



RESEARCH ARTICLE

Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines: A Critical Analysis

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ABSTRACT

Under ICSID arbitration related case of Fraport AG Frankfurt v. Philipphines have long been a focal point in discussions about the protection of foreign investment, state sovereignty and the enforceability of international arbitration decisions. This paper critically examines the implications of the case, focusing on the arbitral award's reasoning, the concept of investor due diligence, and its broader consequences for international investment law that contextualize through comparisons with two other landmark cases: Saluka v. Czech (a successful claim) and Inceysa v. El Salvador (an unsuccessful claim). In Saluka, the tribunal upheld the claim of investor, emphasizing the host state's responsibility to ensure fairness and avoid arbitrary actions, even when legal complexities were involved. By contrast, in Inceysa, the tribunal rejected the investor's claim due to illegality in the investment's formation, aligning with the strict adherence to the legality principle seen in Fraport. However, the unique flaw in Fraport lies in the tribunal's failure to fully scrutinize the Philippines' complicity in enabling the investment despite its alleged non-compliance with domestic law. Unlike Saluka, which balanced investor protection with state sovereignty, or Inceysa, which rightfully penalized outright fraud, the Fraport decision rigidly applied the legality clause without considering the state's role in fostering ambiguity. This oversight diminished the case's potential to address shared responsibilities and regulatory inconsistencies, which are crucial for a fair investment regime in evolving global markets.

Keywords: *arbitral tribunal's reasoning, international investment law, legality clause.*

INTRODUCTION

The adjudication of investment disputes through international arbitration has become a cornerstone of global economic governance, offering a mechanism for resolving conflicts between foreign investors and host states. This process, governed by treaties such as BITs and multilateral frameworks ICSID which aims to ensure legal certainty, protect investments, and uphold principles of fairness and equity. However, the rise of investor-state dispute settlement mechanisms has sparked debates over the balance between protecting investor rights and preserving state sovereignty. Cases such as Fraport AG v. Philippines, Saluka Investments v. Czech Republic, and Inceysa Vallisoletana v. El Salvador exemplify the complexities and controversies inherent in the arbitration process. These cases highlight the tensions between legal ideals and practical realities

In *Fraport v. Philippines* case, it emerged from a dispute over a high-profile infrastructure project—the construction and operation of Terminal 3 at Ninoy Aquino International Airport in Manila. In 1999, Fraport AG, a German airport operator, invested in the project under a concession agreement with the Philippine government. The investment was structured through a local partner to comply with the Philippines' foreign ownership restrictions under the Anti-Dummy Law, which limits foreign equity in public utilities to 40%.¹ Despite receiving initial approvals, the partnership later came under scrutiny, leading to allegations that Fraport exercised control exceeding the allowable limits.

The project faced numerous challenges, including regulatory obstacles, political pressures, and allegations of corruption. By 2002, relations between Fraport and the Philippine government had deteriorated, culminating in the termination of the concession agreement and the government's expropriation of the terminal. Fraport filed an ICSID arbitration claim in 2003, alleging breaches of the Germany-Philippines BIT² and seeking compensation for expropriation, violation of FET standard, and failure to provide full protection and security.

The Philippine government defended its actions by invoking the legality clause in the BIT, arguing that Fraport's investment was not made in accordance with Philippine law due to its alleged violation of the Anti-Dummy Law. It also claimed that the concession agreement was void from the outset and therefore unworthy of protection under international law. The tribunal accepted this argument, ruling against Fraport and emphasizing the critical role of legality clauses in ensuring that only lawful investments are protected under BITs.

This case is frequently compared to other prominent investment disputes, such as *Saluka Investments BV v. Czech Republic* and *Inceysa Vallisoletana SL v. Republic of El Salvador*. In *Saluka*, the tribunal balanced state obligations and investor protections, while in *Inceysa*, the claimant's fraudulent actions led to the dismissal of its case. Unlike these cases, *Fraport* raised questions about the shared responsibilities of investors and states in navigating regulatory ambiguities. It highlighted the tension between enforcing domestic laws and upholding international treaty obligations, making it a cornerstone in the discourse on international investment law.

METHODS

This research adopts a qualitative approach, emphasizing doctrinal and comparative legal analysis, to explore the interplay of legality, ethics, and systemic challenges in international investment arbitration. The primary focus is an in-depth examination of the *Fraport AG v. Republic of the Philippines* case, which is analyzed alongside relevant legal frameworks such as the anti-dummy law, the ICSID Convention, and applicable BITs. Doctrinal analysis is used to assess the tribunal's interpretation and application of key

¹ IAREPORTER Investment Arbitration Reporter, Looking Back: In *Fraport v. Philippines* (1), a tribunal majority declined jurisdiction after deciding that an airport concession investment had been made in violation of local law, p. 1

² ICSID Case No. ARB/03/25, *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*.

principles, including the doctrines of legality and clean hands. This is enriched with perspectives from academic literature to provide a nuanced understanding of the tribunal's approach within the broader landscape of international investment law.

A comparative case study method further strengthens the research, with *Saluka Investments BV v. Czech Republic* and *Inceysa Vallisoletana SL v. Republic of El Salvador* serving as reference points. These cases are scrutinized to reveal how tribunals handle jurisdictional compliance, transparency, and investor conduct. The comparative analysis highlights the diverse reasoning patterns employed and evaluates the consistency of arbitral decisions. This method allows the research to critique the *Fraport* tribunal's decision-making process and provide practical recommendations for enhancing fairness, transparency, and coherence in future arbitration cases.

RESULTS AND DISCUSSION

3.1 The Tribunal's Decision: A Flawed Analysis?

The tribunal's approach in *Fraport AG v. Philippines* has faced significant criticism for its strict and formalistic reliance on the legality clause, which effectively denied *Fraport* the protections of the Germany-Philippines BIT. The ruling hinged on the alleged violation of the Philippine Anti-Dummy Law (ADL), a law with ambiguous enforcement and inconsistent application. While legality clauses are essential for ensuring that investments comply with host-state regulations, the tribunal's step is not taking into account for the nuanced realities of regulatory environments in developing countries. However, the Philippine government had approved and facilitated the investment, creating a reasonable expectation on *Fraport*'s part that its structure was lawful. By disregarding these circumstances, the tribunal narrowly focused on formal compliance, undermining the principles of fairness and equity central to international investment law.

A major flaw in the tribunal's reasoning lies in its treatment of host-state complicity. The Philippine government not only approved *Fraport*'s investment but also failed to enforce the ADL consistently, creating a regulatory environment that arguably invited non-compliance. A more balanced analysis would have considered the state's role in fostering the conditions that led to the alleged violations. This contrasts with the tribunal's reasoning in *Saluka Investments BV v. Czech Republic*, where the host state's discriminatory actions were carefully scrutinized in the context of the investor's legitimate expectations. In failing to address the Philippine government's responsibility, the tribunal in *Fraport* ignored a critical dimension of the dispute, leading to an overly one-sided interpretation of the legality clause.

The decision also reveals a missed opportunity to interpret the BIT's provisions in light of its broader purpose—to promote and protect foreign investment. By strictly enforcing the legality clause without considering mitigating factors, the tribunal risked undermining the very objectives of the treaty. Unlike *Saluka*, where the tribunal took a more balanced approach to align the treaty's language with its investment-promoting goals, the *Fraport* tribunal's rigid interpretation failed to strike an appropriate balance between state sovereignty and investor protection. Such an approach risks discouraging foreign investors

from engaging in jurisdictions with unclear or inconsistently enforced regulations, potentially undermining the development objectives of BITs.

Finally, the *Fraport* tribunal's decision highlights the limitations of overly formalistic reasoning in complex investment disputes. While adherence to domestic laws is a legitimate requirement, tribunals must interpret legality clauses in a way that considers both investor conduct and host-state obligations. The refusal to analyze the ambiguities of the ADL or the government's complicity in facilitating Fraport's investment demonstrates a lack of contextual sensitivity. A more flexible and equitable approach, akin to the reasoning in *Saluka*, could have produced a more balanced outcome. By prioritizing strict legal compliance over fairness and the shared objectives of the BIT, the tribunal in *Fraport* delivered a decision that, while technically defensible, failed to advance the broader goals of international investment law.

Table 1. Illustration of the divergence in tribunal approaches

Factor	Fraport AG v. Philippines	Saluka Investments BV v. Czech Republic	Inceysa Vallisoletana SL v. El Salvador	ICSID Trends
Primary Legal Issue	Legality clause and expropriation	Fair and Equitable Treatment (FET)	Legality clause and fraud	Expropriation in ~30-40% of cases
Claimant Success Rate	Unsuccessful	Successful	Unsuccessful	~38% of cases favor investors
State Success Rate	Successful	Unsuccessful	Successful	~47% of cases favor states
Legality of Investment	Non-compliant (Anti-Dummy Law)	Compliant	Non-compliant (Fraudulent investment)	~15% of ICSID cases hinge on legality
Outcome Justification	Strict application of legality clause	Broad interpretation of FET obligations	Strict application of legality clause	Balanced interpretation varies

Award to Investor (if any)	None	Compensation for harm	None	Compensation in ~35% of cases
Contributions to Investment Law	Reinforced legality clauses	Broadened interpretation of FET	Reinforced focus on fraudulent investments	Highlights host-state and investor duties
Unique Features	Host-state complicity not considered	Broad investor protection emphasized	Fraud undermining investor claims	Regulatory ambiguity impacts outcomes

Therefore, we see that tribunal was overemphasis on legal compliance, using strict interpretation of compliance has drawn criticism for placing disproportionate emphasis on host-state laws. While it is reasonable to expect investors to respect local laws, the tribunal failed to account for the often-fluid nature of regulatory environments in developing countries. This rigid stance undermines the balance between investor protection and state sovereignty, creating uncertainty for foreign investors.³ In addition, ignoring the reality that such regulations in the Philippines have historically been subject to inconsistent enforcement and interpretation by only focusing the anti-dummy law.⁴ This lack of clarity raises questions about the feasibility of compliance, particularly for foreign investors operating in complex regulatory environments.

The decision overlooked the role of the Philippine government in facilitating the investment, despite its alleged illegality. By approving Fraport's business structure and signing the concession agreement, the government arguably contributed to the situation.⁵ The tribunal's failure to critically examine this complicity undermines the equitable principle of estoppel, which could have tempered the host state's reliance on domestic laws to evade treaty obligations.

³ Bjorklund, A. K. "Investment Treaty Law and the Anti-Dummy Law: A Misalignment of Expectations." *Journal of International Arbitration*, 2010.

⁴ Reyes, M. "Legal Ambiguities in Philippine Anti-Dummy Law Enforcement." *Philippine Law Journal*, 2008.

⁵ Schreuer, C. "The Principle of Estoppel in International Law." *Oxford Reports on International Law*, 2006.

3.2 Investor Due Diligence

a. Questionable Standard

The ruling underscored the necessity for investors to conduct thorough due diligence to ensure adherence to the host state's legal framework. While this is a reasonable expectation, the case reveals the limitations of this principle. Even with thorough due diligence, investors cannot always predict how laws will be interpreted or enforced. This is particularly true in jurisdictions with opaque legal frameworks and shifting political landscapes, as seen in the Philippines during the period in question.⁶

Holding Fraport solely accountable for noncompliance ignores the inherent risks of investing in such environments. A more balanced approach would consider the shared responsibilities of the investor and the host state, particularly when the latter actively solicits and facilitates the investment.

b. Legal and Ethical Implications of Secret Shareholder Agreement

The intersection of legality and ethics in international investment arbitration has often been contentious, particularly in cases involving secret agreements including *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, where the presence of clandestine arrangements significantly impacted the tribunal's decision and also as the main problematic one to this case.

- Legal Dimensions: Jurisdictional Objection

A core principle of international investment law is that investments must adhere to the legal framework of the host state. The *Fraport* case exemplifies this, with the tribunal rejecting the claim due to Fraport's investment breaching the Philippine Anti-Dummy Law (ADL). This law prohibits foreign entities from exercising control over certain sectors reserved for Filipino nationals. By structuring secret shareholder agreements to bypass these restrictions, Fraport undermined the legality of its investment.

The tribunal's decision is consistent with the established doctrine of clean hands, which has its roots in equitable principles aiming to ensure that parties seeking legal remedies must themselves act ethically and lawfully. In this case, the tribunal faced jurisdictional objections regarding Fraport's compliance with the Philippine Anti-Dummy Law. These objections challenged the admissibility of the claim, as the investment's legality was in question. The tribunal upheld these objections, applying the clean hands doctrine to dismiss Fraport's claim on the basis of its unlawful conduct. This application underscores the doctrine's function as a gatekeeping mechanism in

⁶ Van Harten, G. "Investment Treaty Arbitration and Due Diligence." Cambridge Studies in International and Comparative Law, 2013.

international investment arbitration, ensuring that tribunals address jurisdictional concerns before delving into the merits of a case., which has its roots in equitable principles aiming to ensure that parties seeking legal remedies must themselves act ethically and lawfully.

Historically, this doctrine has evolved to uphold fairness by denying claims where the claimant's misconduct significantly contributes to the dispute. In international investment law, it has been applied to reinforce compliance with host-state laws and ethical standards. For instance, the decision in *World Duty Free v. Kenya*, where the claimant's bribery invalidated its claim, highlights the importance of this doctrine in discouraging corrupt practices. The doctrine's application in the *Fraport* case underscores its critical role in maintaining the integrity of arbitration processes by penalizing investors who violate the laws of the host state., which denies treaty protection to investments tainted by illegality.

However, the decision raises broader questions about the application of this doctrine. While the tribunal rightly penalized *Fraport* for circumventing Philippine law, it failed to address whether the restrictive nature of the Anti-Dummy Law itself contributed to the creation of these secret agreements. This omission highlights the need for tribunals to consider not only investor misconduct but also the regulatory environment that fosters such behavior.

- Ethical Dimensions: Investor Responsibility and Good Faith

Beyond legal compliance, the use of secret shareholder agreements raises profound ethical concerns. This legal framework is built on the foundation of mutual trust and good faith, ensuring that all parties uphold their commitments and act with integrity. By engaging in clandestine arrangements, *Fraport* violated these ethical norms, eroding the integrity of the investment process.

Transparency is a fundamental expectation in foreign investments. A notable example is the case of *Saluka Investments BV v. Czech Republic*, where transparency played a decisive role. In this case, the tribunal commended *Saluka*'s adherence to transparent and lawful investment practices, which ultimately influenced its favorable ruling. Conversely, the *Fraport v. Philippines* case highlighted the consequences of lacking transparency, as secret agreements undermined the legitimacy of the investment. These contrasting outcomes underscore how transparency can significantly impact the tribunal's assessment and the overall resolution of disputes. Secret agreements, by their very nature, undermine transparency and create an environment of mistrust.⁷ This ethical violation is especially concerning given the overarching goals of international investment treaties,

⁷ Wälde, T. "Abuse of Process in Investment Arbitration." ICSID Review, 2010.

which seek to encourage sustainable and fair investments. Fraport's actions, driven by an apparent desire to maintain control over PIATCO despite legal restrictions, reflect a prioritization of profit over ethical considerations.

The ethical dimension becomes even more pronounced when contrasted with the case of *Saluka Investments BV v. Czech Republic*. Unlike Fraport, Saluka's investment complied with host-state laws and adhered to ethical standards, enabling the tribunal to rule in its favor. The contrast between these cases highlights the pivotal role of ethical conduct in determining the outcome of investment disputes.⁸ Investors who act in good faith and respect host-state laws are more likely to receive protection under international treaties such as BITs as tools for promoting cross-border investment.

CONCLUSION

Fraport case underscores the intricate interplay between legality, ethics, and systemic challenges. The tribunal's decision, that Fraport violated the Philippine Anti-Dummy Law and highlighted the critical role of host-state laws in shaping the boundaries of legitimate investments. This case serves as a stark reminder that compliance with domestic legal frameworks is not merely procedural but foundational to securing treaty protections. However, the tribunal's narrow focus on legal violations missed an opportunity to address the systemic factors, such as overly restrictive regulations, that incentivize secret agreements. This oversight reflects a need for arbitration to evolve beyond adjudicating specific disputes to tackling broader systemic issues in the investment ecosystem.

The ethical dimensions of investor conduct further emphasize the importance of transparency and good faith. Fraport's clandestine arrangements not only violated host-state laws but also eroded the mutual trust essential for fostering sustainable investment relationships. Comparing this case with others like *Saluka* and *Inceysa* reveals that adherence to ethical standards significantly impacts arbitration outcomes. Tribunals must adopt a more holistic approach, considering both the legality and ethical implications of investor behavior. By doing so, they can ensure that international investment arbitration remains a credible and balanced mechanism for resolving disputes.

Moving forward, reform is necessary to address the gaps exposed by the Fraport case. This includes clarifying evidentiary standards for allegations of illegality, promoting transparency in investment practices, and encouraging host states to create regulatory frameworks that minimize ambiguity. Tribunals must also embrace their role as stewards of systemic reform, providing guidance that strengthens the coherence and predictability of international investment law. Only by addressing these challenges can the arbitration system achieve its dual objectives: protecting investor rights while upholding the sovereignty and regulatory autonomy of host states.

⁸ Yannaca-Small, C. "Improving the Balance Between Investor Protection and State Sovereignty." OECD Working Papers on International Investment, 2006.

Finally, the Fraport case serves as a call for reform in arbitration processes. Tribunals must adopt a more holistic and proactive approach that goes beyond adjudicating individual disputes to addressing systemic issues in investment governance. Future rulings should provide clearer guidance on contentious doctrines like clean hands and evidentiary thresholds, ensuring consistency and predictability in arbitration outcomes. By integrating legal precision with ethical considerations, the international arbitration framework can better fulfill its role as a mechanism for resolving disputes and promoting sustainable investments.

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