INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES

Washington D.C.

Case N° ARB/02/6

SGS Société Générale de Surveillance S.A.

(Claimant)

versus

Republic of the Philippines

(Respondent)

ORDER OF THE TRIBUNAL ON FURTHER PROCEEDINGS

Members of the Tribunal

Dr. Ahmed S. El-Kosheri, President

Professor James Crawford SC, Arbitrator

Professor Antonio Crivellaro, Arbitrator

Secretary of the Tribunal

Ms. Martina Polasek

Representing the Claimant

Messrs. Emmanuel Gaillard and
John Savage, Shearman & Sterling

Mr. Jean-Pierre Méan and
Ms. Caroline Ming, SGS Société Générale
de Surveillance S.A.

Representing the Respondent

Professor Christopher Greenwood QC
Ms. Judith Gill, Mr. Matthew Gearing and
Ms. Frances van Eupen, Allen & Overy

Undersecretary Mr. Cornelio C. Gison,
Department of Finance, Philippines and
Ambassador Manuel A. J. Teehankee

DECISION OF THE TRIBUNAL ON FURTHER PROCEEDINGS

A. The Tribunal's Decision on Jurisdiction of January 2004

1. The earlier procedural history of this case was set out in paragraphs 1-11 of the Tribunal's decision of 29 January 2004 ("the Jurisdictional Decision").[1] By that decision the Tribunal upheld its jurisdiction over the dispute under Article VIII(2) of the BIT[2] in combination with Articles X(2) and IV and dismissed the claim so far as it is based on Article VI (expropriation). However, the remedy sought by SGS was predicated on the resolution of an unresolved contractual dispute between the parties in respect of the very subject matter of its claim, and the parties had agreed that disputes under the contract were to be resolved before the courts of the Philippines. Accordingly the Tribunal stayed these proceedings "pending a decision on the amount due but unpaid under the CISS Agreement, a matter which (if not agreed by the parties) is to be determined by the agreed contractual forum under Article 12 of the CISS Agreement". It further decided "that the proceedings will resume on the request of either party as soon as the condition for admissibility set out above has been satisfied".[3]

2. The reason for ordering the stay was set out in paragraphs 174-175 of the Jurisdictional Decision:

> "174. … [A]t the time the present arbitration was commenced, SGS had made substantial efforts to settle the claim through negotiations. Indeed a recommendation had been made by BOC to the Secretary of Finance of the Philippines as to the amount payable—a recommendation with the Secretary of Finance had appeared to accept. SGS's Request for Arbitration clearly pleaded the failure to pay as a breach of the BIT, specifically Article X(2) and IV. But because of Article 12 of the CISS Agreement, it is for the Philippines courts to determine how much is payable, unless the parties themselves can reach a definitive agreement on SGS's claim. Thus this Tribunal is precisely faced with the situation where the Philippines' responsibility under Article X(2) and IV of the BIT—a matter which does fall within its jurisdiction—is subject to 'the factual predicate of a determination' by the Regional Trial Court of the total amount owing by the Respondent.
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> 175. In the circumstances the Tribunal concludes that the circumstance of the fixing of the amount payable under the CISS Agreement—whether by definitive agreement between the parties or by proceedings before the courts of the Philippines—should not require the bringing of a new ICSID claim by SGS, but falls

[1] (2004) 8 ICSID Reports 515.

[2] Swiss Confederation-Republic of the Philippines, Agreement on the Promotion and Reciprocal Protection of Investments, 31 March 1997 (in force, 23 April 1999).

[3] (2004) 8 ICSID Reports 515, 567.

> within the framework of SGS's existing claim in this arbitration. That being so, justice would be best served if the Tribunal were to stay the present proceedings pending determination of the amount payable, either by agreement between the parties or by the Philippine courts in accordance with Article 12 of the CISS Agreement."[4]

3. At the time of the Jurisdictional Decision, SGS's claim was for approximately CHF202 million plus contractual interest. As the Tribunal noted:

> "the present claim is not brought for the amount of CHF192,420,782.26 arguably acknowledged to be due in December 2001 (less the PHP1,000,000 actually paid). It is brought for the outstanding principal amount of CHF202,413.047.36 plus interest calculated in accordance with the CISS Agreement, Article 7.5. SGS's claim thus includes the unreconciled amount of CHF9,992,265.10, as to which there is no evidence at all of an acknowledgement of indebtedness by the Philippines. Moreover the calculation of interest payable under Article 7.5 of the CISS Agreement is not a straightforward matter of arithmetic, but will involve inquiry into relevant due dates and possibly other matters. On any view, a court or tribunal having jurisdiction to determine obligations under the CISS Agreement will have a substantial task to perform."[5]

For these reasons the dispute as to the quantum of SGS's claim was on any view unresolved.

B. Procedural steps since the Jurisdictional Decision

4. Pursuant to paragraph 176 of the Jurisdictional Decision, the parties reported periodically on their efforts to settle the dispute. By early 2007, the parties were expressing diametrically opposed views on this matter.

5. On 9 April 2007, the Secretary wrote to the parties stating that "it was not the Tribunal's intention to order a stay *sine die*, nor is this an appropriate course in an international arbitration under the Convention". Following an exchange of views in writing, a procedural hearing was convened to allow the parties to express their views on (a) the current state of discussions and procedures concerning the dispute; (b) future steps in the present arbitration. To enable that hearing to take place the Tribunal by order communicated to the parties on 26 September 2007 lifted the stay imposed by its Jurisdictional Decision, without prejudice to any further order that might be required either reinstating the procedure on the merits or dismissing the claim as inadmissible.[6]

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4 Ibid, 566-7 (footnotes omitted).
5 Ibid, 528 (para 41) (footnotes omitted).
6 See the Tribunal's letter to the parties of 2 October 2007.

6. Following a further exchange of correspondence and documents, a hearing was held in Paris on 4 December 2007. The positions and supporting arguments of the parties are reflected in what follows.

C. The Current State of the Dispute between the Parties

7. The present Tribunal has already upheld its jurisdiction under the BIT over SGS's claim to payment. The question for the Tribunal is whether the grounds for inadmissibility of that claim still obtain, and what the consequences are in terms of the further disposition of these proceedings. In addressing that question the Tribunal will necessarily have to reach provisional conclusions as to certain matters. It does so in order to provide guidance to the parties as to the next steps to be taken pursuant to this procedural order, and without prejudice to the right of the parties to present further evidence and argument as may be required.

8. The parties have mentioned three elements as affecting or potentially affecting amounts payable under the CISS Agreement: (a) the amounts payable on invoices for services provided under the Agreement (hereafter "the invoice amount"); (b) interest for non-payment; (c) what the Respondent variously describes as a potential "defence", "set-off" or "counterclaim": this will be referred to, for convenience, as the "Chinese fraud" allegation. It is necessarily to deal separately with each of these elements.

(i) Amounts payable on SGS invoices

9. The question of the invoice amount had already been considered by the Commission on Audit before the Jurisdictional Decision. This process continued thereafter, in cooperation between SGS and the Bureau of Customs, with a view "to resolving all the outstanding issues as soon as possible".[7] The Commission issued its final report on 30 November 2005 (hereafter "CoA Report").[8] According to the Executive Summary, the audit "was generally aimed at determining the correctness of SGS billings with the BOC and the determination of the correct amount due and payable relative to the SGS account". It was based on data submitted by SGS corresponding to more

[7] Letter of Commissioner, Bureau of Customs, to SGS, 4 July 2005, attaching certain findings of the 2003 Special Audit Report.

[8] Republic of Philippines, Commission on Audit, Report of the Special Audit of the Accounts of Société Generale de Surveillance with the Bureau of Customs as at 30 November 2005.

than 1.5 million transactions involving a Clean Report of Findings (CRF).[9] According to the Executive Summary, "unpaid billings of SGS which were not covered by the Letter of Credit with the PNB totalled CHF171,161.251.47". The Commission observed that SGS had "positively responded with dispatch to the series of communications coursed through the BOC", that "information submitted by SGS … was very useful" and that it had "substantially complied with the requirements" of the Commission.[10] An Audit Certificate was attached.

10. One of the unresolved issues between the parties in 2004 concerned inspection fees for partial shipments.[11] Without prejudice to its legal position under the CISS Agreement, by letter of 9 November 2005 SGS stated that "as we wish to have the issue resolved without further delay, we will accept the amount of $9,521,595.75 to be deducted from the total claim" in relation to this item. This concession was taken into account in the CoA Report.

11. The CoA Report noted certain limitations of the audit.[12] It only covered the period 1995-2000 due to lack of pre-1995 data. It did not deal with interest charged by the Philippine National Bank for earlier payments to SGS. It noted certain difficulties with exchange rates to the peso. But these difficulties were either resolved or are irrelevant to SGS's claim in this arbitration.

12. SGS argues that the process by which the total sum payable for invoices was determined is binding on the Respondent. The Respondent denies this. For its part the Tribunal, on the basis of the evidence presently before it, would draw the following provisional conclusions:

(1) The audit process was apparently careful and conscientious and it does not appear that it could sensibly be replicated in detail by any court or tribunal, domestic or international.

(2) As the Respondent stressed, the Commission on Audit is not a court and does not make decisions binding on the Ministry of Finance, which is the party of record to the CISS Agreement.

(3) On the other hand, the Commission on Audit is an organ of the Philippines established by Article IX of the Constitution; in conducting the SGS Special Audit it was operating within its mandate and at the request of the Ministry of Finance.

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9 CoA Report, 1.

10 CoA Report, 10-11.

11 This was specifically referred to as a counterclaim in Allen & Overy's letter to Shearman & Sterling of 6 February 2004.

12 CoA Report, 2.

(4) The BOC, the relevant agency within the Ministry of Finance for the implementation of the CISS Agreement, has expressed its acceptance of the invoice amount as determined by the Commission on Audit.[13]

(5) There has been no final or definitive acceptance by the Ministry of Finance of the invoice amount.[14] On the other hand, the Ministry has offered no criticism of the invoice amount, and it may be inferred that there is no basis for criticism. On the contrary the Secretary accepted that the invoice amount should be the "starting point for our discussions".[15]

(ii) SGS's claim for interest

13. In its Request for Arbitration, the Claimant sought by way of damages the amounts due under the CISS Agreement and interest in an unspecified amount.[16] Article 7.5 of the CISS Agreement provides for interest to be paid on unpaid amounts as from the due date defined in the Agreement "at the rate of the then prevailing Swiss Franc LIBOR rate". The claim for interest has not been particularised before the Tribunal but is said to amount to CHF26.5 million.[17]

14. The Commission on Audit did not address the issue of contractual interest. Following the Commission's Report, that issue thus remained unresolved.

15. At the hearing, SGS claimed that during the negotiations it had abandoned its claim to contractual interest. But although it may be implicit in SGS's letters of 25 April 2006 and 23 February 2007 that SGS would have been willing to settle for the prompt payment of the invoice amount, there is no express waiver of the interest claim in these or other letters.

16. In an attempt to clarify matters, counsel for the Claimant formally abandoned its claim for contractual interest at the hearing on 4 December 2007.[18] Instead, he asserted a claim for interest at international law, i.e. extra-contractual interest. But whereas international tribunals do have the

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13 See Bureau of Customs, letter of 8 December 2005 to SGS; Bureau of Customs, letter of 3 May 2006 to Department of Finance; Bureau of Customs, letter of 5 May 2006 to SGS (referring to "the settlement of the outstanding obligations due you in the amount of CHF 171,161,2521.47").

14 This is clear, *inter alia*, from the Undersecretary, Department of Finance's letter to SGS of 25 January 2007.

15 Letter of Undersecretary, Department of Finance to SGS, 25 January 2007.

16 Request for Arbitration, 24 April 2002, para 47(iii).

17 Transcript, 4 December 2007, 115 (Professor Greenwood QC).

18 See Transcript, 4 December 2007, 71-73, 197-198 (Professor Gaillard).

power to award interest on unpaid amounts, that is a discretionary power and depends on the circumstances. Guidance may be obtained from the decision of the Permanent Court of International Justice where interest was awarded only from the date of judgment, that being "the moment when the amount of the sum due has been fixed and the obligation to pay has been established".[19] For the purposes of the international law claim under Article X(2) of the BIT, the first of these conditions was not met prior to 4 December 2007; whether the second is met the Tribunal has not yet determined.

(iii) The "Chinese fraud" allegation

17. The position with respect to this allegation is as follows.

(a) The only material before the Tribunal concerning this allegation is a short, non-contemporaneous press article submitted by the Claimant.[20] It suggests that agents of SGS in China deliberately understated import values, causing losses both to the Philippines (estimated at US$100m) and to SGS (estimated at US$13m). It is said that, on discovery of the fraud, SGS took action to stamp it out – as well it might have done. As an isolated press report, the item can only be treated as background information and not at all as proof of its contents.[21]

(b) The Respondent has never particularised the allegation in any correspondence with SGS or with the Tribunal.[22] In the correspondence before the Tribunal, the most notable letter in this regard is the letter by the Undersecretary, Department of Finance to SGS, dated 25 January 2007.[23] After pointing out that "the findings of the COA do not constitute a final and conclusive determination of sums due", the Undersecretary went on to state:

> "In particular, as you know, *in the course of the ICSID arbitration proceedings* a number of matters were raised on behalf of the ROP which would have a potentially substantial impact upon any amounts due. These were not of course considered in the context of the COA Report but will need to be addressed in any discussions between the parties with a view to resolving the dispute." (emphasis added)

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19 PCIJ, Series A, No 1 (1923), 32. See further ILC Articles on Responsibility of States for Internationally Wrongful Acts, 2001, Art 38 & commentary.

20 Exhibit S73, a Dow Jones news wire of 2003.

21 Cf *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v United States of America (Merits)*, ICJ Reports 1986 p 14, 40-41 (paras 62-63).

22 See Transcript, 4 December 2007, 106 (Professor Greenwood QC).

23 Transcript, 4 December 2007, 153-154 (Professor Greenwood QC).

By contrast with the interest claim, which was hitherto in dispute, it is a considerable overstatement to describe the allegation as a matter raised on behalf of the Respondent in the course of these proceedings. At most it was mentioned as a matter which might require to be investigated in proceedings brought by SGS before the contractual forum.

18. The Tribunal would observe:

(a) The allegation was variously described as a potential "defence", "counterclaim" or "set-off":[24] this is itself a source of uncertainty since the legal incidents of these modes of proceeding are not the same in the legal systems with which the Tribunal is familiar.

(b) Whether or not the allegation could be raised as an ancillary claim under Article 40 of the ICSID Rules of Procedure, the fact is that it has not been so raised.[25]

(c) Nor has the Philippines taken any action of any kind before its own courts against SGS, or any other individual allegedly involved, despite the fact that – if the allegation could be substantiated – one might have expected such proceedings to have been brought, or at least a formal inquiry to have been held.

(d) The period of time concerned was apparently the mid-1990s, overlapping only to a limited extent with the period of the unpaid invoices which are the subject of SGS's claim and which began in 1998. Thus the link between the two issues remains unclear. In particular, even if the allegation had been particularised, it is unclear that it would form part of the same dispute as that brought by SGS before the Tribunal.

(iv) The Tribunal's provisional conclusions

19. As has been explained in paragraph 3 above, the reason why the Tribunal held the present claim inadmissible *pro tem* was that there was (on any view) an unresolved dispute as to the amount payable under the CISS Agreement. The question is whether that is still the case, for the purposes of the Respondent's obligations under the BIT or under the CISS Agreement as underwritten by Article X(2) of the BIT. For this purpose, it should be stressed that a dispute is an actual disagreement as to

[24] E.g. Transcript, 4 December 2007, 108 (Professor Greenwood QC).

[25] The Claimant has expressed its willingness to consent to the counterclaim being brought in these proceedings: e.g. Transcript, 4 December 2007, 6 (Professor Gaillard).

the respective rights and obligations of the parties, and that the test is an objective one.[26] Whether there is a dispute is a matter for the Tribunal to determine in the exercise of its power under Article 41 of the ICSID Convention.

20. The Tribunal's Jurisdictional Decision was predicated on a distinction between the determination of the amount owing under the CISS Agreement (which in case of a dispute was a matter for the contractually-chosen forum), and compliance with the obligations underwritten by Article X(2). As the Tribunal observed, "Article X(2) addresses not the *scope* of the commitments entered into with regard to specific investments but the *performance* of these obligations, once they are ascertained."[27] In the period prior to the hearing of 4 December 2007, the invoice amount had been extensively discussed and (as far as the record shows) practically determined. No doubt it was open to the Ministry of Finance to raise further questions about the invoice amount but in the period since the Special Audit Report of 30 November 2005 it has not done so. It may fairly be assumed that there is no basis for doing so.

21. In reaching this provisional conclusion the Tribunal has not needed to take into account an internal Memorandum of the Commission on Audit of 28 June 2007, prepared in response to an inquiry from the Department of Finance asking whether the Special Audit "is deemed a final and binding determination of the government's liability relative to the SGS claim". The Respondent objected to the production of the Memorandum on the ground that it had not been shown to have been lawfully obtained by SGS.[28] At the hearing on 4 December 2007 the Claimant provided only a summary account of the circumstances in which the Memorandum came into its possession:[29] this did not clarify matters further.

22. In the Tribunal's view it is necessary to distinguish two different questions: whether the Special Audit is binding on the Respondent as a matter of law and whether there is any basis in fact for disputing the conclusion expressed in the Special Audit. It is for the Claimant to show that the conclusion is legally binding – which in the Tribunal's view it has not done. But on the question of

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[26] See most recently *Territorial and Maritime Dispute (Nicaragua v Colombia) (Preliminary Objections)*, ICJ Judgment of 13 December 2007, paras 38, 138 and authorities there cited; in the context of investment arbitration, see *United Parcel Service of America, Inc v Canada (Jurisdiction)*, (2002) 7 ICSID Reports 285, 296-7 (paras 32-36).

[27] 8 ICSID Reports 515, 553 (para 126).

[28] See Transcript, 4 December 2007, 86-88 (Professor Greenwood QC).

[29] See Transcript, 4 December 2007, 51-53 (Mr Savage).

fact, the internal Memorandum is unnecessary: the Special Audit speaks for itself, taken in conjunction with the silence of the Department of Finance on the question of the accuracy of the invoice amount in the two years since the Special Audit was completed. If the Claimant wishes to insist on the admission of the internal Memorandum for any purpose, the Tribunal will require further particularization of the circumstances in which it was produced.[30] But as things stand the Internal Memorandum is not a necessary element in proving any matter on which the Claimant's case depends.

23. In these circumstances, the Tribunal does not discern any continued dispute as to the invoice amount.

24. As to the interest claim, SGS's subsisting but unquantified claim to contractual interest has now been abandoned. Its claim to international law interest for non-payment of the amount due under Article X(2) of the BIT is predicated on the finding of a breach of that article, and as explained above, the conditions for the award of interest under international law (which are in the discretion of the Tribunal) have so far not been met.

25. The "Chinese fraud" allegation has not been particularised despite the considerable passage of time since it emerged. As things stand it does not form part of the dispute before this Tribunal. Nor has it been brought before any competent court of the Philippines. Indeed, on the exiguous material presently available, it cannot be said that there is in any forum a distinct dispute between the parties as to sums due by one to the other arising from the allegation. In these circumstances it is difficult to see how it could of itself preclude the admissibility of SGS's claim to payment under the BIT.

26. The Tribunal would stress again that these conclusions are subject to the proviso set out in paragraph 7 above.

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30 Cf *Methanex Corporation v United States of America*, Final Award, 3 August 2005, Part II, Chapter 1, paras 54-55.

ORDER

27. For these reasons the Tribunal:

(a) confirms the lifting of the stay;

(b) directs the parties to submit written pleadings as follows:

(1) the Claimant, by 21 January 2007, a Memorial, stating the amount now claimed and making any necessary submissions of fact and law;

(2) the Respondent, by 21 March 2007, a Counter-Memorial.

28. The President will convene by telecon a directions hearing following the submission of the Counter-Memorial to decide whether a reply and rejoinder will be necessary. Unless a further round of written pleadings is agreed or decided pursuant to Rule 31(1) of the ICSID Arbitration Rules, the Tribunal envisages a hearing in Paris to be held as soon as possible thereafter. This will allow the Parties to make responsive oral submissions as to the admissibility and merits of the claim.

A. S. El Kosheri

Dr. Ahmed S. El-Kosheri,

President

17 December 2007