

BEFORE THE HONORABLE TRIBUNAL  
ESTABLISHED PURSUANT TO CHAPTER ELEVEN OF THE  
NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

METALCLAD CORPORATION  
CLAIMANT

vs.

THE UNITED MEXICAN STATES  
RESPONDENT

Case No. ARB(AF)/97/1

POST-HEARING BRIEF



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November 9, 1999

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# POST-HEARING BRIEF

## Part One

### Introduction and Brief Retrospective

A hazardous waste landfill has been built by Claimant at La Pedrera; it remains operationally complete and ready to perform its intended function. It has been prevented from operating by a municipality's pronouncement that, despite the issuance of all essential federal and state permits, the project is and will remain legally deficient for want of a certain permit; that permit is one which the Municipality claimed the power to grant but which it purported to withhold from Claimant, on bases that were ultra vires, arbitrary, administratively below international standards and belated in light of Claimant's intervening detrimental reliance.

Ultimately, federal authorities, with whom Claimant had formed a formal agreement allowing operations at the site, informed Claimant that they could do nothing further to bring about operations at La Pedrera. Since late 1995, federal authorities had been made to defend their agreement with Claimant in various proceedings; a by-product of those proceedings was a moratorium on commercial operations, enforced by an injunction which lasted well into the autumn of 1999, the exact status of which remained in dispute at the time of the Hearing in this case. By the time of the Hearing, there had also existed for two years a state decree credited by its signatories with ending whatever theoretical potential there may have existed for Claimant to operate its landfill.

In a subsequent adoption by Respondent of the acts, omissions and policies of the Municipality, in these proceedings Respondent has proposed that the Municipality acted in a manner lawful under domestic law; it has also insisted that NAFTA either does not apply to municipalities or has been complied with. The latter follows, says Respondent, because the Mexican Constitution contemplates that municipalities may issue construction permits; it was that constitutional provision, stresses Respondent, that the Municipality invoked in purporting to forbid operations at La Pedrera. The state decree, moreover, must be ignored argues Respondent because, despite the attributes given it by its authors, and despite common sense, Claimant has not demonstrated how the law has impaired its property rights.

In the light of facts confirmed at the Hearing, Claimant remains confident that Respondent's defense is factually and legally errant; and that acts attributable to Respondent entitle Claimant to damages. In reaching this conclusion, Claimant applies to the facts of record NAFTA Articles 105, 1105 and 1110 and surrounding international legal principles. The acts and omissions upon which it relies are those of officials and institutions at the local, state and federal levels—all entities for whose conduct Respondent is accountable.

The approach sponsored by Claimant is amply supported by the authorities. It includes the following precepts: 1] that acts and omissions<sup>1</sup> attributable to a State may alone or in combination give rise to liability;<sup>2</sup> 2] that a state's responsibility may be engaged even though the state charged was motivated by legitimate sovereign concerns (or by no particular animus at all)<sup>3</sup> and even though the conduct occurred in an informal manner;<sup>4</sup> 3] that responsibility for breaching a treaty may arise even though the questioned conduct is fully consistent with domestic law<sup>4</sup> and that, a fortiori, conduct that is illicit under internal law, may also engage a state's international responsibility; 5] that the immediately preceding principle is not affected by the existence of a domestic procedure or remedy designed to address the complained of conduct,<sup>5</sup> although in certain settings not contemplated by

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<sup>1</sup>See, e.g., *Petrolane*, 27 Iran-U.S. CTR 64 (taking occurred in State's refusal to issue export authorization).

<sup>2</sup>See, e.g., *Amco II* (quoting with approval Commissioner Nielson's observation in the *McCurdy* case [5 Ann. Dig 165] that "even if no single act constitutes a denial of justice, such denial of justice can result from a combination of improper acts." 1 ICSID Reports 569 (1993) at 604.

<sup>3</sup>See, e.g., *Ghana Investments*, 95 ILR at 209.

<sup>4</sup>See, e.g., *Phillips Petroleum*, 14 Iran-U.S. C.T.R. 79.

<sup>4</sup>Cf. Vienna Convention on the Law of Treaties, art. 27 ("A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.").

<sup>5</sup>See, e.g., *ELSI*, at paras. 32, 41-43 124 (award of damages for property's loss of use did not preclude espousal based upon alleged breaches of bilateral treaty).

NAFTA, an aggrieved party may be required to exhaust the domestic remedy before pursuing his rights internationally.<sup>6</sup>

Claimant's view also presupposes that treaties are to be interpreted in light of their objects and purposes and in a manner that avoids absurd results; and, that NAFTA and other treaties of its type aim to promote secure investment environments based upon an international standard, so that Respondent and states similarly situated will attract significant capital commitments from abroad.

Despite Respondent's attempt to make Claimant responsible for all aspects of landfill siting policy and practice, and for a supposed unyielding designation of La Pedrera, federal organs of Respondent were in fact the driving force in these activities, as one would expect them to be given their mandate. Though within the Municipality of Guadalcazar, La Pedrera is separated from that Municipality's main population center by 100 kilometers of highway and by mountainous terrain. Years before Claimant became aware of the site, federal authorities recognized its potential as a location for hazardous waste processing operations; they authorized the former owners of COTERIN to establish and operate a waste transfer station there.

By September 1993, when Claimant exercised its option to purchase COTERIN, that entity had received from federal authorities two site-specific permits: one contemplated construction of an industrial waste landfill (to be completed in one year)<sup>7</sup> the other was an operating permit, that prescribed in detail the manner in which further activities at the site—including certain construction—would be carried out.<sup>8</sup>

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<sup>6</sup>See generally Amerasinghe, *Local Remedies in International Law* (1990). NAFTA Article 1121(2) requires an investor wishing to arbitrate under NAFTA to not continue proceedings before domestic tribunals related to the measure of which it complains. Rather than positing a rule of exhaustion, therefore, the NAFTA merely disallows parallel proceedings.

<sup>7</sup>Excerpted at Reply para. 37.

<sup>8</sup>The latter contained much detail; but it made no mention of local construction permits. The former (the January 1993 federal construction permit) contained a generic, catch-all provision noting that other federal, state, and municipal authorities might impose additional requirements in the course of Claimant's construction activities; on May 11, 1993, the Claimant fulfilled such an additional requirement—the state land use permit.

Article 124 of the Mexican Constitution reserves to the states only those powers not claimed by federal authorities. The powers of municipalities in turn depend upon grants of same by the states—grants allocated from the state’s reserved powers. To the extent that the states have no power to delegate concerning a particular activity, because of federal preemption, municipalities, cannot properly regulate that activity; ex hypothesi, they could receive nothing from the state.

LGEEPA allocates and delineates competency in relation to the regulation of waste. In doing so, it distinguishes hazardous waste from non-hazardous waste, and grants states and municipalities the power to regulate only non-hazardous waste. It reserves for federal authorities the power to regulate hazardous waste. Respondent has not called into question the constitutionality of LGEEPA (nor would the success of its argument affect its international responsibility).

Article 115 of the Mexican Constitution addresses the organization of the constituent states of Mexico. It gives municipalities the power to grant licenses and building permits “under the terms of the respective federal and state laws” and Respondent has conceded that municipal power to issue construction permits ‘may be regulated by federal regulations’.<sup>9</sup> Madam Carabias confirmed at the Hearing, moreover, that if a municipality purported to regulate hazardous waste through the mechanism of construction permitting, it would be exceeding its authority.

## **Part Two**

### **Replies to the Tribunal’s Questions**

#### **1. Is the Federal Government of Mexico Internationally Responsible for Any Conduct of the State or the Municipality Authorities?**

##### **A. In Brief: (Yes).**

Pursuant to established principles of state responsibility, the acts and omissions of municipalities are attributed to the State of which they form a part, even if the conduct under study exceeds the authority of municipalities

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<sup>9</sup>Counter-Memorial, para. 191.



as a matter of the internal law of the State. NAFTA incorporates the foregoing precepts by expressly adopting international law. Standard rules of treaty interpretation applied to NAFTA render the same result when considered in light of NAFTA's objects, the context in which it was formed and the principles of international law otherwise applicable among the parties. Any interpretation that excludes from NAFTA coverage the acts of municipalities is impracticable and would retard and reverse investment flows, contrary to NAFTA's avowed aims. Such an interpretation would also frustrate the goals of certain domestic legislation designed to facilitate NAFTA.

## **B. Discussion.**

### *1) Standard Rules of Treaty Interpretation.*

The relevant customary principles of treaty construction have been codified in the Vienna Convention on Treaties. Article 31 of that text provides that treaty terms shall be interpreted 1) in good faith; 2) in accordance with the ordinary meaning to be given to such terms in their context, and; 3) in light of the treaty's object and purpose. The same convention requires that account be taken of "any relevant rules of international law applicable in relations between the parties."<sup>10</sup> NAFTA expressly adopts that standard approach<sup>11</sup>. Further, under the Vienna Convention, special meaning is to be attributed to a treaty provision only "if it is established that the parties so intended."<sup>12</sup> The meaning derived by the above general rules of interpretation may be confirmed by reference to the "circumstances of [the Treaty's conclusion]."<sup>13</sup>

NAFTA's governing law provision redoubles the impression that its meaning is to be established by reference to international law. Article 1131.1 states: "a Tribunal established under [Section A--Investment] shall decide the issues in dispute in accordance with this agreement and applicable rules of

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<sup>10</sup>Article 31(3)(c).

<sup>11</sup>NAFTA, Article 102(2) requires the Parties to "interpret and apply the provisions of [the NAFTA] in the light of the objectives set out in [Article 102(1)] and in accordance with applicable rules of international law." (Emphasis added.)

<sup>12</sup>*Id.* (Para. 4).

<sup>13</sup>Vienna Convention, art. 31(4).

international law.”<sup>14</sup> As more fully set forth below, Respondent presses a construction of NAFTA that is unlikely given the above-referenced rules of interpretation. It is also one that radically departs from settled rules of state responsibility otherwise applicable among the Parties and, in effect, proposes a “special” meaning without foundation.

Claimant’s views, by contrast, are consistent with NAFTA’s express aims, the circumstances surrounding its formation, the ordinary meaning given the words chosen by NAFTA’s drafters and the fundamental rules of state responsibility. The latter, in turn, are among “applicable rules of international law” to which both the Vienna Convention and the NAFTA refer.

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<sup>14</sup>In relation to Iran-U.S. Claims Tribunal authority, the reservations expressed by the Respondent (who adopted the preliminary views of Canada filed in this case) seem not be shared by the standard references on international law. Tribunal awards, which ordinarily make clear when they are applying international law, have been cited or quoted without qualification by Professors Shaw, Harris, and Brownlie. As to the latter, see 5<sup>th</sup> ed. at 545, n. 105 (treating *Sedco* and non-Tribunal authority alike, though in disagreement). Professor Shaw in a section entitled “The nature of expropriation” quotes as illustrative the following passage from *Starrett Housing*:

measures taken by a state can interfere with property rights to such an extent that these rights must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal title to the property formally remains with the original owner.

Malcom Shaw, INTERNATIONAL LAW 575-76 (4<sup>th</sup> ed., 1997) (*Starrett Housing Corp v. Iran*, 4 Iran-U.S. CTR. 122, 85 ILR 349 (interlocutory award). Professor Harris excerpts *Starrett* at length and in a subsequent note relies heavily upon Iran-U.S. Claims Tribunal authority in explaining when property has been “taken.” See D.J. Harris, CASES AND MATERIALS ON INTERNATIONAL LAW 553-58, nn. 1-2, (5<sup>th</sup> ed., 1998). Respondent, apparently uniquely able to separate the wheat from the chaff, disregards its own admonition in several places, though in at least one instance it grossly mis-characterizes the case it cites. See Rejoinder at p. 135, (n. 360), suggesting that the Tribunal in *Starrett* “refused relief.” In fact, the Tribunal found a taking and awarded the claimants over \$36 million, after using the DCF method. 4 Iran-U.S. CTR 122; 16 Iran-U.S. CTR 112.

## 2) NAFTA's Objects, Purposes and the Circumstances of its Conclusion.

Among the objectives expressed in NAFTA Article 102 is: "substantial increase in investment opportunities in the territories of the Parties."<sup>12</sup> Mexico's contemporaneously enacted law on foreign investment, drafted with NAFTA in mind, carries a concordant goal. As President Salinas made clear, its purpose "is to establish a new legal framework that [inter alia] provides legal certainty to foreign investment in Mexico and establishes clear rules to channel international capital to productive activities."<sup>13</sup>

To exempt municipalities from NAFTA discipline would be to inject into Chapter 11 unpredictability capable of both slowing new investment in Mexico and causing the abandonment of existing investment there. In addition, public and private investment insurance would become scarce if the view maintained by Respondent were to prevail.

## 3) Settled Rules of Attribution Against Which Respondent Struggles.

Article 105 of the NAFTA extends the obligation to "ensure" NAFTA compliance expressly to the state level and, Claimant holds, to the municipal level by implication. This interpretation comports with Article 10 of the ILC Draft Articles on State Responsibility, that states in pertinent part:

*The conduct of an organ of a State, of a territorial governmental entity or of an entity empowered to exercise elements of the governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to internal law or contravened instructions concerning its activity.<sup>14</sup>*

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<sup>12</sup>NAFTA, Article 102.1(c).

<sup>13</sup>Vargas' translation, 33 ILM 208.

<sup>14</sup>37 ILM at 445-45 (emphasis added).

Equally helpful is the general rule stated in Article 6 that provides:

The conduct of an organ of the State shall be considered as an act of that State under international law, *whether that organ belongs to the constituent, legislative, executive, judicial or other power, whether its functions are of an international or an internal character, and whether it holds a superior or subordinate position in the organization of the State.*<sup>15</sup>

#### **4) Respondent's View is Unworkable.**

If states within a federation are subject to NAFTA's obligations, but municipalities are not, how are tribunals to distinguish the two in administering NAFTA given the political and legal inter-dependence between the two units, especially in Mexico? In the present case, for example, the Ecology Decree that Claimant complains of calls for the Reserve's administration to be a collaborative effort between the State of San Luis Potosi and the Municipality of Guadalucazar.

Moreover, given the influence that state administrations exert upon the municipalities, state responsibility analysis under NAFTA would under Respondent's view often involve subsidiary questions of attribution; after all, a given municipality's acts and omissions frequently will have originated in state policies. NAFTA's drafters could not have intended to engender such complexity; and if they had, they would have chosen carefully words of exemption or clarification, just as they did elsewhere in Chapter 11.<sup>16</sup>

### **3. What Does "Tantamount to Expropriation" Mean under NAFTA 1110?**

#### **A. In Ordinary Meaning in Light of the Aims of NAFTA.**

The ordinary meaning of "tantamount" is "equivalent" or "akin to." Article 1110's phrasing is not novel; U.S. BITs have used the same or highly

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<sup>15</sup>*Id.* at 443.

<sup>16</sup>See, e.g., Article 1102(4) ("For greater certainty ..."); Article 1102(3) ("Treatment ... means, with respect to a state or province...."); Article 1105(3) ("Paragraph 2 does not apply to ...."); Article 1106(5) ("Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.").

similar language. Together with the reference to “indirect” expropriations, “tantamount to expropriation” establishes a broad and flexible formulation; it is consistent therefore with modern doctrine that holds that the form, aims and internal legality of a measure are less important than its effect, and that the combined impact of state acts and omissions must be considered in assessing the extent of interference to which property rights have been subjected.<sup>17</sup>

Although NAFTA article 1110 refers to “a measure” [singular] tantamount to . . . expropriation of . . . an investment,” Article 1101 states that Chapter 11 applies to “measures [plural] adopted or maintained by a Party....” Similarly, Article 201 (Definitions of General Application) defines “measure” broadly to include “a practice” (which implies repetition) and “any law, regulation, procedure [or] requirement.” These provisions suggest that the drafters had no conscious preoccupation with single acts taken in isolation.

Legal regimes, regulatory frameworks and policies (whether or not formalized) are the responsibility of the states that formulate, administer or promote them. When evaluating the combined effects of such measures, tribunals have recognized that haphazardness and deficient predictability in a regime’s actual operation may contribute to property interference, and thus may be taken into account in determining whether the totality of state acts is akin to an expropriation.<sup>18</sup> In the present case, several acts attributable to Respondent substantially interfered with Claimants’ investment. Each single act or omission occurred in the context of other failings imputable to Respondent; taken together these were equivalent or akin tantamount to an expropriation.

#### **B. Article 1110 Applied to this Case.**

For organizational convenience, the specific acts and omissions that Claimant complains of will be treated under two headings: one devoted to the

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<sup>17</sup>See, e.g., *Ghana Investments* at 95 ILR at 209-10.

<sup>18</sup>See, e.g., *de Sabla* claim, 6 RIAA at 358, 363, et seq.; Hunt Reports at 379, et seq. (Published edicts so vague and difficult to correspond to the land in question that one could not without extraordinary vigilance and burden protect one’s property from being given away); *The Tattler*, 6 RIAA 48 (seizure of a vessel for want of a license compensable given that—through Canadian officials’ own misunderstanding of the law—the license failed to issue).

Municipal construction permit and the Municipality's lawsuit against federal authorities and, a second, addressing the state environmental decree.

*1) The Municipality's Acts Considered in Context Worked a Taking.*

"Measures" are defined under NAFTA to include "requirements." (See Article 201 definitions). Based upon an alleged "requirement," two formal acts by the Municipality combined with other of Respondent's practices to substantially deprive Claimant of its investment. On October 26, 1994, the Municipality ordered the cessation of all building activities at the site, for want of a municipal construction permit.<sup>19</sup> By the time of that pronouncement, federal authorities had physically lifted the seals at the site to facilitate the federal audit and COTERIN had been authorized to undertake remedial work at the site.<sup>20</sup> The Claimant had also begun to attract and allocate resources on the strength of holding a complete set of federal permits, the state land use permit and the Governor's expression of support.<sup>21</sup>

It is probable that the purported closure of the site by Municipal authorities was precipitated by the above-mentioned federal steps toward eventual operation of the project. Soon after the putative closure, legal experts explain that even if the Municipality's action had not been ultra vires, it failed to comply with Mexican law in the manner of its execution.<sup>22</sup> Pursuant to federal guidance, Claimant made an application to Municipal authorities.

On its face, the Municipality's declaration of an unsatisfied requirement imposed a contingency upon the use of Claimant's private property inconsistent with federal authorizations to construct found in federal permits. Nonetheless, the manner in which *federal* authorities reacted to the closure

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<sup>19</sup>It has not been denied by Respondent that COTERIN was the only entity to have been subjected to this supposed "requirement."

<sup>20</sup>See Reply at para. 44, et seq.

<sup>21</sup>That the Governor was aware of Metalclad's intentions is supported by the balance of evidence, including contemporaneous documentation offered by Claimant and not successfully impeached by Respondent; Claimant's proffer stands in contrast to the failure of the Respondent to produce the Governor's records and day book for the relevant period.

<sup>22</sup>See JURICI Report, pp. 16-20, Mem., Ex. 34, Vol. I.

order and the content of the only state legislation with a colorable bearing upon the project, gave no grounds to be concerned; Claimant was entitled to expect that its application would lead promptly either to issuance of the permit or to further guidance relative to local construction norms.<sup>23</sup>

After 13 months of open activity at the site—of which Municipal officials have admitted knowledge<sup>24</sup>—the second and more conclusive Municipal pronouncement occurred. By declining to grant a permit it defined as essential, the Municipality purported, in substance, to end the project. Whether by design or merely haphazardness, the combination of federal affirmations and acquiescence, state encouragement, and the two-part measure imposed by the Municipality amounted to an expropriation: Claimant was first induced to commit substantial resources in a permanent manner and then was prohibited from availing of the resulting income-producing asset; as a by-product of what Respondent has described as a jurisdictional conflict,<sup>25</sup> Claimant's property was, in effect, sequestered. The indeterminate escrowing

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<sup>23</sup>Claimant's application was a good faith attempt to comply with the above-referenced statute, although there remained considerable confusion as to whether such a permit was superfluous given federal issuance of a permit expressly authorizing construction. Only after consulting with federal officials did Claimant resume building. The direction received was consistent with what Claimant had been told before: federal authority is preemptive; the local permit is not necessary. The application was politically placatory, not legally obligatory. It is significant that the system for which Respondent vouches is, from the standpoint of the potential applicant, self-judging in the first instance; the applicant is supposed to appreciate, though no published guidelines exist, what constitutes "a significant impact on the influenced area." See Transcript, Vol. 9 at 63. Less clear from the elliptical offerings of Respondent on the point is on what basis, if at all, the Municipality makes that assessment.

<sup>24</sup>Despite admitted knowledge of on-going construction and a "facilities tour" (that Respondent characterized as provocative in the extreme,) no action upon the permit application was taken by the Municipality, even though regular monthly meetings were held.

<sup>25</sup>As was clear from Secretary Carabias' testimony, however, the Municipality was not free to arrogate to itself concurrent or exclusive jurisdiction over the environmental effects of hazardous waste landfills. Whatever authority the Municipality may have had to insist on architectural and other local construction norms, it possessed no power to pass upon the hydro-geologic suitability of the landfill nor to assess related matters reserved to organs of the federation with the resources, expertise and constitutional power requisite to such determinations. That the construction permit was purely a pretext under which to interfere with a federal initiative was even apparent to Ms. Marsha Williams, who stressed at the Hearing the ingenuity often exercised by factions opposing landfills.

of Claimant's investment by the Municipality was enforced by court order,<sup>26</sup> eventually acquiesced in by federal authorities and ultimately hailed as proper by Respondent before the present Tribunal.

Even if the Municipality had not waived by acquiescence its power to supervise "construction" customarily understood, any power it might have retained<sup>27</sup> simply did not extend to the matters it ultimately purported to address. Accordingly, as a matter of internal law, the Municipality's methods and objectives cannot be said to have been lawful. Being manifestly without authority and contradictory to antecedent federal authorizations, the "requirement" imposed by the Municipality is not the type of ordinary regulation to which Claimant must be expected to submit. When it did submit to the Municipality, it was entitled to expect that the Municipality would limit its consideration to matters related to construction.

Moreover, because the purpose of the Municipality's conduct was—in essence—to put Claimant out of business at La Pedrera, even conservative authorities would likely concede that a taking had occurred.<sup>28</sup> That the Municipality was inept does not alter the analysis.<sup>29</sup>

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<sup>26</sup>The irregular manner in which the Municipality's measure was "enforced" does not change the substantial interference with Claimant's property that resulted. The Municipality's declaration of legal effect subsists to this day and has been adopted by Respondent in these proceedings. The injunction it procured was nurtured on procedural grounds and ultimately coincided with the state's environmental decree. The sponsors of that decree interpreted it as an unqualified obstacle to operation of the landfill. In the interim, Claimant's financing was quite predictably compromised.

<sup>27</sup>Even if, *arguendo*, the Municipality could regulate collateral aspects of building at the site and even if it had limited itself to matters within its competency, the Municipality waited too long to do so. Its knowing and inexplicably prolonged delay in pronouncing its final view must be taken as a waiver of any residual regulatory power it might have had. Claimant's substantial intervening reliance was reasonable given the advice it received from federal officials.

<sup>28</sup>*Cf.* Brownlie, 5<sup>th</sup> ed. at 535: Professor Brownlie observes that otherwise permissible monopoly regimes having as their sole or primary object the driving out of business a foreign firm might become by that element an expropriation and that "[t]axation which has the precise object and effect of confiscation is probably unlawful." (Citations omitted.)

<sup>29</sup>The power that the Municipality purported to wield was not one that it appeared to understand; its prolonged but informed inaction, the *ex parte* character of its deliberations,



## 2) *The Ecological Decree.*

The State's ecology decree also equates to an expropriation of Claimant's investment. Two precedents illustrate the manner in which the Decree would likely be evaluated by other tribunals. The first is the *Pyramids* case that Claimant has already described to the Tribunal. There, notwithstanding the urging of other organs of the Egyptian government, the Assembly ended the investor's project by the passage of a certain antiquities preservation law. Two tribunals found that the investor's project had been taken. It did not matter that the law was motivated by laudable state goals constitutionally implemented,<sup>30</sup> that alternative investment opportunities within the region in theory remained open to the Claimant, and that the Assembly action reflected genuine and robust public opposition to the project. To no avail were Egypt's arguments making much of technical failures to comply with domestic law,<sup>31</sup> the alleged deficiencies in the Claimant's financing and expertise,<sup>32</sup> the Claimant's employment of former government officials as consultants (and other alleged "irregularities"),<sup>33</sup> and the Respondent's efforts to disclaim informed involvement in siting and approving the project.<sup>34</sup> Egypt's narrow conception of compensable taking and particular reliance on municipal law was equally without effect,<sup>35</sup> the tribunal being concerned that the economic reality of the impact suffered prevail over nuances observed in domestic property law.<sup>36</sup>

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the lack of meeting notice given COTERIN and the failure to enforce the permit requirement for any other business entity in the history of the Municipality are all inconsistent with the power to declare, in essence, forfeiture of an investment. Nor did federal authorities defer to that supposed power. The Convenio confirmed that, in the minds of federal authorities, municipal power over hazardous waste was purely fanciful.

<sup>30</sup>*Pyramids II*, para. 158.

<sup>31</sup>*Pyramids II* at paras. 95, 112.

<sup>32</sup>*Id.* at para. 126.

<sup>33</sup>*Id.* at para. 127.

<sup>34</sup>*See Pyramids II* at paras. 86-99.

<sup>35</sup>*Id.* at paras. 160-72.

<sup>36</sup>*Id.* at paras. 163-68.

The second illustration is provided in the ILC Commentary to be found in the 1977 ILC Yearbook (Vol. II, Part II) that discusses the dictum in the *Mariposa Development Company* case (before the U.S.-Panama General Claims Commission).<sup>37</sup> The tribunal there observed that legislation may sometimes be of such a character that “its mere enactment would destroy the marketability of private property, render it valueless and give rise forthwith to an international claim.”<sup>38</sup> Citing *Mariposa* with approval, the ILC Commentary confirms that a confiscation of property might arise with the mere passage of an act that “seriously reduced the commercial value of the foreigner’s property.”<sup>39</sup>

Thus, Respondent’s insistence that concrete damage be shown to Claimant under the decree is not required by the authorities. Given the independent assessments of Messrs. Sanchez and Medellin—that the decree ended all hope for commercial operations—this Tribunal would be entitled to find that the mere enactment of the state’s ecology law was tantamount to an expropriation.<sup>40</sup>

Also illuminating is the analysis of the arbitrator in *Sapphire International Petrol, Ltd. v. NIOC*. Assessed there was whether the Claimant should be compensated for loss of an opportunity in relation to a concession area that had not yet been prospected so that the presence of oil-bearing beds in that area remained “uncertain.”<sup>41</sup> In holding that the Claimant was entitled to compensation the tribunal reasoned:

It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behaviors of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of damage.

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<sup>37</sup>6 RIAA 340.

<sup>38</sup>ILC Yearbook, *supra*, at para 20.

<sup>39</sup>*Id.*

<sup>40</sup>*Cf. Pyramids II* at para. 122 (“opposition to the project in Egypt and resulting uncertainties about the future further contributed to the reluctance of foreign investors to participate in joint ventures for the construction and operation of the hotels”).

<sup>41</sup>*Id.* at 187.

#### 4. If Claimant Asserts a Violation of NAFTA 1105, What Exactly was the Violation?

##### A. In General.

Claimant asserts several violations of Article 1105. These include Respondent's failure to ensure and provide fair and equitable treatment, its denial of justice to the Claimant, its abuse of rights and the failure of its officials to discharge duties of good faith.

##### 1) *Claimant was Deprived of Fair and Equitable Treatment.*

###### a) In General.

The ordinary meaning of the words "fair" and "equitable" and "ensure" remain the best guides to the pledges made in Articles 105 and 1105. Given the cumulative effect principle recognized in international law, the totality of the circumstances must be examined, and both the procedural and substantive aspects of the treatment received by Claimant are germane.<sup>42</sup>

In contradistinction to Respondent's retrospective, Claimant had to formulate compliant behavior given such information and guidance as was available in 1993-1995, amidst evolving policies, unwritten practices, and considerable discretion in public officials; the latter used that discretion in confronting ad seriatim matters of first impression occurring in a politically-charged setting. Political solutions and legal analysis were blended by those responsible in an amorphous approach which gave Claimant little security.

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<sup>42</sup>No authority known to Claimant suggests that the treatment ensured under Article 1105 is limited to procedural matters to the exclusion of substantive concerns, or vice versa. Good policy supports extending the clause's protection to both facets—procedural and substantive—given that breaches in both areas may prove detrimental to NAFTA's objects. Illustrations are that Spanish courts fell short of the standard in *Barcelona Traction* (F.A. Mann's view) or that measures affecting the provision of permits and licenses must submit to the standard (independently proposed examples by Mann (*infra* at 237) and Sandrino (27 Vand. J. Transnat'l. L. 259, et seq.); they do not, however, exhaust the provisions' ambit. Indeed "[s]o general a provision is likely to be almost sufficient to cover all conceivable cases, and it may well be that other provisions of [certain BITs] are no more than examples or specific instances of this overriding duty." Mann, *Further Studies in International Law*, 234, 238 (1990) (re-printing [1981] Brit. Yearbook Int'l. L. 241-540).

## b) Respondent's View of Fairness.

Despite the advantage of hindsight, Respondent offers argument and displays attitudes that reveal much about its conception of "fair" and "equitable." Claimant here cites but a few examples, many offered by Respondent at the Hearing. In particular Respondent appears to hold:

- Whether the predicates triggering an obligation to apply for a construction permit are present is for the applicant to determine, though no obligation on the part of Respondent exists to ensure minimal transparency.
- Although the law may be unclear, ignorance of the law is no excuse.
- Where the law is at best unclear, if upon advice of one level of government an applicant, contrary to what its due diligence indicates, takes the course which is both the most conservative and politically expedient with respect to another level of government, the applicant should be deemed through its actions to have both clarified the law and consented to whatever exorbitant exercises of jurisdiction may eventuate.
- There is a distinction between knowing that no municipal construction permit has been obtained and knowing that one has been refused. Only in the latter case do federal officials have a duty to speak to prevent an investor's detrimental reliance or to announce limits upon otherwise broadly stated authorizations to construct a federal project.
- What matters is not how federal officials represented their powers, but how they should have represented their powers. An investor must ignore the former and is chargeable with divining the latter.
- Despite the time limits imposed upon a municipality by Constitution and by statute, and abiding confusion about whether such a permit is required, an applicant whose permit request has been ignored must pursue extraordinary procedures to stimulate administrative action; no duty of diligence applies to municipalities.
- Even if as a matter of internal law, some duty of diligence applies to municipalities, it may not be considered by the Tribunal because it is both a matter of Mexican law and because the acts of municipalities are

not expressly mentioned in Article 105 of the NAFTA. It matters not that an investor may have had customary and reasonable expectations with respect to the preceding two points and relied accordingly.

- If as a result of an inter-level dispute among three levels of government, and Claimant's reliance on the representations of one of those levels, Claimant's property is substantially impaired, that is an ordinary business loss in no way chargeable to the host state; conflicts of jurisdiction and confusion over the content of governing law are risks assumed squarely by the investor.

- An investor's legal entitlements under a treaty may vary depending upon whether an investor is perceived to have become involved in local politics.

### c) Components of Procedural Fairness.

#### 1) In General.

The procedural component of fair treatment ought to preclude forfeiture of property that results from a failure to meet standards which, however, reasonable in substance, are poorly noticed<sup>43</sup> or otherwise obscured (non-

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<sup>43</sup>The *Amco I* tribunal held that the claimant had received inadequate notice that its investment would be sacrificed; the tribunal observed that 'warnings' are essential under general principles of law, especially when the very investment is at stake. [*Amco I*, 89 ILR at 470-71]. In *de Sabla*, the Commission agreed with the United States' assessment that Claimant had been subject to unfairness because "although the edicts [announcing the adjudication of her property rights] were both posted and published, the boundaries of the land applied for, as described in the application and consequently the [edicts], were customarily so vague that the landowner could not tell whether the land applied for was on h[er] property or not." [Hunt Report at 439.] These and other authorities confirm that the quality of notice, warning and guidance given to property owners are subject to scrutiny independent of the substantive fairness of the regulation in question. A similar pronouncement is made by the *Amco II* tribunal which held that administrative denial of justice may be established based merely upon the procedures leading to the forfeiture of an investment license, irrespective of whether substantive bases might have existed for the result reached. [*Amco II* at paras. 36, 139.]

transparent);<sup>44</sup> procedural fairness also includes an opportunity to be heard, and that determinations be made with reasonable dispatch.<sup>45</sup>

## 2] An Illustrative Regime Well-Known to the Respondent.

A useful guide to what the NAFTA Parties envisioned as a fair and equitable approach in relation to matters analogous to the present case is found in the Environmental Side Agreement. The Agreement seeks *inter alia* to “promote transparency and public participation in the development of environmental laws, regulations and policies [and] economically efficient and effective environmental measures.”<sup>46</sup>

The Agreement requires that each Party “ensure” that administrative proceedings directed toward the enforcement of environmental laws through the issuance of licenses, permits or authorizations be “fair, open, and equitable” by providing due process of law,<sup>47</sup> and applicant opportunities to present information and evidence.<sup>48</sup> Moreover, said proceedings “are not to be

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<sup>44</sup> A regime which provides only opaque and conflicting guidance or which imposes unreasonable burdens of vigilance upon an investor cannot be said to match the ordinary meaning of fair and equitable. Claimant’s written submissions have already demonstrated that Respondent’s present legal description of the Mexican regime affecting hazardous waste is not that which reasonable due diligence would easily ascertain; nor in practice did Respondent’s regulatory regime operate as Respondent describes. Ignoring the Record, Respondent suggests that the uniform advice of counsel was that a construction permit was essential, arguing further that by applying, Claimant proved the transparency of the regime. Numerous facts confute this convenient oversimplification. At the Hearing, for example, Madam Carabias was led to admit that the representations of federal officials and associated documentation while authorizing construction, were effectively silent as to any limitations on federal power over construction. [See Transcript, Vol. 1 at pp. 190, *et seq.*]

<sup>45</sup> *Cf.* Draft Convention on the Responsibility of States (with commentary by Sohn & Baxter), 55 *Amer. J. Int’l L.* 545, 550 (Article 7: “In determining the fairness of any hearing, it is relevant to consider whether it was held before an independent tribunal and whether the alien was denied ... disposition of his case with a reasonable dispatch at all stages of the proceedings.”)

<sup>46</sup> *Id.*, Art. 1 (Objectives).

<sup>47</sup> Art. 7(1)(a).

<sup>48</sup> *Id.*, Art. 7(1)(c).

unnecessarily complicated “and are not to entail ... unwarranted delays.”<sup>49</sup> Further, final decisions on the merits are to be conveyed promptly to the parties to the proceedings and are to be “based on information or evidence in respect of which the parties were “offered the opportunity to be heard.”<sup>50</sup> Additionally, decision makers are to be “impartial and independent.”<sup>51</sup>

In comparison to the foregoing undertakings, the municipal proceedings that led to the imposition and denial of the construction permit fall woefully short. COTERIN was not invited to the town meeting at which the permit was discussed; it was not notified of the meeting or allowed an opportunity there to present evidence concerning the landfill’s safety; the proceeding occurred after an inexplicable delay—13 months after application was made—and therefore was one of which Claimant’s representatives were unlikely to have been aware through reasonable vigilance.<sup>52</sup>

The Town Council, having pronounced themselves long in advance of the proceeding—without scientific investigation or objective support—cannot be said to have been “independent and impartial” nor to have acted “based on information or evidence in respect of which the parties were offered the opportunity to be heard.” Nor, given the intervening detrimental reliance by Claimant can the substantive outcome be characterized as fair and equitable. The denial of the permit at that late juncture resulted in significant forfeiture by Claimant.

***d) The Governor and Dr. Medellin Did Not Treat COTERIN Fairly or Equitably and Acted in Bad Faith.***

The totality of the acts attributable to Respondent include those of state officials. Governor Sanchez admitted at the Hearing that COTERIN could have reasonably concluded that he supported the project.<sup>53</sup> That his awareness of COTERIN’s specific plans dates to June, 1993 is also supported by the balance of probabilities. His subsequent repudiation of these facts was part of

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<sup>49</sup>*Id.*, Art. 7(1)(d).

<sup>50</sup>*Id.*, Art. 7(2)(c).

<sup>51</sup>*Id.*, Art. 7(4).

<sup>52</sup>*Cf. de Sabla, supra.*

<sup>53</sup>*See Transcript, Vol. II, p. 29, lines 3-14; p. 44, lines 10-16; pp. 45-46.*

a pattern which included various acts of defamation, interference with contractual relations and ultimately promotion of a decree openly admitted to have ended Claimant's investment. Dr. Medellin similarly created false hope, induced ongoing reliance and negotiated in bad faith, as more fully set forth in Claimant's Reply.

Despite Respondent's attempts to undermine his resolve, Ambassador Jones has not revised his original assessment (outlined at Reply, paras. 325, *et seq.*). To recall, he observed: "It was the Governor or his government ... who was less than honest about the events surrounding the permitting of the landfill rather than Metalclad." Claimant suggests that having seen and heard the explanations of Governor Sanchez and Dr. Medellin, Respondent's refusal to call Ambassador Jones to testify was indeed to save embarrassment—but not of Ambassador Jones.

## 2) Denial of Justice Under Article 1105.

For the same reasons, the approach taken by the Municipality constitutes an administrative denial of justice not unlike that found by the *Amco II* tribunal. There deficient investigation and errant factual bases led to forfeiture of an investment license. Even if hypothetically there might have existed substantively reasonable bases upon which to revoke the license, the *procedure* adopted by the investment board fell below the international standard. It thus gave rise to a right to compensation for an unlawful act in the *Chorzow Factory* sense (implying therefore an award of *lucrum cessans*).<sup>54</sup>

Among the relevant themes developed by *Amco I* and *Amco II* was that the procedure should match the gravity of the matter in question. In *Amco*, as in this case, at stake was the very investment. The present case, however, arguably involves even more compelling grounds for compensation than *Amco*, because the deficiencies in process leading to the decision (see the above discussion on fair and equitable treatment) are compounded by wholly insufficient substantive bases; the Municipality's determination was expressly motivated by considerations which were beyond its competency, irrelevant, speculative, or purely political.

Thus, rather than focusing on the time of application, the Municipality judged the application to be ill-founded based upon the progress made at the

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<sup>54</sup>*Amco II*, paras. 176-177.



site during the 13 months COTERIN's application languished before the Town Council. It also invoked as controlling conditions and determinations dating to October 1991, when the Aldretts made their application, making no reference to the intervening federal approvals, the new ownership, the heightened sophistication brought by the new owners, the *Convenio* or the specifics to be found in COTERIN's application.<sup>55</sup>

That the decision to not grant the permit was purely a maneuver to thwart the *Convenio* can be inferred from the minutes of that extraordinary meeting; the Municipal President was encouraged to approach other municipalities to garner their support and to consult legal counsel,<sup>56</sup> presumably in anticipation of a legal battle over jurisdiction. The minutes are moreover quite artificial, reciting—as if it were a fresh matter—the question of COTERIN's application. That portrayal masked the Municipality's inaction and the apparent reason for the extraordinary meeting (the advent of the *Convenio*).

### 3) Abuse of Rights.

Though the Municipality might have had the theoretical right to test an unlikely theory of standing before domestic courts, that it did so to side-track Claimant's federally approved project was abusive. The timing (obviously in response to the *Convenio*) and conceded mission of Mr. Serrato confirm that the maneuver was a substitute for any genuine power over environmental

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<sup>55</sup>Compare the tribunal's description of government acts in *Amco II*, which in the abstract is familiar:

The manner in which Mr. Usman prepared his Summary [which led to revocation of the license] must be described as rushed, over-reliant on [unsubstantiated private] characterizations, factually careless, and insufficiently based on detailed and independent verification with the authorities concerned. *Amco II*, para. 83.

The above-referenced summary was subsequently relied upon in combination with additional carelessly researched, non-specific, and sometimes dated information, [*Amco II*, paras. 83-97], leading the tribunal to conclude that "the whole approach to the issue of revocation of the license was tainted by bad faith, reflected in events and procedures." [Id. at para. 98.]

<sup>56</sup>Leonel Serrato declared that he began his representation of the Municipality about the same time, at the request of the Governor and because of the *Convenio*. (Serrato Declaration, para. 2).

issues. The Abuse of Rights Doctrine is widely recognized—including within Respondent’s legal system—and exists to address state acts of the kind here involved.

**5. Does NAFTA 1114 Have Any Material Bearing on the Issues in this Case?**

Article 1114 does not materially affect the case. Under that provision, a NAFTA Party is entitled to adopt, maintain or enforce measures thought appropriate by it to ensure that investment activities are sensitive to its environment. The express qualification that such measures be “consistent with [Chapter 11]” is significant: where such measures are tantamount to expropriation, fair market value and interest must be paid and due process and fair and equitable treatment must have characterized the measure’s implementation<sup>57</sup>; the measure, even if not constituting acts compensable under Article 1110, must not constitute unfair or inequitable treatment or a denial of justice; nor may it be implemented or promoted in bad faith or abusively (to name some of the protections provided under only 1105 through international law); such measures must also be consistent with the national and most favored nation treatment principles of Articles 1102, 1103, and 1104.

**6(a). With Regard to Hazardous Waste, Did the Federal Authorities Have Exclusive Jurisdiction to Grant or Deny Construction and Operational Permits Based on the Environmental Impact of the Project in the Community? Please Recall Briefly the Relevant Legal Authorities and the Evidence.**

Respecting municipalities, Respondent’s Hearing witnesses rehearsed the concept of “Constitutional autonomy” as though it were a principle with little or no limitation, commonly known, and frequently discussed throughout Mexico. But relevant legal authorities and the evidence are to the contrary.

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<sup>57</sup>Article 1110.

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<sup>57</sup>Article 1110.

## **DISTRIBUTION OF JURISDICTION BETWEEN THE FEDERATION AND THE STATES:**

Article 124 of the Mexican Constitution delineates the jurisdictions between the federal and state policies, providing that powers not expressly granted to the Federation by the Constitution are powers of the several states.

Title Five of the Mexican Constitution refers to "The States of the Federation and the Federal District." Article 115, which is a part of Title Five, establishes:

States will adopt for their interior regime, a republican, representative, popular form of government, having as the basis of their territorial division and of their political and administrative organization the Free Municipality, in accordance with the following basis ...."

In following this Constitutional requirement, the states must observe eight criteria, of which the following are the most relevant:

1. An elected Ayuntamiento will administer Municipalities and no intermediate authority will exist between them and the respective State Government. However, the political independence of an Ayuntamiento is limited by the power of the State legislative branch to suspend or dissolve an Ayuntamiento.
2. Municipalities will administer their patrimony in accordance with the law. They may also issue regulations and other administrative ordinances, in all cases, in accordance to the normative basis established by State laws.
3. Municipalities are empowered to provide certain public services. However, these powers must be exercised with the participation of the State when a law establishes so. Additional public services may be provided by Municipalities when the State legislative branch establishes so.
4. Municipalities will freely administer their treasury. However, approval of their annual income plan and a review of their annual expenditures by the State legislative branch are required.

5. Municipalities may exercise certain powers related to urban planning matters. However, these powers must be exercised in the terms of federal and state laws.

6. If two or more Municipalities are in a conurbation situation, the Federation, the State(s), and the Municipalities involved must jointly perform urban planning tasks, in the terms of the federal law.

7. The President of Mexico and State Governors will command public safety forces in the Municipalities where they are residing provisionally or permanently.

8. State laws must introduce proportional representation of political parties in the structure of Ayuntamientos. The relationship between Municipalities and their employees must observe State laws, which in turn must observe the Mexican Constitution.

Article 115, self-evidently limits the states in determining territorial division, and political and administrative organization. In doing so, it creates municipalities, providing them with legal capacity and conferring upon them certain powers, limited—and to be exercised—in all cases, in terms of:

- 1) The Mexican Constitution (criteria 7 and 8),
- 2) Federal laws (criteria 3, 5, and 6), and
- 3) State laws (criteria 1-5, 8, and all references to the state legislative branch).

#### **INCLUSION OF FRACTION V IN ARTICLE 115 OF THE MEXICAN CONSTITUTION:**

“Municipalities, in the terms of the respective federal and state laws shall be empowered to formulate, approve and administer the zoning and municipal urban development plans; participate in the creation and administration of its territorial reserves; control and survey the use of land in its territorial jurisdiction; intervene in the regularization of urban land possession; grant construction licenses

and permits, and participate in the creation and administration of ecological reserve zones. To this purpose and in accordance with the objectives provided for in the third paragraph of article 27 of this Constitution, the Municipalities shall issue the necessary regulations and administrative orders deemed necessary.”

As established in the preamble of the Constitutional reform and widely reaffirmed by Mexican legal scholars, the main purpose of this amendment was to include municipal governments in the administration of urban development plans in view of the industry decentralization policy followed by the federal government, and to avoid a chaotic conurbation of cities throughout the Mexican territory. The participation of Municipalities with the federation and the states was deemed crucial for decentralization to be successful.

Emilio O. Rabasa and Gloria Caballero, who wrote regarding fraction V, share this view:

“Another subject which extends municipal jurisdiction is that relative to urbanization and therefore, fraction V empowers Municipalities to participate from the formulation to the administration of the urban development plans. This norm is particularly important given the need to decentralize the industry of the country (from Mexico City) to the States.”<sup>58</sup>

#### **LIMITS TO THE POWERS CONFERRED TO THE MUNICIPALITIES IN FRACTION V OF ARTICLE 115 OF THE MEXICAN CONSTITUTION:**

The plain language of fraction V discloses that the powers granted by the Mexican Constitution to Municipalities in this fraction are limited by federal and state laws. The fraction explicitly states:

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<sup>58</sup>“Otra materia que extiende el ámbito municipal es la relativa a la urbanización y así, la nueva fracción V faculta al Municipio a participar desde la formulación hasta la administración de los planes de desarrollo urbano. Esta disposición es particularmente importante dada la necesidad de descentralizar la industria del país hacia la provincia”; Emilio O. Rabasa and Gloria Caballero, “Mexicano: Esta es tu Constitución, p. 311, 9a edición, Editorial Miguel Angel Porrúa, 1994.

“Municipalities, in the terms of the respective federal and state laws, shall be empowered to ....”  
(Emphasis added).

A systematic interpretation of article 115 of the Mexican Constitution indicates that powers granted by the Constitution to municipalities are limited in all cases by federal and state laws. It is reasonable to conclude therefore that fraction V constitutes no exception to the intent of article 115 of the Mexican Constitution. Moreover, taking into account the motives for which fraction V was added to article 115 of the Mexican Constitution, granting construction licenses and permits or any other power, were not meant to confer an absolute power on municipalities. It rather denotes that such power depends and is contingent upon the applicable Federal or State laws.

Ignacio Burgoa Orihuela, one of Mexico's most important Constitutional scholars, supports this point of view when he states that:

“Fractions V and VI of article 115 extended considerably municipal attributions in the matters established in those fractions, subject to, what the federal laws and those (laws) of each State determine, coordinating the activities of the Municipalities with local and federal authorities.”<sup>59</sup> (Emphasis added).

The interpretation that article 115 does not grant per se absolute powers to the municipalities, is shared by the Supreme Court of Justice of Mexico which held the following thesis regarding powers of municipalities:

“Even though it is true that, from a harmonious and systematic interpretation of fractions II, second paragraph, and III h) of article 115 of the Constitution, the Ayuntamientos have, in general, autonomous powersto issue regulations in public security matters within their territory; however, matters exist, like the one referring to protection and security of banking

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<sup>59</sup>Ignacio Burgoa Orihuela, “Constitutional Mexican Law,” p. 897, 1985.

institutions, which the Constitution reserves to the Federation.”<sup>60</sup>

The Supreme Court further states:

“It is evident that the Municipality of Guadalajara lacks reason, when affirming that their power to regulate matters of security and banking protection derives directly from article 115 of the Constitution, given that, although the Municipality has powers to regulate public safety, that does not include the specific matter of banking institutions, given that on one hand, what is established in articles 73, fraction X and 115 fractions II and III of the Mexican Constitution, together with the (applicable federal laws ...); and the (applicable State laws ...) On the other, leads us to conclude that initially and as a right, it corresponds to the Federation to legislate in matters concerning security of banking institutions with the possibility that the Ministry of Interior agrees with the States, and the latter with the Municipalities, to participate coordinately in such matter, thus, eventually issuing regulations in accordance with their powers but within the principles of coordination established by the Federation and the States, but never in an autonomous way.”

The Mexican Constitution does not expressly refer to the protection and security of banking institutions. This matter was reserved to the Federation by virtue of the Banking Institutions Law passed by Congress under its legislative attributions established in article 73, fraction XXIII of the Mexican Constitution, and by the Regulations of Banking Security decreed by the President of Mexico under its attributions established in article 89, fraction I of the Mexican Constitution.

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<sup>60</sup>Constitutional Controversy 56/96. President of the United Mexican States v. Ayuntamiento of the Municipality of Guadalajara, Jalisco. June 16, 1997. Unanimous vote of 9 ministers. Absentees: Mariano Azuela Guitron and Guillermo J. Ortiz Mayagoitia. Author of the opinion: Juan Diaz Romero.



**RELEVANCE OF THE DECEMBER 13, 1996 AMENDMENT TO THE "LGEEPA":**

Similarly, no references to hazardous waste are made in the Mexican Constitution. Hazardous waste matters are the exclusive jurisdiction of the Federation by virtue of the "LGEEPA," passed by Congress under its legislative attributions established in article 73, fraction XXIX-G of the Mexican Constitution.

"LGEEPA" expressly reserves to the Federation the power to regulate and control the handling and final disposal of hazardous waste. It is not a concurrent or coincidental power between the federation, states and municipalities. The clear intent of LGEEPA is underscored in the language excepting all hazardous waste matters from authority extended to states and municipalities.

Municipalities may not intervene nor regulate the construction or operation of a hazardous waste landfill, given that it is out of their jurisdiction. Municipalities may only act in terms of federal and state laws.

Even though the Ecological and Urban Code of the State of San Luis Potosi provides that municipalities will issue construction licenses, municipalities lack power over activities related to hazardous waste, for such power has been expressly and exclusively conferred to the federation. Therefore, in accordance with articles 115 and 124 of the Mexican Constitution, there is no state law applicable to the construction of installations for handling and disposition of hazardous waste.

**RELEVANCE OF THE DECEMBER 13, 1996 AMENDMENT TO THE "LGEEPA":**

Amendments to the "LGEEPA" are relevant to interpret fraction V of article 115 of the Mexican Constitution, since municipalities must act in terms of federal and state laws.

On December 13, 1996, the "LGEEPA" was substantially amended regarding the issuance of local authorizations when the federal government grants an environmental impact authorization. The original text of the "LGEEPA" (1988), did not mention local authorities regarding this subject. By virtue of the amendment, the second paragraph of article 33 establishes that:

“The [environmental impact] authorization issued by the Ministry [of Environment, Natural Resources and Fisheries], will not oblige local authorities in any way when issuing authorizations within their jurisdiction.”

The amendment implies a substantial policy change. Before the amendment and interpreting the second paragraph of article 33 *a contrario sensu*, local authorities *were obliged when issuing authorizations within their jurisdiction* when the federal government issued an environmental impact authorization. After the amendment, local authorities are *not obliged in any way when issuing authorizations* within their jurisdiction when the federal government issues an environmental impact authorization. Even in the best case, the measures utilized were murky, lacking requisite transparency.

Since December 13, 1996, article 115 of the Constitution must be interpreted in light of the amendment to article 33 of the “LGEEPA;” for, it is the federal law that municipalities must be “in accordance with” in the exercise of its Fraction V, article 115 authorities.

It is Claimant’s submission that whether, in the final analysis, the federal government is held to have primacy in matters of hazardous waste is less important than the fact that it was persuasively reasonable for Claimant to rely upon that conclusion. After all, federal officials instructed Claimant that such was the case,<sup>61</sup> the actions of federal, state and local officials all reflected a recognition of federal supremacy; and, the legal regime—on its face and in expert opinion—yield the conclusion of reasonable reliance by Claimant.

**6(b). Conversely, Is it True That, Whatever Authority the Local Municipality Had Regarding the Grant or Denial of Construction Permits, That Authority Did Not Lawfully Extend to Consideration of Environmental Concerns in the Case of Hazardous Waste?**

Much of the discussion concerning question 6a] relates to this question as well. That is to say, if the federal authority is absolute in matters of hazardous waste as set out in LGEEPA, then, a fortiori, any incursion of

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<sup>61</sup>It is the uncontradicted testimony of Lee Deets that Sergio Reyes Lujan, the founding President of INE, when asked directly by Mr. Deets whether Claimant was required to have the municipal construction permit, replied that the federal authority was exclusive, and that the municipality had no authority over matters of hazardous waste. Respondent has not produced Mr. Reyes to deny this testimony.

purported municipal authority to consideration of environmental concerns in matters of hazardous waste is unlawful.

Although assiduously allusive on the topic, Secretary Carabias finally admitted under cross-examination that for a municipality to grant or deny a permit on the basis of environmental criteria would be improper. (Transcript, Vol. I, pp. 72-73.)

Evidence of the actions taken by municipal authorities during the course of the project's history buttresses the conclusion that even they recognized federal superiority. Witness the importuning of federal and state officials to not open the landfill; Mr. Ramos' testimony that local residents of Guadalcazar demonstrated near the Governor's mansion to get him to take action, (which Mr. Ramos testifies the Governor did in the form of the Ecological Decree. Transcript, Vol. III, pp. 30-31).

Further telling evidence lies in the actions taken by the Municipality in response to the Convenio. On November 26, 1994—about a month after the putative closure order from the ecological committee—Governor Sanchez presided over a cabildo meeting and read the press release from PROFEPA announcing the Convenio. Within a few days the Town Council filed an administrative appeal with SEMARNAP to undo the Convenio. After the appeal was rejected by Secretary Carabias, the Town Council filed an *amparo* action against SEMARNAP—not against Claimant. If the municipality were really possessed of the conviction of its Constitutional autonomy and its absolute construction permit power, why an action against the federal agency? Why not simply enjoin the company from operating on the strength of its inherent power?

Finally, the relative unimportance of the municipal construction permit is seen in the evidence, presented by Claimant and uncontradicted by Respondent, that no other construction activity in Guadalcazar required a permit—either before or after construction. Moreover, the State of San Luis Potosi, contrary to statutory requirements, had never received the annual construction permit reports from Guadalcazar, or any other municipality in the state. The essence of the municipal construction permit, to the extent it had any, was no more than minimal in the eyes of those who legislated it (the state) and those who wielded it (the municipality).

**7. If Metalclad were Held Entitled to Receive the Fair Market Value of its Total Investment in Mexico, What Happens to the Ownership of the Investment, i.e., Does Mexico Acquire Ownership or Does Metalclad Continue to Own the Facilities?**

The remedial powers of the Tribunal extend to conditioning payment of fair market value upon the satisfaction of certain concurrent conditions, so that neither party is unjustly enriched. It is conceded that ordinarily Claimant should not retain the property and improvements having also received full value for them. As noted at the Hearing, an appropriate condition for the Tribunal to impose upon Claimant would be the granting of a non-recourse quitclaim deed to the underlying real property and the improvements appertaining thereto, including blueprints and related documentation. An escrow arrangement designed to ensure bilateral compliance may be worth the Tribunal's consideration.

The transfer should relate only to the La Pedrera site, as real property. Attempting to accomplish the transfer of ownership of the associated company or companies would be unduly cumbersome and would implicate the rights of third parties. The award should also be structured to bring finality to the dispute by declaring as of some date certain an end to Claimant's obligations to maintain and secure the property. The fair market value assessments of the experts in this case have been net of remediation costs; in like fashion, the Tribunal's award should expressly extinguish any obligations Claimant may have to remediate the site.

In fixing fair market value, given that Claimant is to transfer the property, the Tribunal may consider the relative power enjoyed by the transferee to ensure—through the issuance of permits—that the site will realize its highest and best use. Accordingly, the quantum should be set so as to not bestow upon Respondent a windfall in the form of a modern landfill purchased at a fire-sale price. Indeed, the inferences employed and amount fixed should strive to encourage investment and to acknowledge that a Party found to have breached the NAFTA is not entitled to insist that damages be demonstrated with perfect certainty.<sup>62</sup>

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<sup>62</sup>See *Sapphire v. NIOC*, at 189 (“Undoubtedly ... such an appraisal is not free from uncertainty. But it is difficult to see what other proof could reasonably have been required of the plaintiff [plaintiff having provided an expert appraisal]”) and compare *Amco II* at para. 183 (“The Tribunal believes that the key lies in focusing

**8. Is the Subject Matter of the Claim in this Arbitration an Allegation of a Breach of an Obligation under NAFTA 1105 or under 1110, or Both, and Would the Quantum of Damages or Compensation Differ According to Whether Liability Might be Found Under One or the Other?**

That Claimant alleges breaches of both articles, as outlined above; the potential difference in compensation is treated here. The question arises because unlike Article 1110, Article 1105 designates no measure of recovery and contemplates injuries to investments that may not rise to the level of constructive takings. Where a breach only partially damages an investment, presumably a tribunal is called upon to fix actual damages just as a domestic court would in delict or contract. Where, as here, the loss is constructively total, uniformity and ease of application may be enhanced by borrowing Article 1110's formula by analogy. Failing that, the traditional formula set out in *Chorzow Factory* may be employed. Under that much-discussed precedent, the failure to comply with Article 1105 should be deemed an internationally illegal act, entitling Claimant to two components of recovery: one representing the value of the undertaking at the time the loss accrued (*damnum emergens*)<sup>63</sup> and an additional measure equal to the profits that Claimant will forego in consequence of the breach (*lucrum cessans*), subject to the caveat that the damages relate to prejudice which is direct and foreseeable.<sup>64</sup>

The underlying thesis of *Chorzow*—the need to restore the injured to his pre-delict status—can be vindicated in various ways. In *Amco II*, the Claimant had lost his investment through an administrative denial of justice. The tribunal, chaired by Rosalyn Higgins, applied the remedial goal identified in *Chorzow* applicable to illegal state conduct—that compensation should to the extent possible “wipe out all the consequences of the illegal act and reestablish the situation which would in all probability, have existed if that act

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on the objectives of compensation where there has been an unlawful interference with contract.”).

<sup>63</sup>See, e.g., *Amoco International Finance Corp. v. Iran*, 15 Iran-U.S. C.T.R. 189 at para. 201: “[T]he list of components enumerated by the [Chorzow] Court as included in the value of the undertaking ... appertain to three categories: corporeal properties (lands, buildings equipment, stocks) contractual rights (supply and delivery contracts) and other intangible valuables (processes, goodwill and ‘future prospects’).”

<sup>64</sup>*Amco II* at paras. 265-67

had not been committed.”<sup>65</sup> It did so by establishing the net present value of the enterprise of which Claimant was deprived (the DCF method)<sup>66</sup>. Use of that method in lieu of literal adoption of often-debated two-component approach of *Chorzow* comports with the modern tendency to value enterprises by reference to their cash- flow, rather than by adding the separate net values of tangibles and intangibles as augmented by a potentially overlapping measure for lost profits.<sup>67</sup> Claimant believes that the DCF method would be an appropriate way to restore the situation that existed before Respondent’s breaches of Article 1105.

**9. In Relation to NAFTA 1110, Does the Evidence Support All the Methods of Determining Market Value Referred to By the Experts?**

For reasons outlined in its closing and its pleadings, Claimant holds that the DCF method is most appropriate for use in this case; its basic structure is common ground among the parties’ experts, though they differ as to the relevant assumptions necessary to its operation. The alternative methods proposed by Respondent’s experts are not reflected in the more authoritative awards, such as *Amco II*, *Pyramids II* and *Starrett* (one of many illustrative awards of the Iran-U.S. Claims Tribunal). Book value and related assessments (e.g., cost less depreciation) might be workable based upon the record, but they are disfavored in relation to income producing enterprises, such as the landfill at La Pedrera. They are grossly under-compensatory in such cases. Comparable sales would be a useful confirmatory technique, but the record provides insufficient data to perform that assessment reliably. Reduction of market capitalization<sup>68</sup> also seems out of step with the established practice of tribunals.<sup>69</sup>

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<sup>65</sup>*Amco II* at para. 267 (quoting *Chorzow* 4 Ann. Dig. 268 at 271).

<sup>66</sup>*Id.* at para. 271.

<sup>67</sup>*Cf. Id.* at para. 271; and see *Amoco International Finance*, *supra* at paras. 191- 264, et seq.]

<sup>68</sup>See Transcript of Oral Hearing, Vol. VIII, pp. 130-132. For more detailed analysis of the reduction of market capitalization concept, putting Claimant’s damages at more than \$100 million.

<sup>69</sup>See Lieblich, *Determinations by International Tribunals of the Economic Value of Expropriated Enterprises*, 7 J. Int’l Arb. 37 (1990).

Claimant's likelihood of having its five-year permit renewed should be presumed on the same basis that RIMSA has been renewed at least once, (it has been operating since 1990, and does not meet the state-of-the-art level of the La Pedrera facility). Secretary Carabias testified that it is still the goal of the Government of Mexico to have as many as 11 CIMARI facilities. Madam Carabias stated that as many as "6 or 7" facilities may be permitted next year. This falls short of the stated goal of having all 11 facilities in place by the year 2000, which will help Mexico deal with about 66% of the hazardous waste being produced. With a plodding pace of bringing facilities on-line, it is reasonable to expect that Claimant's permit would most certainly be renewed for two 5-year periods at least.

### Part Three

#### Further Observations on the Governing Legal and Policy Principles in their Factual Context.

##### 1. The Role of Estoppel, Acquiescence and Related Principles.

###### A. In General.

Tribunals are entitled to draw upon general principles of law, including those that prevent a party from—to the detriment of the other party—changing its view, remaining silent when to do so promotes reliance, or failing to clarify an ambiguous situation of its own making. Whether the precise principle is termed estoppel, acquiescence, or good faith,<sup>70</sup> depends upon the context and jurist speaking. The overlap in terminology notwithstanding, these doctrines remain important tools by which tribunals and domestic fora reach just results.<sup>71</sup> In the present case, a number of acts attributable to Respondent

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<sup>70</sup>The late Michele Virally wrote, for example:

[G]ood faith protects those who trust, reasonably, the appearances created by the behavior of the other international legal actors ([having] confidence in the good faith of those actors), or who have truly fallen in error: the innocent victims, all good faith, of appearances.

*Good Faith in International Law*, 77 Amer. J. Int'l L. 130, 133 (1983).

<sup>71</sup> The *ELSI* Court [at para. 54] observed that silence in the right circumstances might give rise to an estoppel when something ought to have been said [the Court there speaking of estopping invocation of the local remedies rule.] The principle was acknowledged by the Permanent Court in *Chorzow* which considered it:

implicate these considerations. Some of these have been recounted in the Memorial and the Reply and those remarks are incorporated here by reference. In light of certain facts confirmed at the Hearing, Claimant will briefly underscore here the application of these principles to other aspects of the Record, without fully rehearsing argument offered before.

**B. The Municipal Construction Permit—Failing to Act and Failing to Speak.**

At the Hearing, former Municipal President Ramos conceded that following COTERIN's application for a Municipal construction permit, his administration was aware that building moved forward at the site; municipal officials watched activities there using field glasses and reported their observations. The Municipality knew that the project was federally approved and scrutinized. It failed to promptly renew the pronouncement of the former administration—that building could not lawfully be carried out absent a local construction permit. Though the Municipality's inaction during that critical 13-month period remains inexplicable, the several possible explanations that arise do not favor Respondent's view.

The most plausible reconstruction is that, having issued in October 1994 an order in which it had little confidence given LGEEPA's 1988 text, the Municipality rightly viewed the continued progress at the site as a federal refutation of Municipal power to immobilize a federal project. Its inaction

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“generally accepted in the jurisprudence of international arbitration.... that one party cannot avail himself of the fact that the other has not fulfilled some obligation or has not had recourse to some means of redress, if the former party has by some illegal act, prevented the latter from fulfilling the obligation in question[.]” [1927 PCIJ (Series A), No. 9 at 31.]

Referring to that passage in *Chorzow Factory*, Dr. Amerasinghe has observed that although the Court pointed to an illegal act in particular:

[T]he principles of good faith and estoppel have a broader coverage than that [so that] any conduct on the part of one party which is intended to lead and induces the other party to act in a manner which is detrimental to his interests could qualify, there being no special requirement that the conduct be illegal.

*Whither the Local Remedies Rule?*, 5 ICSID Rev. 292, 301 (1990).



reflected its knowledge of the weakness of its position; that position was revealed by the petitions to the federal and state governments to stop the landfill, in recognition of its powerlessness to do so itself. It also reflected the time it needed to develop a political tactic, there being no firm legal precedent upon which to rely. Through its inaction, it demonstrated total disregard for the legal structure under which it purported to operate, that placed strict time limitations on the processing of the permit.<sup>72</sup> As confirmed at the Hearing, even the dangerous demonstration at the facilities tour of March 1995 was insufficient to stimulate a decision concerning the construction permit; rather Municipal inaction continued over an additional seven months, a period punctuated by the audit, audit of the audit, continuing construction activity at the site, and finally, the *Convenio*. During that period, moreover, all other construction within Guadalcazar went forward, unsupported by either an application or a corresponding construction permit. Also, Mr. Ramos admitted that he knew of no other project ever in the Municipality of Guadalcazar that was denied a permit because it was under construction.

Given the foregoing, COTERIN was entitled to adopt one or more of the following inferences:

1] that the application could be deemed granted through the Municipality's inaction during the statutory period;

2] that the lack of priority given the process by the Municipality and its failure to impose that requirement on others meant that the permit was largely clerical (to generate fees);

3] that upon the new Municipal administration's reconsideration of the views and assertions of its predecessors, the permit was deemed inapplicable and therefore the requirement abandoned, (perhaps given federal approvals, the apparent federal view that construction indeed could go forward, and federal willingness to act on behalf of the Municipality in allocating benefits to the Municipality in its negotiation of the *Convenio*); or

4] that the application requirement was imposed in bad faith, to stall the project, and that federal authority was more trustworthy.

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<sup>72</sup>Of course, its own disregard for the technical requirements of domestic law has not prevented Respondent from invoking such requirements or supposed requirements against Claimant wherever possible. It would also place upon Claimant the obligation of knowing those requirements even when they are unknowable.

Given the Municipality's extended inaction, it should carry the burden in refuting the natural inferences that arise from its knowing acquiescence. Moreover, those inferences are reinforced by the Municipality's related actions. In particular, if the Municipality possessed the power it purported to wield, why would it not merely pronounce its determination. Instead, it lobbied federal authorities, and sought the support of other municipalities; it also prosecuted the amparo action—all actions that would be unnecessary if the constitutional grant upon that the Municipality now relies held the content ascribed to it.<sup>73</sup>

The Municipality's precipitous action after 13 months of inaction moreover demonstrates that it attributed to the *Convenio* the rights of operation that Claimant and federal authorities did.<sup>74</sup>

Consistent with the foregoing municipal acts was other conduct attributable to the Respondent. The *Convenio* for example is an important indication of the view promoted by federal authorities. The Respondents themselves have described the *Convenio*<sup>75</sup> as "an agreement between two government agencies and a private enterprise [allowing the private enterprise] to conduct certain activities for which it already obtained federal permits."

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<sup>73</sup>In Respondent's closing, it (Mr. Foy) submitted that the reason the Municipality didn't just take action to halt the project—based upon denial of the construction permit—rather than file an amparo against SEMARNAP and the *Convenio* was "this community wanted remediation." (Transcript, Vol. IX, p. 81.) Respondent of course ignores both the provisions of LGEEPA and the environmental laws of San Luis Potosi which Governor Sanchez and Dr. Medellin threatened more than once to invoke. Moreover, there is no evidence supporting that argument.

<sup>74</sup>Claimant could not, therefore, agree more with Marcia Williams' assessment that the Municipality appeared to have sought a mechanism to give effect to its will.

With the advent of Mr. Serrato, who it is not denied came to the Municipality through the good offices of the Governor, came the drastic but effective strategy of issuing a denial of the construction permit and later exploiting the weaknesses in the *amparo* process. Again, why was the considered advice of Mr. Serrato not to merely inform the federal authorities that the Municipality would use its much touted constitutional power over construction to decline the landfill. Claimant submits that the answer is the same one that explains why various municipalities collaborated to petition federal authorities to not open La Pedrera and why Dr. Medellin twice sought INE reconsideration of its site-specific permit for COTERIN—they had no power in relation to hazardous waste to do otherwise.

<sup>75</sup>Rejoinder at para. 628.

That the *Convenio* was unqualified by any contingency related to local permits and gave affirmative, site-specific, authorization to operate has already been noted. Significantly, the *Convenio* was issued in this form despite the purported closure of the landfill by the Municipality over one year earlier and despite the fact that no construction permit had been issued. Indeed, even after the Municipality's purported closure order in October, 1994, the federal authorities granted a new construction permit (January 31, 1995; construction of the final cell, administrative building, treatment unit, a road system, a laboratory, evaporation lagoon and a fuel station).<sup>76</sup> Following denial of the construction permit on December 5, 1995, federal officials executed a complete lifting of the seals (Feb. 2, 1996) and enlarged by ten-fold the landfill permit capacity. (Feb. 8, 1996.) This seems an unlikely amount of effort for federal officials to expend on a project said to be wholly dependent upon a local construction permit. By that time, the Municipality's administrative action prompted by the *Convenio* had been dismissed by Secretary Carabias for a lack of standing.<sup>77</sup>

Respondent has not satisfactorily explained the actions—or more to the point the inactions—of its federal authorities during the critical period when Claimant was alleged to have been advancing the project illicitly. If, as now suggested by Respondent, the local construction permit was indispensable to lawful operation of a federally permitted hazardous waste landfill, why did federal authorities continue to approve project increments while making several visits to the site, why did they form the *Convenio* and why did they the lift of the seals?

A number of possible explanations might account for federal conduct. The most plausible interpretation of the record is that federal authorities believed in federal primacy (despite the political unpopularity of that doctrine in some quarters).<sup>78</sup> That is, concerning that narrow band of activities

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<sup>76</sup>Memorial Ex. 21.

<sup>77</sup>Action filed 15 December 1995; dismissed 27 December 1995. The Municipality asserted its absolute authority to issue construction and operating permits for all projects within its border. Although the secretary's decision discussed several issues raised by the Municipality's filing *ad cautelam*, she remained totally silent on the local permits and authority.

<sup>78</sup>Certainly as a political matter, federal authorities ultimately sought to walk a fine line, though never losing sight of the imperative nature of their work and the critical need for numerous hazardous waste landfills; they thus formed the *Convenio* with Claimant (unqualified by the long-pending construction permit question), allocated therein

associated with hazardous waste, they believed that a federally permitted project could not—as a legal matter—be held captive by municipal authorities.<sup>79</sup> Under this view, even in the face of the Municipality's assertion of jurisdiction, Claimant was entitled to rely on the federal authorities' understanding of their own power.<sup>80</sup>

By contrast if, contrary to the facts adduced in this case, federal authorities knew full well of the requirement of the local construction permit and elected to not inform Claimant of its essential character and to not insist that the local construction permit be procured before further work, certainly federal authorities had a duty to speak; their failure to do so must be seen as a substantial cause of Claimant's reliance and Respondent would be estopped from relying on that legal deficiency.<sup>81</sup>

If the federal authorities were exceeding their authority, that excess was in part induced by the vacuum created by the Municipality's failure to act during the crucial 13-month period between Claimant's application for a building permit and the application's denial.<sup>82</sup>

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appropriate benefits to the Municipality, but contemporaneously embraced rhetoric of state autonomy that had not been characteristic of the earlier federal approach.

<sup>79</sup>That this is the most likely view adopted by the federal authorities as a legal matter is demonstrated not only by the Convenio's unqualified nature but also the manner in which federal authorities purported to fix the Municipality's weekly health benefits, a per ton surcharge for local programs and so on. What was Claimant supposed infer from these formally agreed terms on behalf of the Municipality?—certainly not that the Municipality was an independent legal regime in relation to matters affecting the processing of hazardous waste.

<sup>80</sup>Federal authorities must be presumed to know the law; their continued supervision and granting of interim approvals is strongly suggestive of a belief in federal primacy, that also is consistent with a plausible reading of the relevant statutory texts, and Mr. Deets' testimony..

<sup>81</sup>Claimant finds no international law support for the proposition that an investor is assumed to know the limits of the host state's organizations better than those organizations themselves. Whatever limits might ultimately be identified by Mexico's Constitutional Court, presumably, Claimant was not expected to know or predict those limits better than the federal authorities themselves. Claimant should also be entitled to rely on the spoken, written and implied sense of the situation conveyed by federal authorities by custom and by the Municipality itself.

<sup>82</sup>As to the protracted inaction by the Municipality, Claimant is reminded of the *Shufeldt* claim (U.S. v. Guatemala) [5 Ann. Digest 179 (1934)] that involved a concession under

Respondent's contention that in lacking a critical permit Claimant enjoyed only a partially permitted project depends upon an artificial elevation of the construction permit from inchoate, untested, at best debatable, constitutional function to firm datum. Other tribunals have recognized that such supposed requirements must be assessed in light of the function and importance given them in actual practice; many countries have formal statements of law and policy that bear no relation to the defacto regulatory framework.<sup>83</sup>

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which Mr. Shufeldt was entitled to prospect for Chicle. By legislative decree, Guatemala abrogated the concession. Guatemala had argued that the concession was constitutionally invalid, so that nothing had properly accrued to Claimant that could be taken. The arbitrator found the concession to be in accord with Guatemalan Law, and that there had occurred an expropriation. He also stressed, however, that estoppel would reach the same result, for: "[r]elying on the good faith of the Government [Mr. Shufeldt] expended large sums in providing the necessary appliances, roads, ...for facilitating and expediting the extraction and export of chicle in the hope of recouping his expenditure by the time the contract expired." [5 Ann. Digest at 180.]

<sup>83</sup>In *Ghana Investments*, the Claimant alleged that Ghana had indirectly expropriated his investment, which took the form of a local limited liability company that had formed a contract with a government entity to develop a resort complex. Substantial work had already been complete when government officials issued a stop-work order, claiming that Claimant's project lacked a building permit. The Tribunal ultimately found that the stop-work order in combination with other factors had effected a constructive expropriation for which fair market value had to be paid. Not unlike the present case, in *Ghana Investments*, the lack of a building permit was the principal justification raised by the host government for its acts. It proved to be no obstacle to recovery.

As to the lack of a building permit, the Tribunal chaired by Judge Schwebel reasoned (closely paraphrased):

The Tribunal finds ... that [Claimant's entity] began work before a building permit was applied for. It appears that [the Government Tourist Company] [the government entity called Ghana Tourist Development Co. (GTDC)] considered granting of a building permit to be a formality that would eventually be discharged, but that was not necessary prior to starting work.... Whether [the Governmental Tourist Company] directed, requested or permitted Claimant's company to begin work without a permit, the Tribunal holds that [Claimant's Entity] was entitled to rely on the indications of [the Governmental Tourist Company] that was the long-term leaseholder of the premises [and] an experienced government-affiliated entity, and to proceed with the work despite the absence of a permit. In this context, the Tribunal has regard especially to

## Part Four

### Claimant's Entitlement to Costs of the Proceeding

#### I. Introduction.

International arbitration tribunals in modern practice have discretion in apportioning costs; thus, neither the American rule (each side bears its own costs) nor the English Rule (costs follow the event) enjoys automatic application.<sup>84</sup> Among the factors that a tribunal is entitled to consider in assessing costs are: 1] the extent to which the claim was well-founded and the corresponding weakness of the Respondent's defenses and wastefulness of its

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the fact that it appeared from [uncontested testimony sponsored by Claimant] that the inability of the [alleged permitting authority] to act upon the application resulted from the absence of any prior permit authorizing the building of the original structure.

While the letter of the law, as pleaded by Respondents, supports the conclusion that extension of works of the character contemplated could not go forward without a permit—or if they did, would be subject to fine or demolition—nevertheless, the practice with regard to this site indicates an exception to the rule.

Elsewhere in its award, the Tribunal stated [p. 210].

As for the failure to issue a building permit, and the partial demolition of the project (whether or not it was prompted by the lack of a building permit), the Respondents have not adequately explained these actions, in view of the time elapsed between the application and the issuance of the stop work order. The work actually carried out by [investor's entity], and Claimant's justifiable reliance on [the governmental entities involved] in liaison with the relevant Governmental agencies. In particular, the Tribunal does not find credible that the authorities in Accra were ignorant of the existence for well over a year of construction activity on one of the most prominent sites in the city ....

<sup>84</sup>Article 31(8) of the British Columbia International Commercial Arbitration Act states in pertinent part "Unless otherwise agreed by the parties, the costs of an arbitration shall be in the discretion of the arbitral tribunal ...." Reprinted in Vol. I, ICCA Handbook. The provision also identifies a range components that may be included in 'costs' and specifies that the payee, payor and structure of payment may be designated by the Tribunal.

decision to not compensate Claimant initially; 2] the resources expended by the respective parties upon matters not central to the case (and the corresponding burden placed upon the counter-party to assess and respond to those matters); 3] the extent to which the respective parties engaged in oppressive conduct; 4] the relative amounts of billed activity undertaken in comparison to the result achieved. For the reasons heretofore argued, Claimant believes that it is entitled to recover damages for violations of the NAFTA. Based upon Respondent's case and comportment, Respondent should also reimburse Claimant's full costs.

## **II. Respondent's Substantive Positions.**

### **A. In General.**

Respondent's defense on the law has been built largely upon one case, (*ELSI*), portrayed as the answer to nearly all questions, to the exclusion of numerous other precedents. Inapposite dictum from two other decisions was also relied upon as was a generally artificial construction of the NAFTA. Though sometimes facially inventive, Respondent's views do not withstand modest scrutiny. Often, they ignore settled principles of state responsibility and the express aims of the NAFTA. They moreover have been dwarfed by Respondent's monumental efforts to convert the case into one controlled by the 1933 and 1934 Acts under which American authorities regulate transactions in securities. A non-exhaustive sampling of these ill-conceived arguments follow.

### **B. Respondent's Substantive Defenses.**

1) *Respondent Argued*: Because Municipalities are not expressly mentioned in Article 105, NAFTA does not extend to acts or omissions chargeable to the Municipality of Guadalcazar .

As developed above, Respondent's view that NAFTA does not extend to the acts of Municipalities suffers from numerous deficiencies. It defies settled rules of treaty interpretation that advise against absurd results and in particular: it ignores NAFTA's objects and purposes, the aims of Mexico's corresponding investment legislation and Mexico's Basel Convention obligations; it fails to take account of the international law principles otherwise applicable among the parties and argues for a dramatic departure from those principles without demonstrating the Parties' clear intent to do so; it ignores the failure of Canada to seize upon its earliest opportunity to make the same point; and, it was proffered with such unfortunate belatedness—long

after such a fundamental issue should have arisen in *Azinian* or this case—that one is entitled to speculate about its pedigree.

Respondent, a party to the NAFTA, is under an obligation to apply NAFTA's terms in good faith. Even if merely born of haste,<sup>85</sup> the position upon which Respondent insists has caused an additional round of pleadings and necessitated filings by the other two NAFTA Parties. Claimant has in turn had to respond not only to the views of Respondent, but also to anticipate the views of Canada and the United States. Additional Tribunal time has also been devoted to the process as a result of Respondent's argument.

2) *Respondent Argued*: Because Chapter 11 does not expressly use the term "transparency," that characteristic is not a component of the fair and equitable treatment that Respondent has pledged to provide.

Transparency is expressly mentioned in NAFTA, Article 102, that presages all the NAFTA chapters. That transparency is not mentioned specifically in Chapter 11 does not limit the scope of the fair and equitable provisions; the ordinary meaning of those terms includes notions of notice, predictability and security of legal regime. Though unwilling to concede a duty to ensure sufficient transparency, Respondent does embrace—supposedly as a general principle—the maxim that ignorance of the law (apparently as delineated by Respondent in retrospect) is no excuse. The incongruity in Respondent's position is apparent; if both prongs of Respondent's argument are credited, investors will be subject to a paradigmatic "catch-22." Such a regime opposes in the extreme what NAFTA seeks to ensure.

In relation to host country legal environments, the imposition of unwritten and discretionary requirements that depart from formal texts has been recognized as problematic by scholars and documented anecdotally for decades.<sup>86</sup> It is no doubt in part what Dr. Shihata suggests when observing:<sup>87</sup>

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<sup>85</sup>From the timing and context of Respondent's arguments on state responsibility, one might be tempted to speculate that Respondent's remarkable theory of non-attribution for a municipality's acts and omissions was advanced in bad faith. Claimant assumes that is not the case but suggests that, lacking the benefit of critical reflection, the position is simply ill-considered. There being no detailed *travaux préparatoires* to restrain zealous advocacy, Respondent was free to question what is unspoken, but doubtless taken for granted, in Article 105.

<sup>86</sup>See, e.g., Gordon, *The Governance of Multinational Enterprises by Third World Nations*, 16 *Inter-Amer. L. Rev.* 310 (1984) (referring to "operational code"—a nebulous array of unwritten regulations which "add uncertainty to the maze of written laws often



What is important is that the applicable rules [concerning investment] be clear and easily identifiable, that they provide fair, non-discriminatory treatment, restrict the role of government agencies in investment decisions and not vest broad discretionary powers in the hands of government employees.

The World Bank, making findings contemporaneous with Claimant's due diligence in this case, concluded that Mexico's regulatory environment was deficient.

Remaining wide and unclear discretionary powers in administrative law matters need to be curbed at all levels of government. Regulations need to be more clearly drafted and in strict compliance with governing law. They also must be less frequently changed. Finally, adequate resources must be made available so as to permit the publication and dissemination of laws, regulations and administrative directions at both federal and state level[s].<sup>88</sup>

Claimant came to discover the same realities only after relying to its detriment on the regime ostensibly in place.<sup>89</sup>

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sufficient in magnitude to cause multinational enterprise negotiators to terminate discussions with a sense of futility."); Folsom, et al., *International Business Transactions* 920 (4<sup>th</sup> ed.) ("Multinational representatives are often perplexed ... Their lawyers are diligent in discovering all the written laws of the host nation which govern investment, but ... new restrictions and road blocks are placed before them. Many may mandate expensive detours which convert profitable investment into a losing one.").

<sup>87</sup>Shihata, *Legal Treatment of Foreign Investment* (1993).

<sup>88</sup>World Bank Study at 107 (Report No. 11823 MX).

<sup>89</sup>Claimant directs the Tribunal to the full witness statement of Salomón Avila Pérez (C-M, Annex Two, Vol. III: Municipal, Tab A). Here reads—from Respondent's own witness—the workings of the Mexican political regime. Note the following:

- Mr. Avila was municipal president from January 1989 through December 1991.
- In December 1990, he learned of construction activity at La Pedrera. No construction permit had been issued.
- On December 11, 1990, he heard there were 25 trucks at the site with waste.
- Avila met with the governor, who "instructed me to stop the trucks with my own policemen."
- Mr. Avila went to the site and arrested 25 truck drivers.
- Later the governor called and "told me to release the drivers and to apologize for having briefly arrested them."

Given the undeniable importance of transparency to the achievement of NAFTA's goals, it is unlikely that NAFTA's drafters intended to exclude that component from Article 1105.

Respondent's effort to discount the transparency requirement betrays its appreciation of the disarray confronting Claimant. The Tribunal will recall the answers to its related questions of Respondent's counsel<sup>90</sup> and the other places within the record where even the abstract principles raised in defense

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- Mr. Avila was told by the governor to "speak to the SEDUE delegate, who knew about the project."
  - Mr. Avila spoke with him and was directed to the deputy-delegate, "the person in charged (sic) of this type of authorizations (sic)."
  - He then spoke with the regional deputy-delegate, Humberto Rodarte Ramon (this is 1990 before Mr. Rodarte had met anyone from or associated with the Claimant).
  - Avila asked him why he issued a permit for a Transfer Station without first consulting with the Municipality and the community.
  - Rodarte stated that it was a federal project, and he was not required to ask Mr. Avila's opinion or the community's.

This testimonial scenario from Respondent's own witness portrays the very regime Claimant says it encountered:

1. A municipal president looking to the governor for instruction and following the governor's instructions;
2. A governor who submitted to federal authority over hazardous waste (this is post-LGEEPA [1988]);
3. Although the municipal construction permit was allegedly discussed between the governor and the president, it was neither invoked on the project nor raised with federal officials, even though the governor and the president knew there was construction activity at the site;
4. The federal official both stated his view of federal primacy and acted accordingly.

<sup>90</sup>See, e.g., Transcript, Vol. IX, at p. 30, et seq. (President Lauterpacht: Are there any academic commentaries on the environmental law of Mexico which an interested person ...[e.g., a] company like Metalclad could turn for authoritative interpretation and guidance on these very issues? [Counsel's reply: President's question restated.] Counsel: "I do not have in my presentation immediately those references and will take that question and consider it. President Lauterpacht: "What the Tribunal needs to know is whether this analysis that Mr. Perezcano has presented, a different version of which Mr. Pearce has presented, is openly set out and is transparent in Mexican law or is there room for confusion"? Counsel: "I will be directing the Tribunal to reexamine from the federal perspective.")

are offered with qualifications and exceptions that would seem to support Claimant's impression of the applicable regime.<sup>91</sup>

3) *Respondent Argued*: Claimant was the victim of a mere jurisdictional conflict—that is, an ordinary business occurrence concerning which Claimant must be deemed to have assumed the risk.

Respondent appears to reason that because landfills often encounter opposition and that sometimes said opposition is reflected in inter-governmental disputes, the acts of one or more of Respondent's constitutionally-ordained constituent units must be likened to purely private action. That the Municipality "speaks for the people" is a platitude not recognized as an excuse under standard theories of attribution.

In a related and recurrent argument, Respondent seems to disenfranchise federal authorities for state responsibility purposes by explaining why the "top-down," non-consultative policy employed by those authorities, was unwise. Even if in theory federal authorities could defer such policy development to Claimant, the practices and attitudes that Respondent complains of antedated Claimant's involvement in Mexico<sup>92</sup>. As explained elsewhere, the same federal policies account for much of the federal-local

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<sup>91</sup>Thus, Respondent conceded that "it is not a matter of the Municipality's jurisdiction to reexamine the federation's examination of the environmental impact study." [Transcript, Vol. 9 at p. 33] suggesting elsewhere that the Municipality retains power merely to "express its views ... on the adequacy [of] the protection of the risks to the local community." [*Id.* at 35.] Respondent chooses its word carefully again in informing the Tribunal "[n]one of the three levels of government ... can trump ... the legitimate exercise of jurisdiction of the other levels of government" (emphasis added). Similar room to maneuver is found in Respondent's written pleadings. See, e.g., Counter-Memorial at para. 191: the power in Municipalities to issue construction permits "may be regulated by federal regulations, but cannot be superseded or ignored." The Claimant asks again, assuming arguendo the correctness of this formula, how can it be said with confidence that federal primacy limited to hazardous waste is not mere "regulation" of municipal powers when one considers the residuum of authority left undisturbed?

<sup>92</sup>The uncontroverted evidence shows: that federal and state officials assisted in the selection of the La Pedrera site; that Dr. Medellin, himself, was one of several UASLP scientists who opined to the state congress that a land use permit for a hazardous waste site at La Pedrera was appropriate; that federal authorities approved the introduction of hazardous waste into the site; that federal officials did not consult with local officials; that—until October 26, 1994—the municipality took no action to close the facility for lack of a construction permit.

tension that surrounded La Pedrera, even before Claimant's arrival. Indeed, that COTERIN was the only entity ever asked to submit to the Municipality's supposed permitting powers is perhaps best explained by the project's *federal* backing and the dynamics of local politics. It is significant that Respondent openly admits that political considerations impeded Claimant's success. Respondent's candor notwithstanding, protection from the vagaries of local politics is one of the acknowledged aims of treaties such as NAFTA.

The *Pyramids* dispute was adjudicated by two learned tribunals, each effectively reaching the same result. It, too, had elements of inter-governmental conflict. Various ministries and Egypt's President lobbied the Assembly to preserve the project, to no avail. Both tribunals found a taking, and nothing appears in either award's reasoning to indicate that a different result would obtain if the Assembly's decision had been first disputed on jurisdictional grounds by the Executive, before acquiescing.<sup>93</sup>

4) *Respondent Argued*: The entire project was a "stock scam."

It is unclear on what basis Respondent wishes the Tribunal to substitute its judgment for that of American regulatory authorities; nor is it clear what standing Respondent enjoys to allege violations, since under American law causes of action are available only to the SEC and to contemporaneous purchasers or sellers of shares.

More fundamentally, while the intent to prejudice the Claimant is apparent, a proper and relevant use of the so-called *prima facie* case—i.e., its bearing on the NAFTA issues—is never established by Respondent, despite its intensive use of forensic securities specialists, and its counsel's insistence on pursuing the issue at the Oral Hearing. Nor are Respondent's allegations of federal securities law violations supported by the facts.<sup>94</sup>

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<sup>93</sup>Respondent protests that *Pyramids* is unhelpful because that claim arose out of a contract. It has not elaborated upon its assertion that the *Convenio* can be meaningfully distinguished from international contracts and concessions protected in the numerous published awards.

<sup>94</sup>Respondent styles its voluminous submission merely as "a *prima facie* case"—apparently meant to convey a belief that, if nothing more, its allegations would in a hypothetical domestic court withstand a procedural attack on the face of the pleadings; a copious use of sheaves and ink notwithstanding, Respondent appears to have set the lowest possible hurdle for itself, contrary to its acceptance of Claimant's submission that a greater burden of proof than normal was appropriate to SEC and Foreign Corrupt Practices Act

Understandably, however, Claimant took seriously the allegations requiring expenditures of time and costs for counsel and company officials.

Uncontroverted facts establish that Claimant built a landfill of appreciable quality and sought through every legitimate means to operate it. The record also demonstrates that Claimant's investors are in large measure sophisticated institutions. Both facts are unlikely ingredients in a plot to manipulate markets. Respondent's only departure from wild speculation is its correct observation that much interest and enthusiasm was generated by investments that held promise for improving Mexico's environment. Respondent's misguided theory of the case was part of general strategy attempting to detach the case from NAFTA. Its attempted re-characterization of the case caused the Tribunal and the Claimant to divert and expend resources unnecessarily. That campaign, which continued well into the Hearing, was wasteful, ineffectual, irrelevant, mean-spirited and costly.

5) *Respondent Argued*: That the Tribunal need not and should not consider questions of Mexican law<sup>95</sup> and that the Tribunal may not sit as a court of appeal from the decisions of Mexican courts [<sup>96</sup>] and that Claimant has admitted, through its conduct, that the Municipality had the jurisdiction it purported to exercise.

**a) The Broad Propositions.**

Requesting the Tribunal to depart from logic and the established practice of tribunals in general, Respondent apparently holds that it is entitled to rest its entire case upon a dubious position of internal law and that the Tribunal must accept it as portrayed without reflecting upon its correctness in theory and practice and how it compares to the international standard established by NAFTA. How in this case does one understand the property rights galvanized in the *Convenio* without considering the mandate given federal authorities? How does one assess the correctness of Claimant's contention that the law was not in fact characterized by clarity or fixed content, and that under any construction, the Municipality's assumption of

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allegations. (See Rejoinder, p. 37, para. 65.)

<sup>95</sup>Rejoinder para. 523.

<sup>96</sup>Rejoinder para. 535, et seq.

power over the environment was unsupported even by the constitutional provision it invoked?

Moreover, the notion that the involvement of a domestic court exempts a matter from tribunal consideration stretches too far; as a general maxim, the exception it contemplates would seem to denature the various due process protections expressly guaranteed in the NAFTA, because courts will often be the State instrument involved, and would eliminate from Article 1105 many garden variety denial of justice cases. While it is clear why Respondent prefers its astonishing theory, it is difficult to envision how a tribunal so encumbered could promote the NAFTA aim of creating "effective procedures for the ... resolution of disputes"<sup>97</sup>.

#### **b) The Related Arguments.**

Conceding that legal clarity could only have been advanced had higher domestic courts examined the matter, Respondent suggested in argument, nonetheless, that inferences arise from Claimant's decision to not continue its *amparo* action and from its application to Municipal authorities; yet, contrary to what Respondent wishes to establish, no unambiguous acquiescence in municipal jurisdiction, nor in the Municipality's purported jurisdiction over hazardous waste, is present in the Record.

As noted above, the initial decision to apply for a construction permit was prompted by the politically calculating advice given to Claimant by federal officials, who expressly discounted the Municipality's claim to a co-equal sphere of jurisdiction. In making its application, Claimant, though appreciating the political expedient at play, should not be deemed to have acquiesced in whatever procedural and substantive excesses the Municipality ultimately found necessary. If the Municipality had any jurisdiction at all, it was limited to matters affecting construction. In taking the advice given it by federal authorities, Claimant merely sought to navigate an emerging jurisdictional conflict; it was a conflict which Claimant played no genuine role in creating and the existence of which Respondent has conceded.

In its closing argument, Respondent (Mr. Foy) represented to the Tribunal that Claimant had received repeated legal advice that it must obtain a local construction permit, and directs attention to the testimony of Mr. Garcia, the law partner of Jose de la Garza. It is appropriate to question the

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<sup>97</sup> NAFTA, art.102(e).

credibility of both de la Garza and Garcia. The evidence shows that these witnesses came to the arbitration with prejudice: once employed by Metalclad, they were later fired after billing for more than \$200,000 U.S. in legal fees; de la Garza asked for \$250,000 (U.S.) to “influence” the governor; their competence was questioned. That they would attempt to turn their former client’s own files and information against it is not unexpected.

Mr. Foy’s clever cobbling together of strategic pieces of exhibits with selected bits of Mr. Garcia’s testimony in an effort to show that Claimant was the beneficiary of a consistent quantum of legal advice on this issue trenches on the truth. (See, Transcript, Vol. IX, pp. 49-51; 59-62.)

A careful look at Mr. Garcia’s statement and exhibits, (Counter-Memorial, Vol. 3A, Tab E, Exhibits 2-6), reveals a condition different from that portrayed by Respondent:

- 1) A full reading of the **August 17, 1994** letter from Garcia to Javier Guerra—not just Mr. Foy’s selected excerpts—discloses that it is not a letter instructing Claimant that it *must* obtain the building permit. Rather, it is one seeking a strategy direction about applying for the permit, and “if it is denied, to proceed before a Federal judge filing a petition [amparo] to obtain from him an order” requiring the City Council to issue the permit. (Garcia, Ex. 3).

One is struck by the logical query: if the municipal power is absolute in this area, then on what basis might Mr. Garcia seek the court’s aid in enjoining the issuance of the construction permit?

- 2) Mr. Neveau’s letter of **September 9, 1994** responds to Garcia’s letter. If one reads all of paragraph 2, instead of the one sentence quoted by Mr. Foy, one finds that Neveau’s position is that “we have the authority from PROFEPA to construct and maintain the project.” But, he states, “*I would like your opinion whether or not this authority supersedes the license to construct.*” He concludes this point by saying the point needs further discussion. (Garcia, Ex. 2).

This letter shows that there is now confusion and uncertainty about the local permit, and Garcia’s opinion is sought. *Other than Garcia’s statement prepared for this arbitration, there is no documentary evidence that Garcia ever gave an opinion.* Moreover, his claim that he advised Mr. Neveau “that

whomever (sic) told him that no local license was required was wrong and that a construction license was required for a project of this size and importance," is without any supporting documentation. (Since no legal criteria exist anywhere identifying a "project of this size and importance" requiring a construction permit, it seems remarkably coincidental that only during this proceeding has Respondent attempted to introduce this notion as a way of explaining why no one else ever had to have a construction permit; and, Garcia's witness statement should carry that same phrase.)

3. Respondent argues that Metalclad got legal advice (from Garcia) to challenge the closure order of the Municipality. Presumably, "that challenge would be on jurisdictional grounds. It would be the basis that the federal primacy point, (sic) you have no jurisdiction to issue a closure order."

"That legal advice was given, and Metalclad on its own decided not to do that." (Transcript, Vol. IX, pp. 59-60.)

But that is not Respondent's own evidence. Garcia states that while he advised Metalclad to challenge the Municipality, the Company's Mexico City lawyer, Manuel Garcia Barragan advised against it. Metalclad took the advice of its lawyer, Lic. Barragan. (Garcia witness statement, ¶51.) Again, one wonders why Garcia, so certain in his position of the Municipality's absolute construction permit authority, could ethically advise the Company to pursue an amparo.

4. What Respondent did not explain about the construction permit application, was that Mr. Garcia reviewed and revised the application; that he provided copies of the pertinent statutes, noting the language to be included in the application; that he requested several "essential documents" to complete the application; and, that he wrote that he judged the application complete. (Garcia, Exhibits 4-7.)
5. It is Mr. Garcia who officiously opines in his statement prepared for this arbitration that "according to Mexican Law, the company accepted the legitimacy of the permit requirement." (Garcia, ¶52.) Noticeably absent, however, is any evidence that, as Metalclad's lawyer, he ever advised the Company of that view; nor, is any legal authority provided.



When looked at from a fuller perspective than Respondent provided on these points in its closing—and especially in light of Mr. Thomas’ question about the duty of candor with respect to the evidence—the Respondent’s tapestry unravels.

Perhaps the World Bank Report on Mexico informs the problem facing Claimant, and others, in legal representation in Mexico. In an entire section on “Lawyer Qualifications”, among other things, the Report notes:

- there is a “dearth in appropriate standards of professional ethics”;
- fundamental deficiencies, such as: low entrance requirements and poor academic achievement; an inadequate sense of social responsibility among the law students toward the profession and the community;
- the license to practice automatically follows the degree; no mandatory (or voluntary) bar examinations;
- “the practice of law in Mexico is simply not regulated. Mexican lawyers are not subject to: any specific regulation of professional practices; any mandatory code of professional responsibility.”<sup>98</sup>

Claimant’s determination that it would not pursue further its *amparo* against the Municipality reflects an attempt to attain its business goal when faced with obstacles that were represented to be negotiable, not immutable legal impediments. As Respondent itself notes, Claimant elected to not pursue additional *amparo* proceedings to facilitate a negotiated solution.<sup>99</sup> Respondent failed to recall, however, the Municipality’s role in fostering that alternative to litigation; its desire that the Claimant abandon the *amparo* path is reflected in its *reuerdo* with Claimant. Nothing in the NAFTA requires the Claimant to exhaust local remedies<sup>100</sup>. NAFTA, while setting forth several pre-conditions to claim eligibility, does not include among them exhaustion of

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<sup>98</sup>World Bank Study at 112 (Report No. 11823 MX).

<sup>99</sup>Transcript, Vol. 9, p. 146.

<sup>100</sup>As noted by The World Bank Report (Reply at para. 451), the four-year norm for *amparo* actions naturally discourages resort to the courts.

domestic remedies. When modern BIT's have retained that requirement, they have done so expressly,<sup>101</sup> and the trend among BITs and analogous instruments tends away from including the requirement.<sup>102</sup> Concurrently, good policy argues against penalizing Claimant for seeking a non-litigious solution to the construction permit impasse.

### III. Procedural Maneuvers and Arguments.

#### A. Respondent's Unsupported Attempt to Strike the Reply.

Invoking a pleading format nowhere settled in arbitral practice, Respondent busied the Tribunal and the Claimant with a motion to fully disallow Claimant's second written pleading. The request, which reflected the expenditure of lavish skill and energy, was nonetheless manifestly inconsistent with the *lex arbitri's* mandate that each party be given a full opportunity of presenting its case and be treated with equality.

One assumes from the wealth of legal talent engaged by Respondent that the futility of the request was well-appreciated when it was lodged. Accordingly, its purposes must have been to engender delay, or intimidate Claimant, or promote some other collateral goal.<sup>103</sup>

#### B. Respondent's Convoluted Approach to NAFTA Articles 1119, 1120 and 1121.

Though consistent with its general approach to interpreting the NAFTA, Respondent's argument for curtailing the Tribunal's competency insists upon an interpretation at odds with common sense. In particular, Respondent contended that "[a]ny act or omission occurring after April 2, 1996, (the date

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<sup>101</sup>See A. Parra, *Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment*, 12 ICSID Rev. 287, 333 (1997).

<sup>102</sup>*Cf. Id.*

<sup>103</sup>Perhaps by its formalistic objection, Respondent was attempting to preserve for itself a basis upon which to attack the ultimate award; ironically, however, success on its part would have had the opposite effect by enhancing only Claimant's grounds for complaint. See New York Convention, art. V(1)(b).

established by Article 1120), cannot be advanced in this claim.”<sup>103</sup> [Counter-Memorial at para. 790.]

Respondent reached this surprising result by working back-wards six months from the date upon which Claimant filed its Notice of Intent to Submit a Claim under 1119. Article 1119 in fact makes no reference, express or implied, to such a limitation. Article 1120, in turn, merely requires that the parties not rush to arbitration before having had time to fact-find and consider possibilities for collaborative dispute resolution; when the claim is filed (or amended) the events relied upon must be at least six months old. Article 1119's 90-day rule reflects similar policies. Respondent's view—that the Article 1119 Notice must relate to matters occurring at six least months before—simply does not flow naturally or logically from the text. Additionally, like many of its other arguments, Respondent's Article 1119 construction is unworkable and inconsistent with good policy. This was more fully treated in the Reply at paras. 243, *et seq.*

### **C. Misleading and Errant Translations.**

Claimant's resources do not enable it to test every translation for which Respondent has vouched. Nonetheless, when Claimant diverted its attention in that manner, it discovered a high incidence of unreliability, necessitating that it scrutinize original documents and Respondent's renditions with especial care. If Respondent's goal was to distract Claimant and further tax Claimant's limited resources, the ploy largely succeeded. Respondent, despite the considerable talent assembled by it, tendered and relied upon many translations that were mere summaries. Other translations proffered by it were simply errant as to matters material to the case. This tendency, commented upon in the Reply at paras. 85, *et seq.*, continued throughout the proceedings<sup>104</sup>.

### **D. Failure to Make Discovery.**

Claimant calls attention to the fact that Respondent has steadfastly refused to provide key information, within its control or access, that would have helped Claimant and the Tribunal to a fuller appreciation of important facts in this case. Information pertaining to RIMSA was important for

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<sup>103</sup>Counter-Memorial at para. 790.

<sup>104</sup>At the Hearing, for example, when counsel for Repondent was reminded that he was relying upon a summary of an original, he undertook to supply a proper translation; the translation was not forthcoming.

comparisons of permits, capacity, volume of waste in the gate, and volume of waste in the ground. Various records of Governor Sanchez, Dr. Medellin were not produced, although Governor Sanchez was apparently able to have with him at the Hearing certain official documents of his choosing, but none of those requested by Claimant. Dr. Medellin simply denied ever having any such records. Results and reports of the criminal investigation of Altimirano, Reyes, and others relating to the La Pedrera landfill—reportedly fully exonerating all those charged—were denied Claimant, even though Respondent fully spread upon the record the entire criminal complaint.

#### **E. Pressure Exerted Upon Claimant's Witnesses and Purloining of Others.**

The non-appearance of Mr. Rodarte at the Hearing resulted from proceedings initiated by Respondent upon the eve of Mr. Rodarte's appearance at the Hearing. The Tribunal will recall that the Mexican Constitution puts at risk the citizenship of those who assist international tribunals. Prior to the proceedings instituted by the Respondent, Claimant had enjoyed the cooperation of Mr. Rodarte. By causing his absence, Respondent also deprived him of the opportunity to counter the charges of corruption leveled at him by Respondent; the record vindicates Mr. Rodarte in respect of those charges, but the confirmation he would have offered in respect of federal policy and federal representations would have assisted the Tribunal and corroborated other evidence presented by Claimant. The thrust and potential of Mr. Rodarte's testimony was well-known to the Respondent; consequently, the timing of the proceedings Respondent instituted should raise inferences unfavorable to it. For a clear—and uncontested—rehearsal of the selection and development of the La Pedrera project, Mr. Rodarte's testimony is most helpful. A reader will also find Rodarte's testimony as to federal primacy consistent with that of Mr. Altamirano, Municipal President Avila Perez, the actions of federal, state and municipal officials and a reasonable reading of the law.

At the Hearing, Respondent attempted—apparently successfully—to retain as an expert for another matter Mr. Lee Deets. Mr. Deets is a cardinal witness in the present case, and his cooperation ordinarily could have been taken for granted in the preparation of this brief. Under the circumstances, Claimant felt unable confidently to do so.

With respect to other witnesses in this case, the Tribunal will recall that Respondent surrendered its position to cross-examine Mr. Richard Nichols, who was present at the entire Hearing almost full-time. Mr. Nichols is the only expert to have actually visited La Pedrera; and to have interviewed BFI

engineers and others with specific project involvement. He is the only expert in this case who has appraised a hazardous waste landfill before La Pedrera, (18 others, in fact).

Ron Robertson, sponsored by Respondent, was shown to be a resentful ex-employee of Metalclad who left under a cloud and as a litigant. When Robertson's testimony was challenged by Claimant, he unilaterally withdrew rather than submit his veracity to cross-examination. Unlike Mr. Rodarte, Mr. Robertson was not the object of a government initiated criminal inquiry. Claimant submits that Robertson's testimony should be given no weight or consideration in this case.

Finally, Claimant recalls that Respondent has failed to produce either Gabriel Quadri—the president of INE during much of the pertinent time, and whose public positions are critical of Respondent; or, Sergio Reyes Lujan, who was the founding president of INE, and who has never denied instructing Claimant that federal authority obviated the municipal construction permit requirement.

#### **F. Partial Disclosure of Amendments to Purchase Agreement.**

Respondent argues that the so-called Amendment Agreement to the Purchase Agreement between Metalclad and the Aldretts, which contains among a number of other things, a contingency dealing with state and municipal approvals and permits, indicates Claimant's awareness of the centrality of the local permit. Respondent explains that it was put into the Agreement as a legal precaution against Aldrett's assurance that the local permit was not necessary to a hazardous waste landfill.

The evidence supports Claimant's position. During the redirect examination of Mr. Kesler, (Transcript, Vol. V, pp. 244-254) he pointed out that:

- 1) The original Amendment to the Agreement was necessitated, not to put in a contingency as to approvals; but, as the wording in the document instructs, to correct Aldrett's failure to convey the real property at La Pedrera for no value, as promised. (Aldrett had instead sold it to COTERIN for \$1 million (pesos). (The Amendment Agreement is in Counter-Memorial, Annex Nine: Exhibits, Vol. I, tab 3.)

- 2) After the Amendment agreement spotlighted by Respondent, another amendment was negotiated over a year later, on January 9, 1996, between the Company and the Aldretts. This later document contains no contingency language referencing state or municipal approvals. This, as Mr. Kesler explained, reflected the confident understanding he, and other officers had, that federal authority fully occupied the field of hazardous waste, and their project was beyond the authority of the state or the municipality. Having been assured from the highest levels of both the United States and Mexican governments that their problem was solved, Mr. Kesler and his colleagues were secure in their trust. (Rejoinder, Exhibit 23.)

### **G. Misrepresentation of Local Permits.**

Both in its opening statement, (Mr. Perezcano), and during its closing remarks, (Mr. Foy), Respondent misrepresented facts. In each instance reference was made to two municipal construction permits applied for by the Claimant or its subsidiaries. And exhibits 24 and 25 of the witness statement of Jorge Hermosillo, (Rejoinder, Vol. 3B, tab A), are tendered as evidence of Respondent's assertion. But Respondent made acute omissions. Most noteworthy is that one of the purported permits provided to Mr. Hermosillo was dated April 20, 1990—more than a year before his first affiliation with anyone associated with Claimant—and the document is directed to "J. A. Hermosillo S and Company"—an entity never connected with Claimant or any of its officials. With Respondent's repeated emphasis on this issue, it is a stretch to think such an oversight was unintentional.

A comparison of the criteria for the so-called "permits" obtained by Mr. Hermosillo with the process imposed upon Claimant in Guadalcazar is striking. The September, 1992 letter sent to Hermosillo from the municipal president of Santa Maria del Rio authorized "you to carry out the construction and installation of your project," but required that he provide them a copy of the state government permit; an agreement letter to abide by LGEEPA requirements; an official document from SEDESOL; the construction and building plans. All of this was to be provided after this "permit" issued, not with an application. This is a municipality also in San Luis Potosi, subject to the same state legislation regarding construction permits as Guadalcazar. When examining the requirements placed upon Claimant when submitting its application to Guadalcazar, a sizeable disparity is seen. The document has neither the heft nor the substance of the municipal construction permit contemplated for La Pedrera. Assuming the existence of this document was

ever communicated to Claimant, it is not unreasonable that it might be underwhelmed by the three paragraph letter's lack of gravitas. Moreover, that such a document would be so easily forthcoming—without any of the necessary volumes of supporting documentation—lends tenability to the idea that upon federal approval of a hazardous waste project, the issuance of a municipal construction permit was perfunctory.

#### H. Troubled Amparo Process.

Much has been made by Respondent about Claimant's failure to pursue its judicial remedies through the amparo process. Respondent bruits this idea about as if the amparo procedure were expeditious, fair, just, and speedy. The distinguished World Bank examined Mexico's legal system and, among other things, found this about the amparo:

There are ... significant problems with *amparo* proceedings. This legal mechanism, intended as recourse in exceptional cases, is now used routinely basically because of a lack of confidence in state level courts. The "amparo" provides an automatic means of appeal to federal courts. Almost every case governed by the civil or commercial code follows a series of four proceedings before it is definitively resolved: (1) proceeding before a state or local trial court; (2) an appeal of the judgement to the appellate court of the same jurisdiction; (3) an *amparo* proceeding before a federal trial court to contest the decision of the state appellate court; and (4) a review by the federal appellate court (i.e. the Supreme Court) of the ruling in the *amparo* proceeding. Given that cases normally take *four or more years to complete*, it is not surprising that there is a general reluctance to litigate.<sup>106</sup>

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<sup>106</sup>World Bank Study at 113 (Report No. 11823 MX).

**IV. Conclusion.**

Claimant restates its prayer for damages of \$90 million (U.S.) plus costs as set forth in the attachment, with interest on the total amount at the rate of 9% per annum.

Respectfully submitted,

LAW OFFICES OF CLYDE C. PEARCE

A handwritten signature in black ink, appearing to read 'Clyde C. Pearce', with a long horizontal stroke extending to the right.

Clyde C. Pearce  
Jack J. Coe, Jr.  
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