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Pittsburgh Post-Gazette

BUSINESS / LAW

How a Pittsburgh rail company fought the Guatemalan government and won

July 16, 2012
By Elizabeth Bloom / Pittsburgh Post-Gazette

Railroad Development Corp.
A steam train crosses the bridge below Agua Caliente, Guatemala. This steel structure was subsequently dismantled by scrap metal thieves after the declaration of "lesivo."

Railroad Development Corp.
After years of little maintenance, loss of traffic, invasion by squatters, the abandonment of operations in 1996, and the destruction caused by Hurricane Mitch in late 1998, commercial service was resumed on April 15, 1999 with service between Guatemala City and El Chile.

Railroad Development Corp.
A track gang replaces ties near Puerto Barrios, Guatemala. In December 1999, commercial service was restored from Guatemala City, to the Atlantic ports of Puerto Barrios and Puerto Santo Tomas.

When the government of Guatemala issued a presidential decree declaring that a railway run by Railroad Development Corp. was harmful to the country's interests, the Green Tree rail company soon found it could no longer effectively run operations.

"When the government declares war on you, people are very, very hesitant to do business with you," said C. Allen Foster of Greenberg Traurig, LLC, who worked on the Washington, D.C.-based legal team representing the company.

The decree was issued in 2006, after the company had refused to develop the national railway along the western coast of the country. Railroad Development Corp. stopped operating the Guatemalan national railway through its Guatemalan affiliate, Ferrovias Guatemala, in September 2007.

It then brought a case to a tribunal of the International Centre for Settlement of Investment Disputes, or ICSID -- a case that finally came full circle this summer.

It is the first case under the Dominican Republic-Central America Free Trade Agreement, better know as CAFTA, thus far that has been brought fully to a decision, according to Whitney Debevoise, partner at Arnold & Porter, LLC, which represented Guatemala. In 2004, the United States signed CAFTA, which is the first trade agreement between the U.S. and smaller developing countries.

Railroad Development Corp. claimed that Guatemala had violated the free trade agreement by failing to provide adequate treatment and security to investors.

On June 29, ICSID ruled against Guatemala, awarding the company approximately $14 million in damages and fees from the Guatemalan government, according to a statement released by the company earlier this month.

'Total abandonment'

The story began back in 1996, when the Guatemalan government stopped operating its national railway via Ferrocarriles de Guatemala, an autonomous government agency that owned and operated the railroad.

"The railroad was in total abandonment," said Mr. Foster.

Guatemala then sought bidders for a 50-year contract to operate the defunct railway, which ran through the country's major towns. Railroad Development Corp. won the contract and started operations in 1997.

Railroad Development Corp. spent millions of dollars rehabilitating the railroad, fixing everything from tracks to locomotives, according to Mr. Foster.

A privately-owned railway management and investment company, Railroad Development Corp. primarily focuses on emerging transportation markets in the developing world. The company has run operations everywhere from Iowa and Argentina to Malawi and Estonia. Its chairman is Henry Posner III, who started the company after working for Conrail.

The freight railway provided an alternative for truck shipping on Guatemala's crumbling roads, according to Mr. Foster. The company gained revenue from allowing businesses to ship products such as steel, bananas and sugar through its lines and from developing ancillary properties along the railroad.

For example, by owning the real estate by the tracks, it started negotiations with a company to develop supermarkets at train stations.

In 2006, Guatemala asked Railroad Development Corp. to renegotiate the concession. The railway was operating in the eastern parts of the country, but Guatemala wanted the company to redevelop the rail closer to the Pacific Ocean. The country believed when it had contracted with the company that Railroad Development would be able to develop the railroad in five stages, but according to Mr. Debevoise, it had completed only one stage.

"Guatemala was frustrated, because they felt [Railroad Development Corp.] had the financial wherewithal to restore the railroad in the whole country," said Mr. Debevoise.

The company's bid materials, he said, included claims that it "would have the money or could get the money to finance the subsequent phases, and that just proved not to be the case."

The company believed the request was made for the benefit of a sugar shipper named Ramon Campollo. The tribunal rejected those claims, according to Mr. Debevoise.

'Harmful to the state'

Railroad Development Corp. refused to develop the western railroad because, Mr. Foster said, it would have lost money in developing a rail there.

As a result, Guatemala issued a "lesivo," or presidential decree, which declared that Railroad Development Corp.'s operations were "harmful to the interests of the state," according to a company statement released earlier this month.

Though, in Mr. Foster's words, Guatemala did not "put troops in the field," the damage had been done. With the government involved, companies terminated or stopped entering into long-term contracts with Railroad Development Corp.

For nine months, the company tried to continue operations, but the effort became unsalvageable. "The company was a dead man walking," Mr. Foster said.

In June 2007, the company went to ICSID to file a complaint against the government under CAFTA, for failing to provide adequate protection to a foreign investor. It ceased operations of the railroad in September of that year.

ICSID, which is a Washington, D.C.-based arm of the World Bank, conducts international arbitration cases, much like organizations such as the International Chamber of Commerce in Paris and the United Nations Commission on International Trade Law in Vienna.

Guatemala made two procedural objections, delaying the case (though the objections were eventually denied by the ICSID).

The resulting three-year delay tacked on $200,000 to damages eventually owed by the country.

Mr. Foster said Guatemala needlessly drew out the case, though Mr. Debevoise pointed out that international arbitration cases often take four years to conduct, and that part of the award will include compounded interest.

"Whatever delay there was, they're being compensated," Mr. Debevoise said.

The award will also deduct rental fees that Railroad Development Corp. collected after the lesivo was issued. All in all, the exact award will depend on negotiations between the two parties, he said.

As part of the settlement, the Railroad Development Corp. will relinquish its 82 percent share in Ferrovias to Guatemala or its appointee. For now, Mr. Foster said Guatemala will have to search for another company willing to run Guatemala's railway, which currently stands unused in the country.

"Whether the government will be able to agree with anybody is a different story," he said.

On Guatemala's end, the country is "happy [it's] going to get this property back, and [it's] looking forward to developing a railroad," said Mr. Debevoise.

The case, he said, was more about returning to the pre-"lesivo" standing than it was about awarding one side over another.

The tribunal's ruling, he said, acknowledged that "this was an unhappy marriage, so we'll just go back and make it as though this never happened."

Elizabeth Bloom: ebloom@post-gazette.com or 412-263-1969.

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