Kluwer Arbitration Blog

# Uruguay Found Liable in Treaty Dispute with Airline Company Investor

Javier Ferrero Díaz (CMS Grau ) · Friday, July 26th, 2024 · Asociación Latinoamericana de Arbitraje (ALARB)

On February 13, 2024, a tribunal comprising of Alexis Mourre, Eduardo Siqueiros and Eduardo Zuleta Jaramillo rendered an award in the case of *Latin American Regional Aviation Holding S. de S.R.L. v. Uruguay* (ICSID Case No. ARB/19/16), under the Panama – Uruguay bilateral investment treaty (the "Treaty").

The dispute concerned Uruguay's national airline Pluna, where the Claimant, a Panamanian company – *Latin American Regional Aviation Holdings S. de S.R.L.* ("LARAH") acquired in 2007 a 75% stake through its subsidiary Leadgate. The other 25% stake in Pluna was held by the public company *Primeras Líneas Uruguayas de Navegación* ("PEA"). During the following years Pluna incurred in several operational and financial difficulties. This resulted in the forced sell of LARAH's indirect shareholding in Pluna to the Uruguayan government in June 2012. The sale was formalized in a Memorandum of Understanding ("MOU") signed with the State without any compensation, and the airline company entered into a bankruptcy proceeding.

In April 2019, LARAH initiated an ICSID arbitration against Uruguay alleging the State's breach of the Treaty, specifically breaches to the fair and equitable treatment standard ("FET" – Art. 4.1 of the Treaty) and an indirect expropriation of its investments (Art. 6.1. of the Treaty). LARAH claimed damages for Uruguay's violations of the Treaty for an amount of US$ 861 million, plus interests calculated until the payment date under a US Prime interest, and the payment of all Claimant's costs.

Uruguay filed jurisdictional objections and requested the Tribunal to deny all of LARAH's claims. In its Award, the Tribunal dismissed Uruguay's jurisdictional objections and found that the State breached the FET standard under the Treaty and incurred in an indirect expropriation of the Claimant's investment.

This article discusses the Tribunal's findings in this case.

**Uruguay's jurisdictional objections**

Uruguay raised three jurisdictional objections based on the lack of a protected investor on the basis of nationality, the lack of a protected investment, and the Claimant's written waiver to submit a

claim against the State. As mentioned, the Tribunal ultimately dismissed all of these objections.

- *LARAH did not provide adequate evidence that at the time of the State's measures it was an indirect shareholder that held 75% of the shares in Puna.*

The Tribunal first noted that the determination of whether Claimant had a 100% stake in South American Regional Aviation Holding Corp. (before named Leadgate) at the critical date of June 15, 2012 – date when the MOU was signed transferring LARAH's shares in Pluna to Uruguay – was a factual analysis part of an international arbitration under the ICSID Arbitration Rules, so Panamanian law did not apply.

After a review of all the facts and evidence, the Tribunal concluded that LARAH held a 100% stake in Leadgate/SARAH since April 30, 2012. Also, LARAH's 100% stake in SARAH's was maintained after this date and until June 15, 2012. Therefore, the Tribunal found that LARAH proved it was a Panamanian company who made an investment in Uruguay, so it was an investor under the ICSID Convention and under the Treaty.

- *LARAH did not perform an investment under the Treaty and the ICSID Convention*

The position of Uruguay was that LARAH was only a mere passive holder of shares in Pluna, which did not comply with the objective elements of a protected "investment" under the *Salini test*, which required that an investment under the ICSID Convention involved a risk-taking by the investor, a certain duration, and a contribution to the economic development of the host State.

The Tribunal concluded that in the present case, even applying a stricter approach under the *Salini test,* LARAH's investment in Pluna objectively qualified as an investment protected under the Treaty. According to the Tribunal in general terms, a 75% indirect stake in a public airline, where the investor exercised management activities complied with the objective investment requirement.

- *LARAH's claims shall be denied since there were part of a transaction under the MOU*

Uruguay alleged that LARAH's claims were subject of a transaction under the MOU where the parties: (a) declared that they had nothing to claim each other; (b) they promised not to present any claims based on facts or circumstances related to Pluna; and (c) they agreed to keep each other harmless from possible actions initiated by others. Uruguay's position was that the parties waived their rights to claim each other from all types of liabilities related to Pluna.

The Tribunal started by recognizing that protection of investments under an investment treaty are based on the granting by the State to the foreign investor of a direct right of action based on the arbitration offer included in the treaty. Therefore, there was no international law principle under which said right could not be waived. However, in the present case, there were some elements that made the Tribunal conclude that LARAH was not part of this waiver.

First, LARAH was not a party of the MOU, and this was not an omission, but instead the result of

the parties' specific will (SARAH, SAO, PEA and the Uruguayan government) of not binding LARAH under the MOU. Second, in the event that LARAH could be considered bound by the waiver under the MOU, said waiver was affected by a resolution condition triggered in the present case, since on July 2014, Pluna – through its workers union – initiated before Uruguayan courts a civil lawsuit against SAO, SARAH and PEA before starting the ICSID arbitration.

**LARAH's claims under the Treaty**

LARAH alleged that Uruguay violated the fair and equitable treatment standard under the Treaty (Art. 4.1) by incurring in arbitrary and discriminatory measures, and illegally expropriated Claimant's investment (Art. 6.1).

- *The FET claim*

The Tribunal began its analysis highlighting that the FET standard under Treaty did not mention a minimum treatment under customary international law, and there was no evidence that the State parties when signing the Treaty had the intention to refer to this minimum standard of treatment. Pursuant to Article 4.1 of the Treaty, "[e]ach Contracting Party shall ensure fair and equitable treatment within its territory to investments of investors of the other Contracting Party and shall ensure that the exercise of the rights recognized herein shall not be hindered in practice." (Non-official English translation). Therefore, the Tribunal concluded that the FET under Article 4.1 of the Treaty was an "autonomous standard".

The Tribunal found that Uruguay adopted between April and May of 2012 a series of illicit measures that violated the FET standard under the Treaty consisting of three interrelated events: (i) the interruption of the cash facility that Pluna enjoyed for its fuel supply by the National Fuel Association ("ANCAP"); (ii) the loss of an important bank loan by ING, which was necessary for Pluna's continuing operations and complex financial situation, due to the State's public opposition; and (iii) a strong press campaign against Pluna, where multiple high public officials made declarations about the management and financial situation of the company.

The Tribunal concluded that these three events generated the paralysis of Pluna, considering the fragile economic and financial situation of the company at that moment, which caused the Claimant to transfer its shareholding to the Uruguayan Government without compensation in June 2012, and the subsequent liquidation of the company.

- *The indirect expropriation claim*

The Tribunal found that the three interrelated events that breached the FET standard, were also relevant for the determination of an indirect expropriation by the State, in breach of Article 6.1 of the Treaty.

Therefore, the Tribunal concluded that Uruguay illegally expropriated the Claimant's investment in Pluna through a set of various measures that generated the paralysis of the airline company and the

loss of its total value, which led to the Claimant's transfer of its shares to the State without any compensation through the MOU.

- *Damages Determination*

The Tribunal established that the damages to which the Claimant was entitled where identical whether Uruguay's liability was based on the breach of the FET standard, or on indirect expropriation. According to the Tribunal, in both events, the damages corresponded to the fair market value of the company at the valuation date (June 15, 2012).

The Tribunal found that the appropriate methodology of damages calculation was not the discounted cash flow ("DCF"), since "*there* [were] *no objective and reasonably reliable data to use to DCF method in this case*" (Non-official English translation) (Award, para. 1018). For the Tribunal, the Claimant's damages calculation of the amount of US$ 861.5 million was too speculative based on the DCF method. The Tribunal's position was based in part in "the objective impossibility of foreseeing with reasonable certainty the evolution of the company's revenues in conditions in which it needed both new capitalization and an adjustment of its strategy, and to foresee with sufficient reliability the way in which the market would receive the significant increase in Pluna's offered capacity, in terms of charge rate, pricing and cost evolution." (Non-official English translation) (Award, para. 1174)

Therefore, the Tribunal concluded based on the sunk costs methodology that the value of the 75% stake in Pluna at valuation date was equivalent to US$ 30 million. Consequently, the Tribunal ordered Uruguay the payment to the Claimant of the amount of US$ 30 million in damages, plus pre award and post award interest under the US prime rate.

With respect to the parties' claims for costs, the Tribunal applied the rule of the "costs follow the event" and ordered Uruguay (as the losing party) to pay a portion of Claimant's costs.

**Conclusion**

The recent ICSID award in *LARAH v. Uruguay* demonstrates that an arbitrary and contradictory conduct by a State, through a strong public opposition by high public officials, with the objective of affecting a company's operations and financial capacity, could be considered a breach of the fair and equitable treatment standard. In addition, a state's conduct which severely affects the normal operations of the company and its economic value, is determinant for a finding of an indirect expropriation.

With respect to damages, considering the financial situation of LARAH, the Tribunal concluded correctly that the DCF methodology was not the appropriate one to compensate the investor for the State's treaty breaches, and instead a sunk costs methodology applied to reduce the speculation in the calculation of a claimant's damages for indirect expropriation.

---

*To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.*


2024 Summits on Commercial Dispute Resolution in China

**17 June – Madrid**
**20 June – Geneva**

Register Now →

This entry was posted on Friday, July 26th, 2024 at 8:57 am and is filed under Investment Arbitration, Investment Disputes, Investment law, Investment protection, Investment Treaties, Latin America, Uruguay
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.