philippine law conclude that the Claimant violated Philippine law.

The Claimant contends that the BIT creates an obligation for the Respondent to admit foreign investments. The Claimant argues that “tribunals will look to the broader purpose of a BIT when defining the scope of a clause containing a reference to the admission of foreign investments and their compliance with local laws” (emphasis added). The Claimant adds that the interpretation of BIT provisions must be guided by the fact that the purpose of bilateral investment treaties is to promote foreign investments.

Finally, it is the Claimant’s contention that the parties’ dispute in this arbitration is indeed about an “investment” made pursuant to the BIT. The Claimant makes a number of assertions in this regard. First, the Claimant maintains that its prima facie showing that its investment satisfied Philippine law has not been rebutted, with the result that the investment must be deemed accepted under the BIT. Second, the Claimant stresses that the Respondent bears the burden to produce evidence that Fraport’s investment was not in accordance with its laws, and that the Respondent cannot satisfy its burden merely by showing non-compliance with local laws. The Claimant also argues that its compliance with Philippine law must be assessed at the time of the investment. Finally, the Claimant maintains that acts of approval and acquiescence of competent authorities constitute further evidence that the Respondent accepted the Claimant’s investment(s).

Against this background, the Tribunal’s analysis and findings in light of the parties’ respective arguments and submissions on jurisdiction follow.

**V. ANALYSIS AND FINDINGS ON JURISDICTION**

**A. Preliminary Observations**

As gleaned from the overview of their respective arguments regarding the issue of jurisdiction, the parties fundamentally disagree on the scope of the BIT in terms of limitations imposed by the laws and regulations of the host state. In order to make a determination in this regard, the terms of
Article 1(1) of the BIT will be recalled:

"Article 1

Definition of Terms

For the purpose of this Agreement:

1. The term 'investment' shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State, and more particularly, though not exclusively:

(a) movable and immovable property as well as other rights in rem, such as mortgages, liens, pledges, usufructs and similar rights;

(b) shares of stocks and debentures of companies or interest in the property of such companies;

(c) claims to money utilized for the purpose of creating an economic value or to any performance having an economic value;

(d) intellectual property rights, in particular copyrights, patents, utility-model patents, registered designs, trademarks, tradenames, trade and business secrets, technical processes, know-how, and good will;

(e) business concessions conferred by law or under contract, including concessions to search for, extract or exploit natural resources;

any alteration of the form in which assets are invested shall not affect their classification as an investment." (emphasis added)

The Tribunal observes that as a result of the BIT's wording, the arguments of both parties address at some length the interpretation to be given to the term “accepted” used in the BIT. For instance, the Respondent points to the following passage from UNCTAD:

"In agreements that apply this limitation, investment that was not established in accordance with the host country’s laws and regulations would not fall within the definition of investment’ as used in the agreement.

Such a limitation in an investment agreement obviously is intended to induce foreign investors to ensure that all local laws and regulations are satisfied in the course of establishing an investment by denying treaty coverage to noncompliant investment." 18

The Respondent also refers to the "objective standard of lawfulness" which must be met. It quotes, in aid of its argument, the following extract from the Dolzer and Stevens treatise:

"A further important consideration as to the limited scope of the BIT’s application is that the

18 UNCTAD, Scope and Definition: UNCTAD Series on issues in international investment agreements at page 24.
requirement that investments be made in accordance with law is premised upon an objective standard of lawfulness.

BITs generally do not include any specific requirements that an investor must follow other than that it must be done in accordance with the law; however, a few BITs have laid down objective conditions in the treaty itself.

Although therefore not a common phenomenon, it is critical to examine whether this type of condition has been introduced by the Contracting Parties, insofar as it may well exclude investments that would otherwise fall under the treaty." 19

303. The Claimant argues that this passage from Dolzer and Stevens is inapposite as it relates solely to circumstances where a State has laws and regulations for the admittance of investments. More particularly, the Claimant does not accept that Article 1(1) of the BIT can be construed as a substantive jurisdictional limitation. The Claimant elaborates as follows:

"[...] An analysis of other BITs shows that there is nothing 'remarkable' about the phrase 'in accordance with domestic law', as it appears to be a common feature of BITs. Even if one were to conclude that these phrases reflect a special emphasis on the part of the contracting parties, such emphasis may only be understood to concern the right of States to regulate the initial access of foreign investments to their territories. This is acknowledged by Professor Dolzer. Such barriers to foreign investment are not, however, at issue in the current dispute." (emphasis added)

304. The Claimant adds:

"It further derives from the object and purpose of the BIT that the phrase 'in accordance with the law' shall not be understood to mean that foreign investments have to comply with each and every provision of domestic law or else risk forfeiture of the protection afforded by the BIT. As Professor Dolzer concedes, 'it would appear implausible to argue that each infraction of the local laws would deprive the investor of the guarantees laid down in the BIT'. Such a conclusion would also contradict general principles of law, such as Article 27 of the Vienna Convention, which provides that '[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty'.

Further, a tribunal would have jurisdiction to hear a claim even in the presence of a violation of local investment laws that could otherwise deprive it of jurisdiction when, for example, 'the actions of the Respondent were out of proportion with any non-compliance that may have existed'. It would indeed be inappropriate and inconsistent with the BIT to deprive the investor of the protections of the BIT on the basis of non-compliance with municipal law where, for example, such noncompliance may be cured or rectified by the investor."

305. It is further observed that the boundaries of this Tribunal's jurisdiction are delimited by the arbitration agreement, in the instant case, both the BIT and the Washington Convention. Article 25 of the Washington Convention, which provides, *inter alia*, parameters of jurisdiction *ratione materiae*, does not define “investment”, leaving it to parties who incorporate ICSID jurisdiction to provide a definition if they wish. In bilateral investment treaties which incorporate an ICSID arbitration option, the word “investment” is a term of art, whose content in each instance is to be determined by the language of the pertinent BIT which serves as a *lex specialis* with respect to Article 25 of the Washington Convention.

306. With respect to a bilateral investment treaty that defines "investment", it is possible that an economic transaction that might qualify *factually and financially* as an investment (i.e. be comprised of capital imported by a foreign entity into the economy of another state which is party to a BIT), falls, nonetheless, outside the jurisdiction of the tribunal established under the pertinent BIT, because *legally* it is not an “investment” within the meaning of the BIT. This will occur when the transaction that might otherwise qualify as an "investment" fails *ratione temporis*, as occurred in *Empresa Lucchetti S.A. et al v. Republic of Peru*\(^{20}\), or fails *ratione personae*, as occurred in *Soufraki v. The United Arab Emirates*\(^{21}\). It will also occur when the transaction fails to qualify *ratione materiae*, as occurred in *Inceysa Vallisoletana, S.L. v. Republic of El Salvador*\(^{22}\).

307. In the case before this Tribunal, there are no plausible objections to its jurisdiction *ratione temporis* or *ratione personae*. Objections have, however, been lodged with respect to its jurisdiction *ratione materiae*. In addressing these objections, the Tribunal will first consider the factual allegations regarding the Claimant's investment as it relates to the laws of the Philippines, in particular the ADL. The Tribunal will then set forth the legal standards established by the relevant instruments before proceeding to elaborate its own analysis.

**B. The Pertinent Facts**

308. On 11 January 1999, the law firm of Quisumbing Torres ("QT"), which is based in Manila and is affiliated with Baker & McKenzie, submitted a preliminary due diligence report on legal issues to Fraport or FAG as it was then known as part of Fraport's preparations for its planned investment in the Philippines. Lest segments be taken out of context, the Tribunal believes it will be useful to quote *in extenso*, emphasizing the portions of the QT report that are of special relevance by setting them in boldface.

309. At pages 6-9 of its report, QT stated:

"*Regulatory Environment*

We set out certain general aspects of Philippine law, which will assist in understanding this preliminary Report:

\(^{20}\) ICSID Case No. ARB/03/4 (7 February 2005).
\(^{21}\) ICSID Case No. ARB/02/07 (7 July 2004).
\(^{22}\) ICSID Case No. ARB/03/26 (2 August 2006)
(a) **Foreign Ownership.** RA 7042, Foreign Investments Act of 1991, as amended (FIA) governs and regulates equity investments in domestic corporations made by non-Philippine nationals, either in the form of foreign exchange or other assets actually transferred into the Philippines.

Generally, a non-Philippine national may own up to 100% of domestic corporations, except domestic corporations engaged in any business activity included in the Negative List of the FIA. The Negative List of the FIA contains the areas of economic activities where foreign ownership is prohibited or limited. The Negative List contains 2 lists, List A and List B. List A contains areas of investment where foreign ownership is limited by mandate of the Philippine Constitution and/or by specific laws. List B contains areas of investment where foreign ownership is limited for reasons of security, defense, risk to health and morals and protection of local small and medium scale enterprises.

The following are included in the Negative Lists of the FIA:

- Operation and ownership of public utilities (up to 40% foreign equity allowed)
- Retail Trade (no foreign equity allowed)
- The practice of licensed professions such as engineering (no foreign equity allowed)
- Ownership of private lands (up to 40% foreign equity allowed) and
- Advertising (up to 30% foreign equity allowed).

In respect of ownership and operation of public utilities, the Philippine Constitution provides that:

No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty percentum of whose capital is owned by such citizens, nor shall such franchise, certificate or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the governing body of a public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines.’ (underscoring supplied)

Pursuant to the Philippine Constitution, if the operation of the infrastructure or development facility requires a public utility franchise, the BOT Law requires that the project proponent must be a Filipino or a corporation registered with the SEC and owned up to a least 60% by Filipinos.

Philippine law does not provide an exact definition of a public utility. In the 1989 Supreme Court case of Albana v. Reyes (175 SCRA 264), 'public utility' was defined in a footnote only citing American Jurisprudence as follows:

A 'public utility' is a business or service engaged in regularly supplying the public with some
commodity or service of public consequence such as electricity, gas, water, transportation, telephone or telegraph service. Apart from statutes which define public utilities that are within the purview of such statutes, it would be difficult to construct a definition of a public utility which would fit every conceivable case. As its name indicates, however, the term public utility implies a public use and service to the public.

This means that the term ‘public utility’ may be subject to a broad interpretation. Other than utilities traditionally falling within the term public utility, it is not certain as to what activities fall within the term public utility.

Generally, the operations of the Project fall within the meaning of a public utility. Thus, foreign ownership of the Company is limited to 40% of its capital.

The Concession Agreement appears to imply that the Company will undertake both public utility activities and non-public utility activities.

Although the leasing of space for the operations of retail outlets or restaurants or for putting up advertising signs, in the terminal, are not nationalized or partially nationalized activities, engaging in retail, restaurant or advertising business are covered by nationalization laws. The transportation business is also considered a public utility business.

The limitations on foreign equity in corporations engaging in these activities are as follows:

- Operation and ownership of public utilities (up to 40% foreign equity allowed).
- Retail Trade (includes restaurant business) (no foreign equity allowed).
- Advertising (up to 30% foreign equity allowed).

(b) Anti-Dummy Law. Commonwealth Act No. 108 (as amended by Presidential Decree No. 715), otherwise known as the ‘Anti-Dummy Law’ imposes criminal and civil penalties to those violating nationalization laws. The Anti-Dummy Law prohibits, among others, foreign nationals from:

'interven(ing) in the management, operation, administration or control thereof, whether as an officer, employee or laborer therein with or without remuneration, except technical personnel whose employment may be specifically authorized by the Secretary of Justice'.

In addition, the Anti-Dummy law provides that:

'the election of aliens as members of the board of directors or governing body of corporations or associations engaging in partially-nationalized activities shall be allowed in proportion to their allowable participation or share in the capital of such entities'.

As a public utility, the operations and ownership of the Company are also covered by the Anti-Dummy Law.

This means that any arrangements with foreign nationals by the Company will have to be considered carefully. Foreign nationals may only be employed in technical positions after prior approval of the Secretary of Justice. All executive and management positions must be
occupied by Filipino citizens.” (emphasis added)

310. In its Executive Summary of the same due diligence report, QT stated:

"1. The operation and ownership of a public utility is reserved by the Philippine Constitution to Filipino citizens or to domestic corporations owned at least 60% by Filipinos. This means that foreign nationals can only own a maximum of 40% of the capital of a public utility. The operations of the Company generally fall within the term ‘public utility’. Thus, the direct equity investment of FAG together with the equity in the Company presently held by foreign nationals cannot exceed 40% of the outstanding capital stock of the Company. At present, the Company is owned 75% by Philippine nationals and 25% by foreign nationals.

2. The Anti-Dummy Law prohibits foreign nationals from, among others, intervening in the management, operation, administration or control of a company engaged in a partially nationalized activity (e.g. a public utility) except as technical personnel with specific authority from the Secretary of the Department of Justice. Further the Philippine Constitution provides that all executive and management positions in a public utility company must be occupied by Filipino citizens. However, foreign nationals are entitled to such number of directors [sic] in the board of a public utility in proportion to their actual and allowable equity in the Company. In view of the Anti-Dummy Law and the provisions of the Philippine Constitution, arrangements, other than mere equity investments between FAG and the Company, must be considered carefully.” (emphasis added)

311. Nine days later on 20 January 1999, the financial services firm of KPMG submitted to Fraport or FAG, as it was then known, a due diligence report on financial issues. In light of its extensive analysis, KPMG identified three alternatives for Fraport:

“Subject to the above milestone provisions, we believe that the following are the best alternatives open to FAG with regards to its role in NAIA Terminal 3:

1. Invest in the project and simultaneously take on the responsibility as Master Concessionaire.

Considering that we believe the Project is generally viable, this would appear to be the ideal alternative available to FAG. As Master Concessionaire, FAG would have the access and authority to manage the operation to ensure that their best interests are taken into account as an investor because of the planned majority shareholding structure with PAGS and Pair Cargo. More so considering that PIATCO does not possess the experience nor expertise to properly manage and coordinate the technical and commercial operations of an international airport terminal.

The dual role of investor and Master Concessionaire would minimise any agency problems and costs associated with FAG coming in only as an investor, hence we have not offered the latter as an alternative. We believe that considering FAG’s limited exposure in the Philippines taking a less active role than being actually part of the project as Master Concessionaire where it can readily protect its interests would not be prudent.
It should be noted, that at this time we are not in a position to offer further advice particularly on the structuring of FAG’s entry because this is beyond the confines of this engagement.

Upon entry, however, FAG should consider that PIATCO indicated that it would be heavily reliant on FAG as Master Concessionaire to realize the full potential of the Project upon operation. Consequently, the entry of FAG would require a substantial commitment of resources on a continuing basis covering not only the initial investment but other resources, such as funds and people, for its role as Master Concessionaire. The resources would be used formulating concepts, strategies and a business plan in the pre-operational phase and to manage the new terminal in the operational period.

This alternative offers 2 financial benefits - cash dividends and management fees. In terms of the latter, there is also significant potential for performance related compensation, should FAG desire to include such provisions in its contract as Master Concessionaire. In general terms, we believe that a fixed fee plus performance related compensation calculated on certain targets and milestones with full cost recovery would be an ideal structure. More definitive advice requires further study, which would fall under a separate engagement, as this would be beyond the current engagement scope.

2. Enter only as the contracted Master Concessionaire in exchange for a management fee.

We believe that this would be the next best alternative, although it does offer a more limited potential for profitability. As Master Concessionaire, FAG would profit only in terms of receiving management fees for its services. **The inherent risk covering this alternative is that unless FAG secures sufficient authority and leverage from PIATCO to make necessary changes, modifications and orders to better ensure the successful [sic] of their role and subsequent tasks as Master Concessionaire FAG may not really capture the full benefits under this alternative.**

Unless this is clarified and ensured at the outset, there is a significant potential for problems in meeting performance targets especially if certain FAG recommended facility specifications that are integral to successful airport terminal operations are not implemented. **If FAG believes that securing the necessary authority and leverage discussed above would be [a] problem, then only alternatives 1 and 3 should be considered.**

3. Do not invest in the Project and do not assume role of Master Concessionaire for the new terminal.

Although we believe that the Project is viable and has the good profit potential for its investors and participants, i.e. good chances of healthy performance related compensation, FAG always has this option if it feels that its expectations are not in the line with our findings.” (emphasis added)

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312. There is no indication in the record as to whether Fraport made the QT due diligence report available to KPMG.

313. Fraport's final report to its supervisory body of 26 February 1999 addressed the concerns of the KPMG report with respect to the preferred structuring of the investment from a financial perspective, but ignored the legal concerns which QT had expressed with respect to the ADL. The
proposed arrangements set forth in Fraport's final report did not comply with the legal requirements of Philippine law which QT had spelled out. Indeed, Fraport did not mince words, as the underscored segment indicates:

Under Philippine law, the share of non-Philippine capital in PIATCO may not exceed 40%. Currently, 25% are in non-Philippine ownership, with only 10% being up for sale. This means that FAG can have a maximum direct share in PIATCO of 25% (nominally 63.75 million DM). This investment is written into the Sale Purchase Agreement.

Within PIATCO, all shareholders will enter into a Shareholder Agreement that will also define the management appointments, voting rights and provisions for the acquisition and sale of shares.

Another Shareholder Agreement between FAG, PAGS, Paircargo and PTI makes sure that the above-mentioned parties will hold a majority of 51% in PIATCO. It also establishes that FAG will be consulted in matters that represent its core competencies (retailing, terminal operation). PAGS and Paircargo are willing to accept the professional advice of FAG in above-mentioned decisions as binding, which, however, cannot be enforced legally because of local laws. In order to reinforce this declaration of intent, the idea is for GlobeGround and FAG to conclude an additional agreement under German law making the provisions of the Shareholder Agreement binding on the mandate holders.

After the afore-mentioned transactions, PIATCO will only have a passive role, while the main activities will be controlled by PTI as concessionaire for operations and center management.

As a result of its direct investment in PIATCO of 25%, FAG will receive two seats on the Board out of eleven, and, as a result of the direct investment via PTI, it will receive two seats on the Board on behalf of PTI, one of which will be occupied by FAG. Together with the mandates of PAGS and Paircargo, the consortium will have six seats on the Board of PIATCO.

PIATCO will limit itself in the future to oversee compliance with all agreements and the agreement with the Government. The entire project management will be assigned to PTI, i.e. PTI will plan, build and operate the terminal. We have a joint 51% share in PIATCO via our partnership with PAGS and Paircargo. According to the agreements FAG will have financial and operating control over the project.

According to the agreements, FAG will assume the management function together with PAGS/ GlobeGround (see Fig. 2 and Fig. 3 for the following comments). In terms of dividing up the business, PAGS/GlobeGround will be responsible for anything to do with local dealings and FAG will be responsible for anything to do with the airport. The partners will be given the right to make proposals for management positions based on their respective responsibilities. The shareholders of PAGS have decided that GlobeGround V DLH will handle PAGS' management positions." (emphasis added)

314. Previously, on 19 January 1999, the PIATCO Master Concession Concept Brief had made the arrangement explicit:

"In compliance with the requirements of Asian Development Bank and Export-Import Bank of Japan (Senior Lenders), PIATCO intends to appoint a Master Concessionaire (MC) which will
be an entity controlled by an internationally-known airport terminal operator with proven recent experience in managing international airport terminals at least of the size and with the full management scope described herein. At this point, PIATCO is looking to Flughafen Frankfurt Main AG (FAG) to be the international airport terminal operator.

The MC may be a joint venture consisting of FAG and a Filipino company. The ratio of national to foreign participation should be in accordance with Philippine laws. **A shareholders agreement will have to secure the actual control by FAG as may be allowed by Philippine laws.** Actual control refers to full executive and management control by FAG. This requirement of actual control must be backed up by an undertaking from the shareholders of the MC in favor of PIATCO and Senior Lenders so that PIATCO and Senior Lenders can enforce such requirements. Changes to the shareholders agreement relating to FAG’s exercise of actual control of the MC will require PIATCO’s consent. FAG will be expected to guarantee the performance in all respects of the functions to be carried out by the Master Concessionaire.” (emphasis added)

315. Fraport’s Supervisory Board, which was charged with making the decision of whether to proceed with the project, was fully aware of the inconsistency of the proposed arrangements with Philippine law. In a document dated 7 March 1999, i.e. before its decision was taken, Dr. Werner Schmidt, a member of the Board wrote (“Comments on Investing in the Consortium for the Construction and Operation of Terminal 3 in Manila, Philippines” (Meeting of the Supervisory Board re Agenda Item 8 on March 12, 1999)):

"A. Control of the Consortium of Companies by FAG

The documents show that an actual majority shareholding by FAG is to be reached by investment in various nested equity interests and the granting of a shareholder loan to PAGS against a subordinate collateral. In fact, FAG’s equity interest shall total 64%. A ‘control agreement’ shall ensure that FAAG exercises control over the enterprise.

This is also absolutely necessary since KPMG points out repeatedly that the current owners are not in a position to ensure the proper operation of the airport.

In fact, however, such control is not practicable for legal reasons, as PIATCO’s legal due diligence states the following: ‘Foreign citizens are prohibited from intervening in the management, operation or control of the company...’ Moreover, the summary of the agreements contains the statement that ‘a decisive voting right of FAG would violate the anti-dummy law of the Philippines’.

Consequently, **FAG cannot legally enforce its intended leadership in this consortium.** This, however, is the most important prerequisite for the entire transaction.” (emphasis added)

316. Like the QT due diligence report, Werner Schmidt’s comments were ignored. Indeed, the legal problem to which he drew attention appears to have been ignored from the very outset; those concerned with designing the architecture of the Terminal 3 project always assumed, as did KPMG, that Fraport’s effective control of the project was vital for its success. In a letter dated 18 December 1998 from the Chairman and President of Fraport to a senior investment officer in ADB, i.e. one of the Senior Lenders, Fraport’s Chairman had summarized discussions with ADB as follows:
“(i) Single point operator for both airside and landside which is currently envisioned to be a company made up of FAG, Paircargo and PAGS (FPP). This company will be a 60/40 Filipino company in accordance with the requirements of Philippine Law.

(ii) Within the FPP, FAG will have effective control and responsibility for the performance of the master concessionaire.” (emphasis added)

317. Similarly, on 19 January 1999, Jesse Ang, then CFO of PIATCO, had written to John Archer, Department Head, Product, Marketing and Consulting of FAG, as Fraport was then named, referring to "the percentage ownership of FAG within FPP and the manner in which FAG will assume and retain effective control" (emphasis added). But the attached Concept Brief elaborated that "[a] shareholders agreement will have to secure the actual control by FAG as may be allowed by Philippine laws" (emphasis added).

318. Mr. Ang's letter referred to what was allowed by Philippine law. The problem was that the actual control and management that a Senior Lender, KPMG and Fraport's Supervisory Board understood to be necessary for the success of the investment was not compatible with the ADL, as QT had explained to Fraport.

319. Fraport proceeded to deal with this problem by implementing the strategy described in its confidential documents of concluding secret shareholder agreements that circumvented the relevant Philippine law. A confidential shareholders agreement between it, Paircargo, PAGS and PTI, concluded on 6 July 1999, characterized by the Respondent as the "Control Agreement" or "Pooling Agreement", provided in Article 2.02:

"2.02 The Shareholders' or their directors' vote shall be determined in accordance with the following rules:

(1) Within a reasonable time prior to the date set for a stockholders’ or board meeting, the Shareholders shall have their own preliminary meeting for the purpose of extensive discussions and deliberations on the matters to be put to a vote. During the preliminary meeting, the Shareholders shall thoroughly discuss all the possible consequences of an affirmative and of a negative note, with a view to arriving at a unanimous vote. The position of each Shareholder during the preliminary meeting shall be given equal weight (i.e., FAG, PAIRCARGO, PAGS and PTI shall have one vote each).

(2) In case the Shareholders are unable to reach a common position,

(a) The Shareholders shall consult FAG and FAG may make recommendations in relation to any of the following matters (which matters fall within FAG’s area of expertise and competence):

(i) the implementation of the O&M Agreement, as executed;

(ii) the operation, maintenance and management of the Terminal Complex;

(iii) the conduct of commercial operations within the Terminal Complex in the ordinary course of business.
The Shareholders shall thereafter act upon the recommendations of FAG.

(b) in all other matters not covered by (a) above, the issue shall be submitted to the respective boards of directors of the Shareholders for further independent deliberations. If the position taken by the boards of directors is not unanimous, unless the Shareholders thereafter agree to postpone any action on the matter, the issue shall be submitted for resolution by three (3) arbitrators appointed under and acting pursuant to the Rules of Arbitration of the International Chamber of Commerce. Arbitration shall be for the purpose of determining the course of action most favorable to the interests of the Shareholders and most consistent with Article 1.02. The place of arbitration shall be Singapore and the language of arbitration shall be English. Arbitration shall be concluded within sixty (60) days from submission.

The following, without limitation, shall be deemed matters not covered by (a) above: the amendment of the Corporation's Articles of Incorporation or By-laws; the amendment of the PIATCO Shareholders' Agreement; the dividend policy of the Corporation a public offering of the shares of stock of the Corporation the election of directors, the appointment of officers; the formation of committees and their composition the appointment of and entering into contracts with consultants, advisers and external auditors; the maintenance of corporate accounts; the designation of authorized representatives and check signatories; the conduct of business outside the Terminal Complex, such as hotels, convention centers and jewelry manufacturing; relations with GRP in matters not falling under (a) above."

Under Article 1.07 of the above-quoted FAG-PAIRCARGO-PAGS-PTI Shareholders' Agreement, strict confidentiality was undertaken:

"1.07 The Shareholders shall keep the terms and conditions of this Agreement strictly confidential and undertake not to disclose the contents hereof to any third party without the prior written consent of the other Shareholders, except to the extent necessary in order to perform their obligations hereunder or to enforce the provisions hereof."

A second relevant agreement was the Addendum to the PIATCO Shareholders' Agreement of 6 July 1999. Article 9 of the Addendum gave "exclusive authority" to Fraport as finance arranger:

"Notwithstanding any provision in the Shareholders Agreement to the contrary, FAG shall be the finance arranger for the Project and shall have the exclusive authority to determine the financial arrangements for the Project, if necessary, including the nomination of the Company's financial advisers, on terms and conditions not disadvantageous to the Company. Articles 7.1.2, 7.1.4 and 8.1.18 shall not be construed to include and shall not apply to the financial arrangements to be undertaken or arranged by FAG for the Company. FAG hereby undertakes to obtain debt financing for the Project from third party Project Lenders and undertakes to work for a successful financial closing. However, FAG shall not be responsible for any event or circumstance beyond its control. FAG acknowledges the fact that the Company has, to date, expended substantial sums of money in an effort to obtain a successful debt financing from international financial institutions."

The Tribunal notes that this agreement, while it does not contain a confidentiality clause, was only
produced to the Tribunal in January 2006 during the hearing on jurisdiction and liability, at the President’s request and insistence.

323. The Tribunal need not refer to the other secret agreements which were only discovered in January 2006. Indeed, the above-quoted agreements and, in addition, the Claimant’s own internal documents show that Fraport was consciously, intentionally and covertly structuring its investment in a way which it knew to be a violation of the ADL. Fraport’s equity investment in terms of the statutorily limited percentage in the Terminal 3 project was lawful under Philippine law. Fraport’s controlling and managing the investment was not. Despite having been advised and plainly understanding this, Fraport secretly designed its investment in the project so as to have that prohibited management and control, in particular by reserving to itself the ultimate authority as a shareholder in PIATCO to decide those matters set out in subparagraphs (i), (ii) and (iii) of Article 2.02 (2) (a) of the FAG-PAIRCARGO-PAGS-PTI Shareholders’ Agreement of 6 July 1999.

324. In a meeting on 14 December 1999, Herr Vogel posed a number of questions to QT, once again indicating Fraport’s awareness of a concern about violations of the ADL. A week later, in a letter of 21 December 1999, the law firm of QT responded. QT stated the question posed to it as follows (at page 1):

"We understand that together with SB Capital Investment Corporation (‘SB Capital’) and using appropriate legal structures/vehicles, FAG is contemplating acquiring 26% of PIATCO. FAG currently directly owns 25% of PIATCO. We understand that other foreign shareholders, namely Chuan Hup Incorporated (‘Chuan Hup’) and Nissho Iwai Corporation (‘Nissho Iwai’) own 10% and 5% of PIATCO respectively. Chuan Hup may be selling its 5% of PIATCO. We further understand that the other 21% will be purchased from the other shareholders.

16. You inquire in respect of the following:

1. To what possible extent may foreigners assume positions in public utility companies?"

325. QT, in answering the first question, reviewed the relevant Philippine constitutional law and then stated (at page 3-4):

"However, the constitutional provision should be read in conjunction with the Anti-Dummy Law which appears to contain a more rigid prohibition in respect to alien employment in public utility companies. Under the AntiDummy Law, in respect of nationalized and partially nationalized activities, foreign nationals are prohibited from intervening in the management, operation, administration or control of the business, whether as an officer, employee or laborer, with or without remuneration, except:

a. technical personnel whose employment may be specifically authorized by the Secretary of Justice; and

b. as members of the board of directors of the corporation in proportion to their actual and allowable equity participation.

23 These secret shareholder agreements include a shareholders’ agreement amongst PTH Inc. and FAG dated 6 July 1999, as well as a shareholders’ agreement amongst PAGS and FAG of the same date.
In this regard the Supreme Court has held in the case of *King v. Hernaez (4 SCRA 792)* that the words ‘management, operation, administration and control,’ followed by the words ‘whether as an officer, employee or laborer’ in the nationalized or partially nationalized business enterprise signify that the employment of a person who is not a Filipino citizen even in a minor or clerical or non-control position is prohibited.

Based on the foregoing, it appears that aside from holding positions in PIATCO’s board of directors in proportion to its share in PIATCO’s equity,

FAG’s representatives can only be appointed to technical positions in PIATCO’s enterprise, upon prior approval by the Secretary of Justice.

Included among the allowable positions is that of Chairman of the Board of Directors because, generally, the Chairman is the head of the board of directors.

In respect of technical personnel in public utility companies, the Department of Justice (“DO”x) has held that the criteria used by the DO in granting specific authorization to employ alien “technical personnel” in a nationalized business or activity are: whether the position sought to be filled is technical in nature, taking into consideration the duties involved therein, and whether the applicant possesses the required qualifications. In this connection, it may be stressed that DO, in construing the term “technical personnel” to determine whether it applies to a given situation usually refers the application for employment of technical personnel in partly nationalized undertakings to the government office that exercises supervision over the employing corporation for its comment and recommendation (DOX Opinion No. 120, dated 30 June 1982). Thus, if FAG would like to have representatives appointed to positions outside of PIATCO’s board of directors, the employment of these representatives would have *sic* authorized by the DOX as technical personnel. The DOX will likely refer this matter for recommendation by the Department of Transportation and Communications.” (emphasis added)

326. The preliminary meeting required in Article 2.02 (1) of the FAG-PAIRCARGO- PAGS-PTI Shareholders’ Agreement of 6 July 1999, which ensured Fraport’s control over the items specified in Article 2.02 (2) thereof, was not consistent with the ADL. The actual board meeting in which the other shareholders were obliged to act in accordance with the confidential preliminary meeting was no more than a rubber stamp of “the recommendations of FAG”. The confidentiality clause contained in this shareholder agreement indicates that Fraport’s strategy was to conceal its illegal control from the Philippine authorities.

327. In summary, Fraport had been fully advised and was fully aware of the ADL and the incompatibility with the ADL of the structure of its investment which it planned and ultimately put into place with the secret shareholder agreements.

328. The Claimant had opportunities to provide an explanation in this regard during the hearing. The relevant part of the cross-examination on 10 January 2006 of Mr. Bender, Chairman of Fraport’s Executive Board, follows:

“1320
Q. Sir, let me ask you another question based on that same paragraph on page 5, the third bullet point.

Do you see, sir, the sentence there that states, PAGS and Paircargo are willing to accept the professional advice of Fraport in above-mentioned decisions as binding which, however, cannot be enforced legally because of local laws?

A. Yes, I see it.

Q. So, sir, in fact, Fraport, PAGS, Paircargo, and PTI were agreeing to certain provisions that were not enforceable legally under Philippines law; correct?

A. No. That is not correct because if I see this correctly, this dates back to February 26, '99, and only after that we received counsel by the Philippines attorneys, and then all the agreements were entered into were then based on the legal advice that we received, and for that reason this is not an agreement, but this is just the way the considerations were in February of 1999, and later on the agreements, of course, were reworded and
7 rephrased.

8 Q. Sir, at this point in time, in this
document, executives of Fraport were proposing that
Fraport enter into an agreement that it knew was
not enforceable legally under Philippines law;
correct?

13 A. No, that is an erroneous quote. This part
of this sentence, however, cannot be enforced
legally because of local law.

16 Q. Is that an accurate statement in this
document?

18 A. Yes, I just quoted from this document.

19 Q. And that was your understanding of the
situation at this point in time, in March of 1999?

21 A. Yes. This was in February of '99, by the
way, not in March, and that was the state of the

considerations at that point in time, and it was
clear that there is an Anti-Dummy Law imposing
certain restrictions in terms of the rights of the
Fraport AG, and then based on counsel's advice,
which we didn't have at that point in time, but
received later on. Based on counsel's advice, then
we worded the agreements to be in accordance and in
agreement with Filipino law.

9 Q. Sir, you referred a couple of times to
10 advice under Philippines law in connection with
11 these terms. Have you ever seen any written
12 Philippine law opinions with regard to those terms?
13 A. I don't remember exactly, but I don't
14 think so that I have seen that, but they reported
15 our project managers and the employees responsible
16 for the project reported to the executive board
17 that the contracts are in line with the Philippine
18 law, and also told us that we had this advice by QT
19 law firm."

329. No document from the firm of QT supporting the above-quoted statement that the secret shareholder agreements at issue were "in line with the Philippine law" is to be found in the extensive record of this arbitration. The documents which were produced to the Tribunal, all of which emanate from Fraport, contradict this statement insofar as they were even responsive to the questions posed. It seems that the Republic of the Philippines is factually correct in its Post-Hearing Memorandum when it says "[n]ot only is there is no evidence of any counsel's review of the shareholder agreements in 1999, the record shows that every Philippine lawyer who looked at Fraport's shareholder agreements after that time advised that they violated the Anti-Dummy Law".

330. In 2001, as noted earlier, Fraport, anxious to secure a loan from a consortium, referred to as the Senior Lenders, which would reduce its own financial exposure, was again advised, this time by legal counsel for the Senior Lenders, of the incompatibility of its arrangements with the ADL. The due diligence report of the law firm of SyCip, which was not produced to the Tribunal, is, however, referred to in the email traffic between officials of Fraport which is part of the record before the Tribunal. Thus every legal due diligence report with respect to the way that Fraport had elected to structure its investment in PIATCO confirmed that it was in violation of the ADL and thus in violation of Philippine law.

331. On 2 June 2001, after the SyCip report, Mr. Bernd Struck, Fraport's Executive Vice President, wrote a stern letter to QT:

"Having received your report of the meeting held with the counsel of the Senior Lenders, I am deeply concerned about the way, how the position of Fraport in the NAIA IPT III Project is threatened by issues under the Anti Dummy Law. The same is true in relation to the Second Addendum, where we had discussed the Anti Dummy Law issues extensively before we learned that the nomination rights structure already adopted on the level of PIATCO and on the level of PTI might constitute a breach of the Anti Dummy Law.

Fraport is a foreign investor and cannot be familiar with the Philippine laws and regulations.
We have to rely on the legal advice obtained on the Philippines and in particular from your
distinguished law firm. Large parts of the contractual structure of our investment have been
crafted by your distinguished firm, and the amounts at risk are paramount if something goes
wrong because of a possible non-compliance with the local law.

We therefore expect that the advice obtained from your firm is consistent and provides us
with a firm legal basis which enables you and us to defend the structures created against any
attack from whatever side. If you find out that certain contemplated structures are not, or
may not be, in line with Philippine law, we wish that you warn us early enough, and that you
advise us early enough on safe alternatives to achieve our goals. Please understand that it is
not acceptable for us if resolutions which have been adopted, and which have been prepared
by you, are questioned thereafter, or if contractual structures on which you have advised are
questioned by the Senior Lenders or any other party without being vigorously defended by
you against any attack whatsoever.

Please make sure that Quisumbing Torres is represented by partners familiar with our Project
and the contracts concluded in relation thereto during all upcoming discussions with the
Senior Lenders' counsels, and I would very much appreciate your personal attendance during
these meetings.

Please make also sure that whoever will join these meetings shall have all necessary
information and shall defend vigorously the legality of the agreements entered into during
the course of this Project."

332. Whatever Mr. Struck's personal knowledge may have been, considering the documents which have
been excerpted in the previous pages of this Award and, in particular, Werner Schmidt's statement
to Fraport's Supervisory Board when it was considering the investment, the Tribunal cannot see
how the highest executive levels of Fraport can evade their own responsibility and attribute
responsibility for its problems to a mistake of QT, some obscurity on this point in Philippine law, or
Fraport's misunderstanding of QT's warning. It is especially difficult to see how the highest
executive levels of Fraport can plausibly claim not to have been aware of the advice previously
given and confirmed in the communication of Werner Schmidt regarding the incompatibility of the
arrangements that Fraport had concluded with PIATCO with the legal requirements of the
Philippines. The Tribunal is persuaded from Fraport's own internal and contemporaneous
documents that it was consistently aware that the way it was structuring its investment in the
Philippines was in violation of the ADL and accordingly sought to keep those arrangements secret.

333. While this factual record is troubling, it does not eo ipso mean that the Tribunal is without
jurisdiction ratione materiae to hear the substance of the claim. The Tribunal's task is to make this
determination in accordance with applicable legal standards, which are considered next.

C. The Applicable Legal Standards

334. As observed earlier, the BIT at issue in this arbitration has a jurisdictional limitation ratione
materiae to which the Tribunal now turns.
335. Article 1(1) of the BIT provides that for the purpose of this Agreement "[t]he term investment' shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State [...]". The qualification "accepted in accordance with the respective laws and regulations of either Contracting State" applies to every form of investment covered by the BIT. Article 2(1) provides:

"Each Contracting State shall promote as far as possible investments in its territory by investors of the other Contracting State and admit such investments in accordance with its Constitution, laws and regulations as referred to Article 1, paragraph 1. [...]"

336. The Protocol to the Agreement, which was concluded on the same day as the BIT, states in reference to Article 2:

"As provided for in the Constitution of the Republic of the Philippines, foreign investors are not allowed to own land in the territory of the Republic of the Philippines. However investors are allowed to own up to 40% of the equity of a company which can then acquire ownership of land."

337. The Republic's Instrument of Ratification, which was exchanged with Germany on 10 July 1997, provided:

"KNOW YE, that whereas, the Agreement between the Republic of the Philippines and the Federal Republic of Germany for the Promotion and Reciprocal Protection of Investments was signed in Bonn on 18 April 1997;

WHEREAS, the Agreement, consisting of eleven (11) Articles, seeks to promote, protect and create a favorable condition for investments by investors of one Contracting Party in the territory of the other Contracting Party based on the principle of mutual respect for sovereignty, equality and mutual benefit;

WHEREAS, the Agreement provides that the investment shall be in the areas allowed by and in accordance with the Constitutions, laws and regulations of each of the Contracting Parties;

WHEREAS, the Agreement also provides for the free transfer of investments and returns thereto out of the Contracting Parties territories;

WHEREAS, Article 11 of the Agreement provides that it shall enter into force on the first day of the second month following the date of exchange of the German instrument of ratification and the Philippine notification of approval;

NOW, THEREFORE, be it known that I, FIDEL V. RAMOS, President of the Republic of the Philippines, after having seen and considered the aforementioned Agreement Between the Republic of the Philippines and the Federal Republic of Germany for the Promotion and Reciprocal Protection of Investments, do hereby ratify and confirm the same and each and every Article and Clause thereof.

IN TESTIMONY WHEREOF, I have hereunto set my hand and caused the seal of the Republic of the Philippines to be affixed.” (emphasis added)
Because the exchange of instruments of ratification puts a treaty into effect in accordance with its terms, the second preambular paragraph emphasized above is particularly important in regard to the issue at bar.

While all of these provisions are manifestly limitations *ratione materiae*, their interpretation is not simple. Article 31 of the Vienna Convention on the Law of Treaties enjoins interpretation of particular provisions in their context, *i.e.* with reference to the rest of the treaty and in the light of its objects and purposes. The fact that there are three explicit references in the total of 16 provisions in the Treaty and Protocol plus an additional reference in the Instrument of Ratification, which selected only four items in the treaty deemed so important to the Philippines as to require additional recitation, indicates the significance of this condition. The parties had in mind explicit constitutional limitations in the Philippines. Article 2 of the Protocol as well as the Instrument of Ratification make that clear beyond peradventure of doubt.

It is also clear that the parties were anxious to encourage investment, which was the *raison d'etre* of the treaty. But while a treaty should be interpreted in the light of its objects and purposes, it would be a violation of all the canons of interpretation to pretend to use its objects and purposes, which are, by their nature, a deduction on the part of the interpreter, to nullify four explicit provisions. Plainly, as indicated by these four provisions, economic transactions undertaken by a national of one of the parties to the BIT had to meet certain legal requirements of the host state in order to qualify as an “investment” and fall under the Treaty.

There are some linguistic differences between the provisions. In the equally authentic German version of the Treaty, the same verb “zulassen” is used in both Article 1 and Article 2, while the English version uses two different verbs: “accept” and “admit” in Articles 1 and 2, respectively. Article 1(1) refers to investments “accepted in accordance with the respective laws and regulations of either Contracting State”. Article 2(1) obliges each state to “admit such investments in accordance with its Constitution, laws and regulations as referred to in Article 1, paragraph 1”. The Instrument of Ratification states that “[t]he Agreement provides that the investment shall be in the areas allowed by and in accordance with the Constitutions, laws and regulations of each of the Contracting Parties”.

But lest any difference be inferred from the use of two different verbs in the English version, the Tribunal would note that the chapeau of Article 2 is “Promotion and Acceptance” and “acceptance” is the verb used in Article 1 (the chapeau of Article 1 is “Definition of Terms”). Thus, this linguistic difference does not appear to indicate an intentional nuance and hence to be legally significant. Article 2 refers to the Constitution, as well as laws and regulations; Article 1 uses a generic reference to laws and regulations. Here again, the difference does not appear significant. The Instrument of Ratification of the Philippines which is only in English does not include the word “acceptance” but simply requires that investments be “in the areas allowed by and in accordance with [...]”.

Broadly speaking, there are two types of international investments. The first is comprised of an investment based on or accompanied by some explicit agreement with or unilateral communication from the host state; the second involves an investment in the market of the host

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state without an accompanying specific agreement between the investor and the government of the host state. The English version of the BIT might be read as applying Articles 1(1) and 2(1) only to the first type of investment. But such a construction would seem unreasonable and even doubtful for a number of reasons. First, it is unlikely that state parties would insist on compliance with their respective constitutions, laws and regulations only with respect to the first type of investment but would, at the same time, discharge potential investors from such compliance with respect to the quite common type of investments in the second category. Second, ad Article 2 of the Protocol, which elaborates Article 2 of the Treaty, relates to purchasing shares in a company which might then acquire land in the territory of the Republic. The acquisition of shares by a foreign investor in a domestic corporation is a legal transaction that does not, by its nature, involve some action by the government involving acceptance or permission. Third, the Instrument of Ratification uses a comprehensive formulation: “the investment shall be in the areas allowed by and in accordance with [...]”. So it would appear that the material restrictions on investments relate both to investments of the first and second types.

344. With respect to the temporal extension of the condition in the relevant provisions of the BIT, it has been contended by the Respondent and some of its experts that an investment, in order to maintain jurisdictional standing under the BIT, must not only be “in accordance” with relevant domestic law at the time of commencement of the investment but must continuously remain in compliance with domestic law, such that a departure from some laws or regulations in the course of the operation of the BIT would deprive a tribunal under the BIT of jurisdiction.

345. Although this contention is not relevant to the analysis of the problem which the Tribunal has before it, namely the entry of the investment and not the way it was subsequently conducted, the Tribunal would note that this part of the Respondent's interpretation appears to be a forced construction of the pertinent provisions in the context of the entire Treaty. The language of both Articles 1 and 2 of the BIT emphasizes the initiation of the investment. Moreover the effective operation of the BIT regime would appear to require that jurisdictional compliance be limited to the initiation of the investment. If, at the time of the initiation of the investment, there has been compliance with the law of the host state, allegations by the host state of violations of its law in the course of the investment, as a justification for state action with respect to the investment, might be a defense to claimed substantive violations of the BIT, but could not deprive a tribunal acting under the authority of the BIT of its jurisdiction.

346. There is, however, the question of estoppel. Principles of fairness should require a tribunal to hold a government estopped from raising violations of its own law as a jurisdictional defense when it knowingly overlooked them and endorsed an investment which was not in compliance with its law.

347. But a covert arrangement, which by its nature is unknown to the government officials who may have given approbation to the project, cannot be any basis for estoppel: the covert character of the arrangement would deprive any legal validity (assuming that informal and possibly contra legem endorsements would have legal validity under the relevant law) that an expression of approbation or an endorsement might otherwise have had. There is no indication in the record that the Republic of the Philippines knew, should have known or could have known of the covert arrangements which were not in accordance with Philippine law when Fraport first made its investment in 1999.

348. Having set forth the legal standards applicable to its jurisdictional analysis, the Tribunal now turns to its interpretation of the ADL.
D. The Tribunal's Interpretation of the ADL

349. While the relevant provisions of the ADL have been set out earlier in this chapter, the Tribunal deems it useful to reproduce here, in extenso, Commonwealth Act No. 108, entitled An Act to Punish Acts of Evasion of the Laws on the Nationalization of Certain Rights, Franchises or Privileges, commonly known as the Anti-Dummy Law:

"SEC. 1. In all cases in which any constitutional or legal provision requires Philippine or any other specific citizenship as a requisite for the exercise or enjoyment of a right, franchise or privilege, any citizen of the Philippines or any other specific country who allows his name or citizenship to be used for the purpose of evading such provision, and any alien or foreigner profiting thereby, shall be punished by imprisonment for not less than five nor more than fifteen years, and by a fine of not less than the value of the right, franchise or privilege, which is enjoyed or acquired in violation of the provisions hereof but in no case less than five thousand pesos.

The fact that the citizen of the Philippines or of any specific country charged with a violation of this Act had, at the time of the acquisition of his holdings in the corporations or associations referred to in section two of this Act, no real or personal property, credit or other assets the value of which shall at least be equivalent to said holdings, shall be evidence of a violation of this Act.

SEC. 2. In all cases in which a constitutional or legal provision requires that, in order that a corporation or association may exercise or enjoy a right, franchise or privilege, not less than a certain per centum of its capital must be owned by citizens of the Philippines or of any other specific country, it shall be unlawful to falsely stimulate the existence of such minimum of stock or capital as owned by such citizens, for the purpose of evading said provision. The president or managers and directors or trustees of corporations or associations convicted of a violation of this section shall be punished by imprisonment of not less than five nor more than fifteen years, and by a fine of not less than the value of the right.

SEC. 2-A. Any person, corporation, or association, which having in its name or under its control, a right, franchise, privilege, property or business, the exercise or enjoyment of which is expressly reserved by the Constitution or the laws to citizens of the Philippines or of any other specific country, or to corporations or associations at least sixty per centum of the capital of which is owned by such citizens, permits or allows the use, exploitation or enjoyment thereof by a person, corporation or association not possessing the requisites prescribed by the Constitution or the laws of the Philippines; or leases, or in any other way, transfers or conveys said right, franchise, privilege, property or business to a person, corporation or association not otherwise qualified under the Constitution, or existing laws; or in any manner permits or allows any person, not possessing the qualifications required by the Constitution, or existing laws to acquire, use, exploit or enjoy a right, franchise, privilege, property or business, the exercise and enjoyment of which are expressly reserved by the Constitution or existing laws to citizens of the Philippines or of any other specific country, to intervene in the management, operation, administration or control thereof, whether as an officer, employee or laborer therein with or without remuneration except technical personnel whose employment may be specifically authorized by the Secretary of Justice, and any person who knowingly aids, assists, or abets in the planning,
consummation or perpetration of any of the acts herein above enumerated shall be punished by imprisonment for not less than five nor more than fifteen years and by a fine of not less than the value of the right, franchise or privilege enjoyed or acquired in violation of the provisions hereof but in no case less than five thousand pesos: Provided, however, That the president, managers or persons in charge of corporations, associations or partnerships violating the provisions of this section shall be criminally liable in lieu thereof: Provided, further, That any person, corporation or association shall, in addition to the penalty imposed herein, forfeit such right, franchise, privilege and the property provisions of this Act: And Provided, finally, That the election of aliens as members of the board of directors or governing body of corporations or associations engaging in partially nationalized activities shall be allowed in proportion to their allowable participation or share in the capital of such entities."

(emphasis added)

The Tribunal need hardly add that statutory interpretations are never to be made in hypothetical legislative vacuums. Each interpretation must be made in the light of the Constitution and the ensemble of legislation of which a particular statute is a part.

350. The issue upon which the Tribunal focuses in connection with the ADL is not to be found in the fact that Fraport may have exceeded the statutorily determined level of equity investment lawfully permitted to a foreign investor in a constitutionally defined category of public utilities. In the view of the Tribunal, Fraport did not. Nor did Fraport violate the “in accordance” requirement of the BIT in that it may have loaned “too” much money to the public utility in question. Neither of these actions, both essentially quantitative, translates *per se* into managerial control over a modern corporation. But the FAG-PAIRCARGO-PAGS-PTI Shareholders’ Agreement of 6 July 1999, set forth earlier in this Award, does.

351. That agreement makes the preliminary meeting of the shareholders the moment of actual decision: the board meeting that follows it simply endorses the outcomes. At the preliminary meeting, two things which sound in the ADL happen: first, the actual voting weight according to the percentage of shares held (which is subject to a statutory cap under Philippine law) is ignored and replaced by an equalization of the voting power of each of the shareholders (“The position of each Shareholder during the preliminary meeting shall be given equal weight (i.e., FAG, PAIRCARGO, PAGS and PTI shall have one vote each).”). Second, even then, if the shareholders do not agree, Fraport's view is controlling with respect to the matters itemized in Article 2.02 (2). In short, for those items, Fraport secures managerial control in violation of the ADL.

352. It is clear from the texts of the ADL, as confirmed by the QT due diligence report, that it was managerial control which was the concern of the Constitution and the ADL; quantitative findings such as the percentage of equity investment were simply “significant indicators” or “badges” as Philippine law puts it. In terms of quantitative findings, Fraport is correct that the Republic’s relaxation of the quantitative test was especially clear after the abrogation of the “Grandfather Rule” for computing, for ADL purposes, the percentage of foreign equity (which seemed to create a strong legal presumption) and the adoption of the so-called “Control Rule”. The “Control Rule”, the shorthand reference in Philippine law for the replacement of the Grandfather Rule, is a misleading rubric, for it does not involve an empirical examination to determine whether a foreign investor

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actually exercises managerial control. It simply uses a more lenient non-cumulative quantitative test for computing the permissible equity ceiling and does not turn the new quantitative test into an irrebuttable presumption, as might have been inferred from Department of Justice Opinion No. 165.

353. Nothing in the record even suggests that the relaxation of the quantitative test of the Grandfather Rule by the introduction of the more lenient Control Rule can be interpreted to mean that the relevant constitutional provision and the ADL prohibiting managerial control ceased to be applicable. None of the lawyers consulted by Fraport in the various due diligences it commissioned assumed that the constitutional provision and the ADL had lapsed by operation of desuetude. Quite the contrary. Nor is there anything in the National Bureau of Investigation ("NBI") or DOX documents, i.e. the record established as part of the ADL proceedings, to which the Tribunal will turn below, to suggest that the agencies of the Philippine Government hold that view.

354. Under Philippine law, there are two ways of establishing an ADL violation:

   *first*, a quantitative test (whether the numerical threshold applied is the cumulative one in the Grandfather Rule or the non-cumulative one in the Control Rule), which, if violated, leads to a *praesumptio juris*; or

   *second*, an actual demonstration of managerial control, in which case the quantum of equity in the company is irrelevant.

In other words, if a foreign investor owned, let us say, 15% of the equity of a public utility, but had secret managerial and control agreements with the Philippine component, that would constitute a violation of the ADL.

355. The first way is only a means of inferring the second way. The only relevant change in Philippine law was with respect to the quantitative way of establishing a violation, i.e. replacing the cumulative computational formula of the Grandfather Rule with the more generous, non-cumulative formula of the Control Rule. The Tribunal's concern here is not with Fraport's quantitative equity; it is with the secret shareholder agreements. In the context of the internal Fraport documents, the secret shareholder agreements show that Fraport from the outset understood, with precision, the Philippine legal prohibition but believed that if it complied with it, the prospective investment could not be profitable. So it elected to proceed with the investment by secretly violating Philippine law through the secret shareholder agreements. These agreements evidence that Fraport planned and knew that its investment was not "in accordance" with Philippine law.

356. It is correct that Fraport's real modality of intervention in "the management, operation, administration or control" of PIATCO for the items specified in the FAG-PAIRCARGO-PAGS-PTI Shareholders' Agreement is as a shareholder in the confidential but binding preliminary meeting described at Article 2.02 thereof. Fraport does not, as the ADL specifies, intervene "as an officer, employee or laborer" in the subsequent formal board meeting that rubber-stamps the result of the confidential but binding meeting. To be sure, the formal modality of unlawful intervention would still be accomplished by Fraport's designated officer in PIATCO; indeed the real control decision would always have to be implemented, wherever it may have been made, by "an officer, employee or laborer" within PIATCO; that would satisfy a literal interpretation. But a literal interpretation...
here could produce an absurdity: an alien would violate the ADL if its designated officer intervened to manage and control matters A, B and C, but the same alien would not violate the ADL if it secretly intervened as a shareholder to manage and control those same matters. The Tribunal construes this part of the ADL as covering intervention by shareholders, if that is the actual means of intervening in “the management, operation, administration or control” of PIATCO. Nor does this interpretation impose a retroactive burden on Fraport, for its own documents, which the Tribunal reviewed above, indicate that Fraport was well aware that the arrangements it was making were not in accordance with the ADL.

E. The ADL Proceedings in The Philippines

357. In 2003, two Philippine lawyers, Messrs. Balayan and Bernas, complained to the NBI that the officers and directors of Fraport and PIATCO had violated the ADL, referring to the fact that Fraport owned 61.44% of PIATCO’s shares. As the NBI Report makes clear, “[t]he procedures instituted by the NBI in response to the complaints of Balayan and Bernas] are merely to gather facts and evidence to determine the need to refer the matter to the Prosecutor's Office for Preliminary Investigation”.

358. The "sole express basis" for the ADL complaints rested on statements in the Request for ICSID arbitration. The documents submitted to the NBI, which are listed at pages 7-13 of the Report, did not include the secret shareholder agreements nor Fraport’s internal documents which have been set out above. Indeed, the NBI received an affidavit to the contrary. The NBI Report records:

"Subjects CHENG ONG, ET. [sic] al., likewise alleged that none of them are bound by any contract commitment or undertaking to allow Fraport AG to, in any manner, exercise legal rights reserved under Philippine law to Philippine citizens or Philippine nationals. They further alleged that Complainants have failed to even insinuate the existence of any such contract, commitment or undertaking, much less submit any evidence thereof."

359. This was not correct, as is clear from the documents which the Tribunal has set out above.

360. The arguments considered in the NBI Report about immunity and the admissibility of the Request for ICSID arbitration, whose equity share descriptions were the basis of the two ADL complaints, are not relevant for the Tribunal’s inquiry. The NBI Report concluded that there had been a violation by Fraport of the quantitative test of the Grandfather Rule. But the ratio of the NBI Report was that the annulment of the PIATCO concession by the Supreme Court before Fraport could have exercised the potential managerial control it had acquired, which the NBI inferred from the quantitative indicators, rendered the ADL violation moot. The NBI Report nonetheless recommended prosecution on the basis of the Respondents "intent".

361. As a matter of Philippine law, the NBI Report is plainly incorrect in its application of what had become the obsolete "Grandfather" quantitative test. But more important for the analysis of the Tribunal is that the NBI could have known nothing of the secret shareholder agreements, which were only produced in the present arbitration in December 2005 and January 2006. Yet the existence of the secret shareholder agreements was the critical factor for answering the question of whether there was a violation of the ADL.
362. The NBI Report was issued in June 2004. Eighteen months later, the Prosecutor rejected the NBI recommendation in his report which was issued on 27 December 2006.

363. Again, the jurisdictional and admissibility issues in that latter Prosecutor’s Report are not relevant for the analysis of the Tribunal. The Prosecutor summarized the Bernas and Balayan complaints as based on a quantitative violation of the ADL: Fraport’s equity exceeded 60% by its own admission and would exceed 71% if the holdings of Nissho Iwai were included. The Chengs rejected this Grandfather type computation and, more relevantly, said:

"The Board of Directors of the said corporations are controlled by Filipino citizens to the extent of at least 60% of the total number of members of the said Board.

The FRAPORT’s financial contribution and technical support to the PIATCO are completely irrelevant in so far as the Anti-Dummy law was concerned since none of those have been attended by an unlawful level of control over PIATCO’s board of directors or management. The officers of PIATCO are all Filipino citizens and they never acted as fronts or FRAPORT AG’s dummy or lending their names for FRAPORT AG’s benefit. Any allegations, statements or act made by FRAPORT AG before ICSID is not binding upon them as they are not parties thereto."

364. This was consistent with the Cheng’s submission to the NBI, which is quoted above. It is an accurate statement of Philippine law but a misrepresentation of the critical facts.

365. The Prosecutor stated that “it is obvious that the complainants erroneously used the Grandfather Rule”. The Prosecutor relied upon the Foreign Investments Act, which adopts a non-cumulative and more lenient quantitative test and quoted approvingly an SEC opinion of 23 November 1993 which affirms the non-cumulative computation for the equity of the foreign investor, subject however to an important proviso: "provided, however, that the voting and Board membership requirements under Section 3 R.A. 7042 are complied with." The Prosecutor applied the same lenient quantitative test with respect to loans by a foreign investor to a public utility type corporation the issue was not quantum but “what is prohibited is the engagement by the alien himself of a nationalized activity” (emphasis added).

366. The Prosecutor agreed that if the Terminal concession had been annulled, the ADL could not be applied. But the Prosecutor’s rejection of the NBI report was centrally based upon the applicability of the more lenient non-cumulative computational formula and not on the secret shareholder agreements. At page 10 of the Report, the Prosecutor states, in what is the central holding:

"From the foregoing corporate structure of PIATCO, it is far-fetched that a foreign corporation like FRAPORT could gain dominion, control and ascendancy in the management or control of PIATCO considering 60% of its shares are owned by Filipinos […]. Thus, the prohibitions imposed under the provisions of the Anti-Dummy Law have not been transgressed specifically that is, to prevent foreign intervention or participation in areas traditionally reserved for citizens of the Philippines or to corporations or associations at least 60% of the capital stock of which is owned by citizens of the Philippines or allowing a noqualified person or corporation from intervening ‘in the management, operation, administration or control’ of such right, franchise, privilege, property or business."
What is missing here is reference to or any indication of awareness of the actual secret shareholder agreements by which the management and control prohibited by the ADL was effectively assigned to Fraport. Indeed, in holding that the so-called "badges of dummy status" "were inconclusive and inapplicable to the present case", the Prosecutor quoted, regarding the third badge, that "[t]he organization structure of PIATCO would unmistakably show Fraport's clear and concrete control over affairs of the respondent". But, as is clear from the factual account set out above, the secret shareholder agreements were designed to and did precisely this. Neither the NBI nor DOX Reports deals with the issue of the secret shareholder agreements and their violation of the ADL.

This Tribunal decided to review the full record of evidence regarding the ADL proceedings which resulted in the Department of Justice's Chief State Prosecutor's Resolution of 27 December 2006 (the "Prosecutor's Resolution") dismissing the Bernas and Balayan complaints. Accordingly, as noted earlier in the Award, it requested all of those documents from the Respondent, and the Claimant supplemented the record with other documents. Aside from the legal question of whether a finding by a competent Philippine institution on a matter which arises both under Philippine law and under the BIT binds this Tribunal, the factual question, on which the Tribunal sought to satisfy itself, was whether the secret shareholder agreements constituted part of that record and had been considered in the ADL proceedings. The Respondent contended:

"Rather, this Tribunal has before it Fraport's secret shareholder agreements themselves (which Fraport belatedly produced at the oral hearing in January 2006). These documents provide the critical proof that Fraport intended to, and did, implement a scheme to exert financial dominance and effective corporate control of PIATCO, and thereby evade Philippine nationality and anti-dummy laws. The Philippine DOX, by contrast, has never had the central evidence proving Fraport's violations of the Anti-Dummy Law, including

- Fraport's Final Holding Report, which set out Fraport's intention to evade Philippine nationality laws;
- Fraport's secret shareholder agreements with the Chengs, which established the means by which Fraport obtained unlawful influence in PIATCO and PTI, through 'pooling,' block voting, vetoes, and the right to appoint, indirectly, members of PIATCO's board of directors; and
- Fraport's secret loan agreements to the Chengs, which enabled the Chengs to make their share subscription payments in PIATCO and its shell companies.

These critical documents were unavailable to the DOX, not for lack of effort or interest, but (1) because of the confidentiality designation in this arbitration under the ordered confidentiality agreement; and (2) because Fraport, through German courts, blocked the Philippine DOX's request for mutual legal assistance in Germany. Having denied the Philippine DOX the crucial and relevant evidence, Fraport cannot celebrate the DOX's dismissal as evidence of its innocence." 26

Neither the NBI Report nor the Prosecutor's Resolution, it will be recalled, refers to the secret shareholder agreements. The DOX Prosecutor's summary of the Bernas/Balayan complaints also imports that the secret shareholder agreements were not part of the record, despite oblique references to Fraport's control over PIATCO:

26 See Respondent's letter to the Tribunal of 11 January 2007 at page 2 (supra at paragraph 70).
"Complainant Bernas, alleged among others that Fraport, the officers/directors PIATCO violated the Anti-Dummy as he pointed out in the Request for Arbitration of Fraport with the International Centre for Settlement of Investment Disputes as regards to NAIA Terminal 3 Project where it allegedly flaunted its 61.44% foreign ownership in PIATCO. He further added that Nisho [sic] Iwai, a foreign corporation, has equity shareholdings of 10% in PIATCO, which if combined with Fraport's 61.44 ownership would result to a 71.44 % foreign ownership. Thus, 31.44 percent over and above the 40% foreign ownership allowed by the Constitution.

He, likewise, stressed that badges of a dummy status as embodied in Department of Justice Opinion No. 165, Series of 1984 are present in PIATCO’s stockholding composition. He explained that through Fraport’s equity stockholding together with Nissho Iwai equity, provided practically all the funds for the operation of PIATCO. In addition, he stated that along with dominant foreign equity contributions, Fraport arranged most of the borrowed funds that were used in the construction of NAIA Terminal 3. This fact can be gleaned from the records of the Senate Blue Ribbon Committee, which showed that the Cheng Group has only contributed US$9.7 million, while the rest of the funds used come from Fraport ranging from US$ 425 million to US$ 500 million.

Furthermore, he alleged that Fraport may have practically provided all the technological support for the construction of the NAIA Terminal III Project. This came about by reason of the Fraport's representative designation as technical and operation manager for the Project, through PTI. He opined that neither the consortium nor any of the shareholders could provide funds, which could have been used to pay for technical expertise or services. With these controlling or withholding flow of funds and extension of expertise, Fraport obviously influenced the management and operations of PIATCO.

Meanwhile, complainant Balayan alleged that Fraport in conspiracy with the member corporation in consortium who participated in the bidding process for the construction of NAIA Terminal Project violated the Constitution and Commonwealth Act No. 108. This is due to the fact that Fraport ownership with PIATCO 61 % comprising of: direct ownership of 30% and indirect ownership of 31.44 % through PAGS, PTH and PTI. He also added that since Nissho Iwai, a foreign corporation has a 10 % shareholding in PIATCO, the total foreign ownership in PIATCO is 71.44 %." (emphasis added)

370. According to the DOX Prosecutor, “badges of dummy status”, in light of the now-confirmed "Control Test", are “inconclusive and inapplicable” when "determining the nationality of the corporation". The Prosecutor's reasoning thus suggests that it focussed on whether an ADL violation had been demonstrated by a quantitative determination of nationality as opposed to an actual demonstration of managerial control. As noted, the evidentiary record before the DOX Prosecutor did not include the direct evidence of such managerial control, such as the secret shareholder agreements.

371. While it is clear that the Prosecutor's Resolution and the related NBI Report focussed on the issue of nationality as opposed to the issue of managerial control, the record of these proceedings does include references to a "control agreement" and "adjustments] of the Shareholder Agreement", as noted by the Claimant. The Claimant has drawn attention to Balayan's Consolidated Reply-Affidavit dated 20 November 2006 in this regard. Balayan's Consolidated Reply-Affidavit expressly refers to the Schmidt Report which recommended a “control agreement”. Reference is made
therein to Fraport’s “intention to control the management of respondent PIATCO”, as it was discussed at the Supervisory Board Meeting on 12 March 1999. This section of Balayan’s Consolidated Reply-Affidavit also identifies one of the July 1999 shareholder agreements, namely the Addendum to the PIATCO Shareholders Agreement dated 6 July 1999 (referred to as “Annex S” of the Complaint-Affidavit 29). But the Tribunal would note that this is not the secret “Control Agreement” described earlier in this chapter as being critical to the issue of jurisdiction ratione materiae.

372. Nor does Dr. Schmidt’s statement, which was quoted in extenso earlier in this chapter, indicate that secret shareholder agreements had been concluded and actually existed. It is useful to recall the critical passages in Dr. Schmidt’s words of 7 March 1999 to Fraport’s Supervisory Board:

“In fact, FAG’s equity interest shall total 64%. A ‘control agreement’ shall ensure that FAG exercises control over the enterprise.

This is also absolutely necessary since KPMG points out repeatedly that the current owners are not in a position to ensure the proper operation of the airport.

In fact, however, such control is not practicable for legal reasons, as PIATCO’s legal due diligence states the following: ‘Foreign citizens are prohibited from intervening in the management, operation or control of the company […]’. Moreover, the summary of the agreements contains the statement that ‘a decisive voting right of FAG would violate the antidummy law of the Philippines’.

Consequently, FAG cannot legally enforce its intended leadership in this consortium. This, however, is the most important prerequisite for the entire transaction.” (emphasis added)

373. These words would not indicate to an investigator charged with determining whether there was probable cause for a criminal indictment, but from whom the existence and content of the secret shareholder agreements were kept by operation of the confidentiality agreement between the parties to the present arbitration, that such secret agreements were ever concluded. Indeed, the secret agreements continued to be denied by Fraport’s officers who were the respondents in the ADL proceedings. Thus, in a comment submitted as part of the ADL proceedings on 19 January 2007, Dr. Stiller stated:

“Fraport never entered into a control agreement with respect to PIATCO. It is quite natural for a foreign investor, who plans an investment in a legal environment not familiar to it, to explore all legal options available in the relevant jurisdiction. That a foreign investor explores its legal options and then complies with the law is exactly what can be expected from a prudent investor, and does not violate any law.”

374. Dr. Stiller had made the same point before in a manifestation submitted as part of the ADL

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27 See Claimant’s letter of 12 January 2007 at page 3 (supra at paragraph 71).
28 At paragraphs 16.8 and following under the heading “Respondent Fraport Exercises Management and Control of Respondent PIATCO”.
29 It is further noted that the Balayan Complaint-Affidavit states that Fraport increased its shareholdings in 1999 pursuant to four agreements dated 6 July 1999 (at paragraph 10), but solely attaches the Addendum to the PIATCO Shareholders Agreement dated 6 July 1999. The June 2004 NBI Report also refers to these four 1999 shareholder agreements at paragraph 39.
proceedings on 8 December 2006:

"At no time did PIATCO or its stockholders allow the intervention of aliens in its management, operation, administration or control. The Philippine shareholders are actually in control. Control is exercised by the board of directors of PIATCO and not by Fraport. Fraport did not cause, or procure, or itself in any way participate in the management, operation, administration or control of PIATCO other than by nominating the members of the board, to the extent it was authorized to do so under the shareholder agreements. Note that the law allows aliens to be elected to the governing board of nationalized or partly nationalized entities in proportion to their allowable participation of share in the capital of such entities, although such alien directors may not occupy management positions. Aside from pure speculation that control of PIATCO flows from Fraport's alleged substantial funding of the project, there is no independent and concrete proof of control. Admittedly, the Philippine shareholders have always been firmly in control."

375. Plainly Balayan and Bernas suspected and alleged that there was a conspiracy on the part of Fraport to control PIATCO. That was the common predicate of their respective ADL complaints. Balayan's Consolidated Reply-Affidavit does not expressly refer to the secret shareholder agreements, as he was unaware of them, but his conclusion indicates his suspicion of some such arrangement. Balayan's Consolidated Reply- Affidavit states:

"16.13 The organizational structure of respondent PIATCO would unmistakably demonstrate respondent Fraport's clear and concrete control over the affairs of respondent PIATCO in that respondent Fraport has assigned consultants and officers in the Philippines for the NAIA Terminal III project. Thus, in view of respondent Fraport's hold on both the financial and technical operations of respondent PIATCO, respondent Fraport has necessarily assumed complete and steadfast control over the management of respondent PIATCO's affairs over the NAIA Terminal HI project.

17. Indeed, the totality of the foregoing plainly shows that respondents Fraport, PIATCO, PTH, PTI, PAGS and Paircargo, in conspiracy and for the benefit of one another, knowingly aided, assisted, and/or abetted in the planning, consummation or perpetuation of violations of the Anti-Dummy Law. Resultantly, appropriate criminal charges should be filed against all the respondents." (emphasis added)

376. Balayan's Complaint-Affidavit dated 19 November 2003 is referred to in the NBI Report as containing "details [of] how respondents have allegedly fraudulently created an elaborate web in order to hide their ploy to circumvent our nationality laws". Later in the NBI Report, there is also a reference to the "scheme to violate the anti-dummy law". The point is argued in Balayan's Reply- Affidavit dated 21 June 2004 as follows:

"3.2 Indeed, it may be conceded that, on paper, the capital structure of respondent PIATCO complies with the constitutional limit on foreign ownership. However, this does not serve to stop the NBI from further investigating respondents because even if the capital stock of a corporation appears to comply superficially with the requirement of at least sixty percent (60%) Filipino ownership, this may actually be disregarded, and a review of the contracts or agreements governing the actual relationship of its shareholders may be undertaken by the
proper government agency to determine whether the Constitution and the Anti-Dummy Law have, in fact, been violated. Otherwise, the Anti-Dummy Law, which was designed to [sic] precisely to prevent foreign intervention or participation in areas of investment reserved for Philippine nationals whether directly or indirectly through the use of 'dummy relationships', would be an utter failure and rendered vacuous and nugatory. Notably, respondents have not even disputed, much less denied, the Complaint-Affidavit dated 19 November 2003, which details how respondents herein have fraudulently created an elaborate web in order to hide their ploy to circumvent our nationality laws.” (emphasis in original)

377.   Not surprisingly, the theories put forward by Bernas and Balayan, without the benefit of the secret shareholder agreements, could not and did not persuade the DOX Prosecutor. As every lawyer knows, to bring an indictment and initiate a criminal prosecution, one needs evidence and not theories. The evidence was to be had in the secret shareholder agreements. The ADL charges were accordingly dismissed.

378.   The Prosecutor's Resolution was subsequently challenged pursuant to Bernas' Motion for Reconsideration dated 18 January 2007 and Balayan's Petition for Review dated 19 January 2007. The former, in particular, is described as being based on the following grounds 30:

"1. Section 3(a) of the Foreign Investment Act, as cited in the assailed resolution does not provide the phrase 'the control test shall be applied for this purpose';

2. The actual citation of SEC Opinion dated November 23 1993 which allegedly resolved 'to do away with the strict application of the Grand Father Rule and instead applied the Control Test in determining corporate nationality for purposes of investment was not stated;

3. The administrative interpretations of the DOX and SEC are at best persuasive, and not controlling, hence, reliance thereon is misplaced;

4. There is no Supreme Court decision stating that the Grand Father Rule is no longer the de jure standard in determining the nationality of a corporation for purposes of criminal prosecution for violation of the Anti-Dummy Law;

5. The resolution would in effect render impossible for anyone to be indicted for violating the Anti-Dummy Law;

6. This Office erred in setting aside the badges of dummy status as enunciated in one of its opinions;"

379.   On 15 March 2007, Bernas' Motion for Reconsideration was granted by a DOX Resolution recommending that a criminal indictment for ADL violations be filed with the appropriate court as follows (at pages 12-13):

"After a careful evaluation of the arguments raised in the motion for reconsideration, it is respectfully opined by this Office that the same is meritorious.

Record shows that all foreign investments without using the control test to determine the nationality of the corporation constitutes 71.44% thereby violating the Anti-Dummy Law.

Lastly, settled is the rule that preliminary investigation is essentially inquisitorial and is often the only means to discover who may be charged with crime, its function is merely to determine the existence of probable cause. (Pilapil vs. Sandiganbayan, 221 SCRA349)

WHEREFORE, the motion for reconsideration is hereby respectfully recommended to be GRANTED. Let an information for violation of AntiDummy Law be filed against herein respondents before the appropriate court."

380. Having reviewed the additional 1900 pages of documents produced by the Respondent on 14 March 2007, it is clear to the Tribunal that the record of the ADL proceedings did not include the secret shareholder agreements themselves. It is true that there are various references to shareholder agreements generally, and some copies of them, but the vast majority of such references relate to the 2001 shareholder agreements. In fact, apart from the 1999 Addendum to the PIATCO Shareholders Agreement referred to inter alia in Balayan’s Consolidated Reply-Affidavit, which was set out above, there is no actual copy of any of the 1999 shareholder agreements and, a fortiori, of any of the secret shareholder agreements.

381. The 1999 Addendum to PIATCO Shareholders Agreement is the only 1999 shareholder agreement that the Claimant has identified as being part of the record in the ADL proceedings, with the added observation that shareholder agreements were “discussed” in the proceedings of the Philippine Senate Blue Ribbon Committee in August and September 200231. The Claimant argues that there are “many references to shareholder agreements”, but, as the quotation from its submission shows, fails to point to any of the secret shareholder agreements32:

"See, e.g., PIATCO’s Amended Articles of Incorporation, Annex D to Balayan Complaint-Affidavit (Ex. R-510 Annex B), at ROP-T-00159 (‘Shares represented by this Certificate are subject to the terms of the Shareholders’ Agreement, which was executed by and among the Corporation’s Shareholders on 23 August 2001...’); PIATCO’s Audited Financial Statements, Annex N to Balayan Complaint-Affidavit (Ex. R-510 Annex B), at ROP-T-00347 (Summary of ‘Significant Contracts’, including Memorandum of Understanding, July 6, 1999, O&M Agreement and Advisory Services Agreement); PIATCO’s Amended By-Laws, Annex B to Respondent Castro’s Counter-Affidavit, Ex. R-545, at ROP-T-01489 (referring to ‘PIATCO Shareholders Agreement dated 14 July 1997 among the stockholders of the Corporation, as amended and supplemented by the Addendum to the PIATCO Shareholders Agreement dated 17 May 2001, and any and all other amendments and supplements thereeto...’)."

382. Thus, the Respondent is correct in stating that “neither the prosecutors nor the Sandiganbayan had access to the more substantial record of evidence presented to this Tribunal [...] because of the confidentiality restrictions”33. The Tribunal will consider the legal significance of this factual

32 See ibid, at footnote 4.
F. The Claimant's Concealment of the Secret Shareholder Agreements

383. Although the Respondent raised objections to jurisdiction and admissibility, the specific objection based on a violation of the ADL, as a challenge to jurisdiction *ratione materiae*, was essentially argued in post-hearing submissions because most of the documents that established it were produced either immediately before the hearing on jurisdiction and liability or, at the President's insistence, during the hearing itself. As a result, the Claimant's contention that the Respondent's experts did not address this problem is jejune the Respondent, its experts and the Tribunal cannot be expected to be clairvoyant and could not have known of this critical issue before the hearing.

384. The Claimant argues, nonetheless, that the word "accepted" in Article 1(1) of the BIT is critical to the operation of that provision and since the Philippines did not establish an acceptance regime, that provision does not apply. As noted above, the word "acceptance" does not appear in the Instrument of Ratification, which simply states that "the Agreement provides that the investment shall be in the areas allowed by and in accordance with the Constitutions, laws and regulations of each of the Contracting Parties". But, without regard to that, it is, as explained in the analysis of the BIT earlier in this Award, unreasonable to assume that state parties would incorporate a reiterated insistence on compliance with their respective constitutions, laws and regulations only not to have them apply.

385. Nor is there need for an acceptance procedure for the purchase of shares, the form of putative investment in this case and the focus of *ad* Article 2 of the Protocol, which elaborates Article 2 of the BIT. It relates to purchasing shares in a company which might then acquire land in the territory of the Republic. The acquisition of shares by a foreign investor in a domestic corporation is a legal transaction that does not, by its nature, require some action by the government involving acceptance or permission, yet it is quite clear from the BIT and the Protocol that accordance with the host state's law is nonetheless required. That was the ostensible form of Fraport's putative investment. And, to repeat, the Instrument of Ratification makes no mention of "acceptance" but speaks only of "areas allowed by and in accordance with".

386. The Claimant argues, further, presumably in the alternative, that there was, in fact, acceptance through many acts of the Respondent and that the Respondent "has never initiated any official action pursuant to the Nationality or Anti-Dummy Laws".

387. As a matter of law, the Claimant is correct that the cumulative actions of a host government may constitute an informal "acceptance" of a foreign investment that otherwise violates its law. The Claimant is also correct that a failure to prosecute something of the order of a violation of the ADL, such that an investor reasonably inferred that it was acting lawfully and made further investments, could obviate an objection to jurisdiction *ratione materiae*. The issue here, however, is fact. The Claimant, knowing of the violation of the ADL, consciously concealed it, such that any actions that might otherwise have been viewed by a foreign investor in good faith as endorsements by the Philippine government cannot be deemed to have cured the violation or estopped the Government. The Respondent could hardly have initiated legal action against the Claimant for violations which...
the Claimant had concealed.

388. The timing of the initiation of criminal action by the host state in the instant case is particularly complex. A detailed confidentiality agreement was negotiated by the parties to this arbitration and noted by the Tribunal. At the insistence of the Claimant, it precluded the Philippines from using material which might be produced in the course of document exchange in criminal proceedings in the Philippines.

389. Even in the absence of such an agreement, it is doubtful whether the Philippines could have lawfully undertaken an action which usurped a matter within the jurisdiction of the Tribunal. It is significant that Fraport's directors, who were respondents in the ADL proceedings, submitted a letter in those proceedings before the Prosecutor, stating:

"The ICSID has the exclusive jurisdiction to decide the issues presented to it pursuant to the agreement between Germany and the Government of the Republic of the Philippines."

390. Assuming further that the findings of the Prosecutor had dealt directly with the secret shareholder agreements, which is not the case here, such a finding would not constitute a res judicata because of a difference in the identity of the parties and the claim. The complaints designed to initiate ADL prosecutions were undertaken by private citizens in a type of actio popularis which is available in Philippine law. The parties were different, the claim (initiation of a criminal action) and the issues that were the ratio of the preliminary decision were different from those which engage this Tribunal.

391. Moreover, holdings of municipal legal institutions cannot be binding with respect to matters properly within the jurisdiction of this Tribunal. As the Inceysa tribunal put it, "as the legality of the investment is a premise for this Tribunal's jurisdiction, the determination of such legality can only be made by the tribunal hearing the case, i.e. by this Arbitral Tribunal" 34. The Claimant can hardly challenge this legal proposition, for if this were not the case, then its entire substantive case would fail; the decision of the Philippine Supreme Court would have decided the issue against it.

392. The Tribunal agrees with the point of law in the Claimant's additional argument which is based on "the foreign investor's reasonable reliance upon the state's contemporaneous manifestations of its understanding of its laws". A foreign investor is, indeed, entitled to reasonable reliance upon the state's contemporaneous manifestations of its understanding of its laws. The Claimant's problem, again, derives from the facts. The Claimant argues:

"Fraport was aware of the Nationality and Anti-Dummy Laws from the outset. Fraport continuously sought and acted upon Philippine legal advice to ensure compliance." (emphasis added)

393. This assertion is simply incorrect, as the review of pertinent facts which is set out above and which is based entirely on the Claimant's own documents, shows.

394. The Tribunal cannot agree, as a matter of law, with the Claimant's contention that "[e]ven if there

34 At paragraph 209.
could be said to be an issue as to whether the Philippine laws were complied with [...], it could be of only municipal, not international legal significance”. This interpretation, if accepted, would deprive a significant part of the ordinary words of a treaty of any meaning and effect. The BIT is, to be sure, an international instrument, mechanism which is hardly unusual in treaties and, indeed, occurs in the Washington Convention. A failure to comply with the national law to which a treaty refers will have an international legal effect.

395. The Claimant offers a congeries of arguments to the effect that it never actually exercised control over PIATCO and subsequently revised the secret shareholder agreements to bring them into conformity with the ADL which, in any event, the Claimant alleges, does not criminalize attempts to violate it. The Respondent characterizes these arguments as admissions. The Tribunal does not but rather takes them as legitimate arguments in the alternative which scrupulous counsel are entitled to make. Nonetheless, the arguments fail, for two reasons: first, because the relevance of compliance with national law for jurisdiction ratione materiae purposes is at the moment of the investment, as explained in the analysis of the BIT’s terms. That is a limitation which actually works in favour of both the foreign investor and international arbitral jurisdiction. Second, because the ADL, which the Claimant only quotes selectively, criminalizes:

"any person who knowingly aids, assists, or abets in the planning, consummation or perpetration of any of the acts herein above enumerated shall be punished by imprisonment for not less than five nor more than fifteen years [...]." 35

The contention that Fraport never intended to exercise the power which it took pains to acquire through the secret shareholder agreements is simply not credible.

G. Conclusion

396. When the question is whether the investment is in accordance with the law of the host state, considerable arguments may be made in favour of construing jurisdiction ratione materiae in a more liberal way which is generous to the investor. In some circumstances, the law in question of the host state may not be entirely clear and mistakes may be made in good faith. An indicator of a good faith error would be the failure of a competent local counsel's legal due diligence report to flag that issue. Another indicator that should work in favour of an investor that had run afool of a prohibition in local law would be that the offending arrangement was not central to the profitability of the investment, such that the investor might have made the investment in ways that acceded with local law without any loss of projected profitability. This would indicate the good faith of the investor.

397. In this case, the comportment of the foreign investor, as is clear from its own records, was egregious and cannot benefit from presumptions which might ordinarily operate in favour of the investor.

398. The record indicates that (i) the BIT explicitly and reiteratedly required that an investment, in order to qualify for BIT protection, had to be in accordance with the host state's law and (ii) local counsel

35 Anti-Dummy Law, Commonwealth Act No. 108, section 2-A.
explicitly warned that a particular structural arrangement would violate a serious provision of Philippine law. Moreover, the violation qua violation was explicitly discussed at the level of the Board of Directors. In view of the due diligence study prepared by financial experts (who had apparently not been briefed on the local law restrictions), the investor, Fraport, concluded that the only plausible way for its equity investment to prove profitable was to arrange secretly for management and control of the project in a way which the investor knew were not in accordance with the law of the Philippines. This was accomplished by Article 2.02 of the FAG-PAIRCARGO-PAGS-PTI Shareholders' Agreement of 6 July 1999 which allowed Fraport (or FAG as it was then known) to have a casting and controlling vote over matters which fell within its "area of expertise and competence". Thus the violation could not be deemed to be inadvertent and irrelevant to the investment. It was central to the success of the project. The awareness that the arrangements were not in accordance with Philippine law was manifested by the decision to make the arrangements secretly and to try to make them effective under foreign law. All of these facts derive from internal Fraport documents whose credibility can hardly be impeached by Fraport.

399. A brief comment on evidentiary standards: whatever standard of proof is required under Philippine law to prove a criminal act, the jurisdictional question before this Tribunal, which is seized of an international investment dispute, is not a determination of a crime but whether an economic transaction by a German company was made "in accordance" with Philippine law and thus qualifies as an "investment" under the German-Philippine BIT. Even assuming, however, that the "preponderance of evidence" test which applies in civil law must yield in the instant case to a "beyond a reasonable doubt" test because the subject of the "in accordance" inquiry is a Philippine criminal statute, this is a case in which res ipsa loquitur. The relevant facts, all of which are found in Fraport's own documents, are incontrovertible.

400. There is a further troubling factor. Despite requests for document production, the obvious relevance of these secret documents to the Respondent's jurisdictional objection, and a stern warning by the President of the Tribunal early in the arbitration that adverse consequences could be drawn from the failure to produce such documents, it was only in the course of the hearing that the existence of many of these documents became known. It was only at the insistence of the President of the Tribunal at that moment that they were finally produced. In that regard, it lies ill in Fraport's mouth to allege, in its defense, that the Philippines had not "ever taken any action under its own laws to charge Fraport with any violation of those laws". If Fraport, as its own documents attest, concealed the agreements in violation of the ADL, how could the Philippines take any legal action against it?

401. Fraport knowingly and intentionally circumvented the ADL by means of secret shareholder agreements. As a consequence, it cannot claim to have made an investment "in accordance with law". Nor can it claim that high officials of the Respondent subsequently waived the legal requirements and validated Fraport's investment, for the Respondent's officials could not have known of the violation. Because there is no "investment in accordance with law", the Tribunal lacks jurisdiction ratione materiae.

402. As for policy, BITs oblige governments to conduct their relations with foreign investors in a transparent fashion. Some reciprocal if not identical obligations lie on the foreign investor. One of those is the obligation to make the investment in accordance with the host state's law. It is arguable that even an investment which is not made in accordance with host state law may import economic value to the host state. But that is not the only goal of this sector of international law. Respect for
the integrity of the law of the host state is also a critical part of development and a concern of 
international investment law. That said, the Tribunal's decision in this matter does not rest on 
policy. It is the language of the BIT which is dispositive and it is unequivocal in this matter.

403. In *Lucchetti v. Peru*, the tribunal observed that:

"Lucchetti may therefore consider it a harsh result that its effort at obtaining an international 
remedy is brought to a halt before the merits of its contentions are even examined. Such a 
conclusion, however, would not be warranted in light of the fact that Lucchetti did not have 
an *a priori* entitlement to this international forum." \(^{36}\)

404. Nor does Fraport, *mutatis mutandis*, in the instant case. Compliance with the host state's laws is an 
Fraport's ostensible purchase of shares in the Terminal 3 project, which concealed a different type 
of unlawful investment, is not an "investment" which is covered by the BIT. As the BIT is the basis 
of jurisdiction of this Tribunal, Fraport's claim must be rejected for lack of jurisdiction *ratione 
materiae*.

**VI. COSTS**

405. The Respondent has prevailed in this proceeding since the Tribunal has decided that the dispute is 
not within its jurisdiction and that the Claimant's claim is therefore dismissed. The general practice 
in international arbitration is that the successful party should recover its legal costs. Having regard 
to all the circumstances of this unusual arbitration, the Tribunal is of the view that such an 
approach would be inappropriate. There is no successful party on the merits in the traditional 
sense. Accordingly, the Tribunal, in the exercise of its discretion, has formed the view that each 
party shall bear in full its own legal costs as well as one half of the arbitration costs, including the 
administration fees for the use of the Centre.

**VII. AWARD**

406. For the reasons set forth herein and pursuant to Rules 41(5) and 47(1)(i) and (j) of the Arbitration 
Rules and Article 61(2) of the Convention, a majority of the Arbitral Tribunal decides:

1. To accept the objection to the jurisdiction of the International Centre for Settlement of 
Investment Disputes raised by the Republic of the Philippines;

2. To declare that the Centre does not have jurisdiction to hear this dispute and that this 
Arbitral Tribunal is not competent to resolve it;

3. To dismiss the claim of Fraport AG Frankfurt Airport Services Worldwide; and

4. To order that each party shall bear in full its own legal costs and that the payment of the

\(^{36}\) At paragraph 61.
fees and expenses of the members of the Arbitral Tribunal and of the administrative fees for the use of the Centre shall be paid in equal share by each party.