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

ROBERT AZINIAN, KENNETH DAVITIAN AND ELLEN BACA, CLAIMANTS

VS.

THE UNITED MEXICAN STATES, RESPONDENT

REJOINDER

COUNSEL FOR THE RESPONDENT:
Hugo Perezcano Díaz

ASSISTED BY:

Secretaría de Comercio y Fomento Industrial
Carla Tochijara Vargas
Fernando Reséndiz Wong

Thomas & Davis
Christopher Thomas
J. Cameron Mowatt
Máximo Romero Jiménez
Alejandro Posadas Urtusuástegui
Katharina Byrne
Carlos G. García

Shaw, Pittman, Potts & Trowbridge
Stephan E. Becker
Nancy A. Fischer

ORGANIZATION OF THE RESPONDENT'S REJOINDER

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Part Two: Preliminary Objection on a Point of Law

Part Three: The Continued Relevance of the Domestic Legal Proceedings

Part Four: The Facts After Two Rounds of Pleadings

Part Five: Observations Concerning the Statement of Law in the Claimants' Reply, and the Respondent's Statement of Law in Answer Thereto

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1. The Government of Mexico hereby submits this Rejoinder to the Reply of the Claimants dated January 19, 1999.

INTRODUCTION

2. The Claimants have failed to propound a claim that has any basis in law under Chapter Eleven of the NAFTA. Notwithstanding that they now admit that there was no "denial of justice" in the legal proceedings that DESONA initiated in the Mexican courts, they now seek to have this Tribunal embark on a *de novo* reconsideration of issues that have been resolved in the *Ayuntamiento's* favor by three Mexican courts.

3. Accordingly, Part Two of this Rejoinder sets out a preliminary objection on a point of law arising from the Claimants' failure state a claim that has a proper basis under the NAFTA. The Tribunal has no jurisdiction to make an award for a mere breach of contract claim in the absence of cogent evidence that there was a denial of justice or other action that elevates the claim to the international level and engages the principles of state responsibility.

4. In the event that the Tribunal is unable to decide this preliminary objection without considering the evidence adduced by the parties, the Rejoinder's response to the characterization of the facts and other arguments made in the Reply follows in Parts Three to Six.

PART ONE: SUMMARY OF SALIENT FACTS

5. On November 4, 1992 the *Ayuntamiento* of Naucalpan met in *Cabildo* session to hear a proposal for the grant of a concession for public waste collection and disposal services described by its proponents as "the Integral Solution" to the Municipality's waste problems.

6. The *Cabildo* was informed that the concessionaire would make a total investment of 60 million new pesos to: (i) replace the Municipality's aging fleet of garbage trucks with "new and modern equipment", (ii) take over the Municipality's existing waste collection services and provide services in the commercial and industrial sector, (iii) take over the operation and further development of the local landfill (and future landfills), (iv) construct a co-generation facility that would utilize methane gas from the landfill to generate electricity, and (v) establish a recycling facility.

7. The *Cabildo* was further informed that the objects of the concession would be funded and performed by a consortium of four companies—Global Waste, Bryan A. Stirrat & Associates, Sunlaw Energy, and Mexico Diesel—and that the proceeds of the sale of electricity from the co-generation facility would pay for the entire cost of operating the Municipality's waste collection and disposal system during the 15 year life span of the concession. The four companies were described as leaders in their respective fields. Global Waste was described as having "more than 40 years experience" in the waste management business.

8. The *Ayuntamiento* approved the grant of concession on the basis of the proponents' representations as to the objects of the concession and the financial and technical attributes of the proposed concessionaire. However, because the term of concession was to extend beyond the

end of the *Ayuntamiento's* term in office (one year hence), it was necessary to obtain the approval of the State Legislature.

9. The objects of the concession (i.e. the features of "the Integral Solution") and the attributes of the concessionaire (i.e. the technical and financial capacity of the four-company consortium) were presented to the State Legislature in essentially the same terms that they had been presented to the *Ayuntamiento*. Significantly, legislators were informed that the objects of the concession would be performed by the aforementioned consortium of companies (now including Sunlaw de Mexico, a joint venture between Sunlaw Energy and Mexico Diesel) and that Global Waste was a leading waste management company in California that had "more than 40 years experience" in the waste management business. On August 4, 1993, the State Legislature approved the *Ayuntamiento's* November 3, 1992 grant of concession.

10. On November 15, 1993 the Municipal President and the Municipal Secretary executed a concession contract that differed from the concession approved by the *Ayuntamiento* and the State Legislature in the following material respects:

a) The concession contract did not describe the concessionaire as a consortium consisting of Global Waste, Sunlaw Energy, Mexico Diesel, and Bryan A. Strirrat & Associates, nor did it refer in any manner to the provision of services by the consortium or any of its members. Instead, the concessionaire was described as DESONA alone, now presented as a company owned by Messrs. Azinian, Goldenstein, and Davitian, and not the members of the consortium;

b) The concession contract did not require the construction of a co-generation plant for the production of electricity to generate revenue to that would pay the cost of operating the Municipality's waste collection and disposal system during the term of the concession. Instead it provided that the concessionaire would establish a co-generation facility in the future, if such proved economically viable, but the Municipality would pay the concessionaire its annual waste collection budget for the first two years of the concession (and an amount to be agreed for the remaining 13 years) for residential waste collection, and the concessionaire would be entitled to charge fees for collection of waste from commercial and industrial enterprises; and

c) The concession contract did not require the concessionaire to replace, at its expense, the Municipality's fleet of aging trucks with "new and modern equipment". Instead it required the Municipality to turn over its trucks, employees and service facilities to the concessionaire who would be obligated to introduce 70 "state-of-the-art" units during the first year of the concession, according to a delivery schedule in the concession contract.

11. In sum, what was presented to the *Ayuntamiento* and the State Congress as a project to modernize the Municipality's waste collection and disposal system that would be undertaken by a consortium of companies and would not require any financial contribution from the Municipality was changed (without the approval of the *Ayuntamiento* or the State Congress) to a bare waste collection concession, to be performed by DESONA alone, that required the

Municipality to pay the concessionaire its annual budget for the first two years (and more in subsequent years) and required commercial and industrial residents to pay fees to the concessionaire for collection of their waste.

12. When the new administration took office on January 1, 1994, DESONA was already in default under the concession contract, having failed (as at that date) to put in service seven "state-of-the-art" waste collection trucks. As a result, the Municipality's waste accumulation problems had not been alleviated as promised but were worsening.

13. In January 1994, the Municipality's Secretary of Economic Development engaged Messrs. Azinian and Goldenstein in discussions about the Municipality's continuing (and worsening) waste accumulation problem and DESONA's failure to supply new waste collection vehicles. Messrs. Azinian and Goldenstein gave assurances that the new vehicles would be delivered shortly and that the waste accumulation problem would be alleviated.

14. In February 1994, the Municipality's Secretary of Economic Development learned that the vehicles that DESONA intended to supply were actually used trucks (up to 13 years old) and that, due to import restrictions maintained under the NAFTA, they could not be imported into Mexico without special dispensation from federal authorities. He began investigating the background of the Global Waste and its purported principals and learned that both Global and Mr. Azinian were or had been in bankruptcy and that only Mr. Davitian had any experience in the waste management business.

15. On March 7, 1994, upon receiving the advice of outside counsel, the *Ayuntamiento* resolved to initiate the administrative nullification of the concession based on 27 irregularities that counsel had identified in connection with the awarding and performance of the concession. Mr. Davitian and DESONA's legal counsel were formally notified of the 27 irregularities on March 10, 1994. They were informed that DESONA should provide an answer and submit evidence in its defense to the *Ayuntamiento* by March 17, 1994[1].

16. Instead of responding, DESONA commenced proceedings before the State Administrative Tribunal on March 15, 1994. It challenged the nullification proceedings on the grounds, *inter alia*, that (i) the *Ayuntamiento* and the company had entered into a concession contract setting out the rights and obligations of both parties; and (ii) that the parties had agreed in the contract there had been no error or any other cause of nullity.

17. The Municipality defended the action and adduced evidence in support of its findings on the 27 irregularities. The record evidence in this proceeding – denied in its entirety by the Claimants, but not contradicted – is that DESONA did not attempt to contradict the facts as alleged by the Municipality, even though it had ample opportunity to present evidence and was

1. As DESONA failed to submit an answer or explanation regarding any of the 27 irregularities, the *Ayumtamiento* resolved to nullify the concession on March 21, 1994. It should also be noted that, as at March 21, 1994 DESONA was in default of the concession contract by reason of its failure to deliver 14 state-of-art garbage trucks, its failure to adequately collect waste in public areas, and its failure to pay the rent and operating costs of the Rincon Verde landfill. The Claimants do not allege that the company was in full compliance with the concession contract. They contend only that DESONA was "substantially in compliance" with the terms of the contract. Reply at Section III, paragraph 66.

called upon by the court to produce documents that would establish its financial capacity to perform the objects of the concession.

18. On July 4, 1994, after holding a hearing and affording both parties an opportunity to adduce evidence and make submissions, the State Administrative Tribunal held that the Municipality was justified in invoking the administrative nullification procedure. It also held *inter alia*: (i) that DESONA did not have private law contractual rights because the concession pertained to a public service and was subject to limits and conditions that are set out in the law; and (ii) that DESONA had failed to demonstrate that it possessed the financial and technical capacity needed to provide public waste collection services efficiently and consistently[2].

19. DESONA appealed this decision to the Superior Chamber of the State Administrative Tribunal. On November 17, 1994 the Superior Chamber unanimously upheld the Municipality's resolution to nullify the concession on nine of the 27 irregularities. It held that the first ground alone (failure to include the consortium of companies in the incorporation of DESONA) was "sufficient on its own to support the administrative nullification of the concession which did not have the necessary technical and economic capacity and management experience to provide the public waste collection service in an adequate, opportune and efficient manner…"[3].

20. DESONA appealed again by commencing an *amparo* in the Federal Circuit Court. It lost again on May 18, 1995 when the court upheld the Municipality's resolution to nullify the concession. The court noted that "it was perfectly clear that this was an administrative concession…" and that "it is unquestionable that the administrative act cannot be considered a contract".

21. On March 10, 1997, the Claimants then filed the Notice of Claim in this proceeding.

PART TWO: PRELIMINARY OBJECTION ON A POINT OF LAW

22. In the Respondent's submission, the Claimants' case as clarified by its Reply demonstrates that there is no claim that can be considered by this Tribunal. The claim is at base one for breach of contract. While the Claimants have alleged breaches of Articles 1105 and 1110 of the NAFTA, there is no evidence on the record that supports their attempt to elevate the claim to the international level, thus engaging the principles of state responsibility.

A. The Tribunal's Jurisdiction is to Determine Solely Whether There Has Been a Violation of NAFTA Chapter Eleven

23. This Tribunal has the jurisdiction to determine only whether there has been a breach of any of the obligations contained in Section A of Chapter Eleven. The governing law of this dispute is only the NAFTA.

2. Counter-Memorial, paragraph 127.

3. Counter-Memorial, paragraph 129.

24. The Claim has been certified by the ICSID as a claim pursuant to NAFTA Article 1116 ("Claim by an Investor of a Party on Its Own Behalf"), and alleges violations of Article 1110 ("Expropriation and Compensation") and Article 1105 ("Minimum Standard of Treatment"). The governing law in the instant case is Section A of Chapter Eleven.

25. In addition, it warrants noting that the concession and the concession contract were subject to the law of the State of Mexico.

26. The Tribunal's limited jurisdiction is of fundamental importance.

27. In contrast to NAFTA, the ICSID Convention, for example, confers a wide jurisdiction on tribunals established thereunder[4]. In cases considered under that Convention, the agreement to arbitrate has often included a broad choice of law provision allowing the Tribunal to resolve any disputes in accordance with domestic law or "general principles of law". For example, in *AGIP v. Congo*, the governing arbitration clause provided as follows:

> All disputes that may arise with respect to the application or interpretation of the present Protocol of Agreement will be finally settled in accordance with the Convention for the Settlement of Investment Disputes ....
>
> The law of the Congo, supplemented if need be by any principles of international law, will be applicable.[5]

28. The only issue before the Tribunal is whether in the Municipality's decision to nullify the concession (pursuant to domestic law) which was subsequently upheld by three Mexican courts constitutes a breach of NAFTA Chapter Eleven and therefore gives rise to state responsibility on the part of the Respondent.

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4. Article 42 of the ICSID Convention provides that the applicable law for the settlement of disputes shall be as follows:

> (1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

Article 25(1) of the ICSID Convention provides that "[t]he jurisdiction of the [ICSID] shall extend to any legal dispute arising directly out of an investment, between a Contracting State ... and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the [ICSID]." Mexico is not a member of the Convention, is not a Contracting State, and has not consented to submit "any legal dispute arising directly out of an investment" for resolution by the ICSID. Rather, Mexico has consented to the jurisdiction of the ICSID only to resolve the issue of whether it has acted inconsistently with NAFTA Chapter Eleven.

5. *AGIP SPA v. The Government of the People's Republic of The Congo*, 1 ICSID Reports 306, 313 (Award, November 30, 1979). In *Benvenuti & Bonfant v. Congo*, 1 ICSID Reports 330, 340-41, 349 (Award, August 15, 1980), an agreement under dispute conferred a similarly broad jurisdiction on the ICSID tribunal consideration of the contract:

> All disputes which may arise between the parties in the execution of the present protocol of agreement and which have not been resolved by agreement, will be subject to arbitration within the framework of the Convention of 18 March 1965 for the Settlement of Investment Disputes ...

B. The Respondent's Alleged "Wrongful Repudiation" of the Contract Claim Does not Fall Within the Tribunal's Jurisdiction

29. The Reply presents an issue of legal principle which is of fundamental importance to Chapter Eleven's operation. It concerns the nature of the claim that an investor seeks to put before a tribunal such as the present one.

30. In the Respondent's submission, Chapter Eleven is not intended to provide a means for investors to launch what are at best claims for breach of contract before a NAFTA Tribunal. Section III of the Reply's Legal Submissions is entitled: "The City's Wrongful Repudiation of the Concession Contract Violates Articles 1110 and 1105 of NAFTA".

31. The Claimants agree that their claim is not premised on an alleged denial of justice. They state:

> In essence, Respondent is attempting to characterize Claimants' claims as a denial of justice claim.... Claimants, however, do not assert that the Mexican administrative and judicial proceedings constituted a denial of justice for which the Mexican government is liable or ask the Tribunal to sit as a court of appeal from the Mexican courts. Claimants are not asking the Tribunal to evaluate the correctness of the Mexican courts' decisions on issues of Mexican law. As has been pointed out above, *whether the Concession Contract was valid under Mexican law is irrelevant to the international claims before the Tribunal*... Instead, claimants are asking the Tribunal to determine that the wrongful repudiation of the Concession Contract was a violation of international law, specifically Articles 1110 and 1105 of NAFTA. [emphasis added.]

32. The Claimants, therefore, have clarified that their legal theory is that, notwithstanding that the Mexican courts determined that the concession was obtained through a number of material misrepresentations, and that the Claimants do not dispute that the Mexican court proceedings were fair, an international law of contracts should be applied to find that the concession was "wrongfully repudiated" or, alternatively, that the *Ayuntamiento* breached the concession contract, and that it was a violation of the NAFTA for the Municipality to nullify it.

33. Even if the Claimants' evidence was accepted (the Respondent says that it should not), the Claimants cannot point to cogent evidence on the record of any act that elevates their "wrongful repudiation" claim to the level of an international claim for which the Mexican State can be held responsible. The widely accepted principles of state responsibility do not support a claim for wrongful repudiation of a contract[6].

34. The key facts in this regard are the following:

a) The Municipality granted a concession for performance of a public service based in part upon certain attributes represented by the Claimants;

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6. The Respondent considers that there was no wrongful repudiation of the concession. Rather, the concession was nullified according to law and the nullification was subsequently challenged unsuccessfully in the courts.

b) in furtherance of the grant of concession, the Claimants' company[7] entered into a concession contract with a Municipality;

c) the contract was subject to the law of the State of Mexico;

d) there was a dispute over the performance of the services required and the basis on which the concession had been obtained;

e) the Claimants admit that their company did not <u>fully</u> perform the concession at the time that it was nullified[8];

f) the Municipality was advised by counsel to commence a process of administrative nullification (a process that is both well established and prescribed by domestic law);

g) it did so, giving the Claimants' company notice as required under the State law;

h) the Claimants' company chose not to respond to the notice and instead commenced legal proceedings against the proposed nullification;

i) in the absence of a response from the company, the Municipality nullified the contract in accordance with State law;

j) the company's claim against the Municipality was dismissed, in part because it failed to offer evidence to contradict the Municipality's evidence of misrepresentation and lack of technical and financial capacity;

k) the company initiated and lost an appeal in the State courts which upheld the Municipality's resolution to nullify the grant of concession;

l) the company then commenced and lost a federal *amparo*, which upheld the actions of the *Ayuntamiento* on the same grounds as the State courts;

m) all three courts held that DESONA could not allege breach of contract because the rights of the parties were governed by administrative law applicable to the granting and termination of concessions for the performance of public services; and

n) there was no change to legislation or regulation made by any level of government of the Respondent that had the effect of changing the law under which the concession was granted.

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7. For purposes of this argument, it is assumed that the version of DESONA which signed the Concession Contract was the concession-holder. However, the Respondent contests this.

8. The Reply states: "As has already been discussed, DESONA was substantially in compliance with its obligations under the Concession Contract". At Section III, paragraph 66. There is no claim that DESONA had fully performed the concession.

35. As noted above, the Tribunal's jurisdiction is to determine only whether there has been a denial of the minimum standards of treatment required by international law or an expropriation.

36. It is widely recognized that a claim based on breach of contract (which is denied in any event) cannot suffice to raise a purely domestic legal dispute to the level of an international claim. Even those States which have advocated relatively expansive approaches to international law[9] agree that mere breach of contract cannot be advanced as a basis for an international claim. Brownlie, for example, states:

> The practice of the capital-exporting states, such as the United States and the United Kingdom, clearly requires some element, beyond the mere breach of contract, which would constitute a confiscatory taking or denial of justice *strictu sensu.* On analysis most of the arbitral decisions cited in support of the view that breach of contract by the contracting state is an international wrong are found not to be on point, either because the tribunal was not applying international law or because the decision rested on some element apart from the breach of contract[10].

37. Amerasinghe comments similarly:

> In the decisions of international tribunals there are a few bare statements that appear to support the view that a breach of contract with an alien by a State is a breach of international law. There is little or no evidence, though, that any breach of such a contract by a State has *per se* been treated as a breach of international law in any case. On the other hand, there is evidence that such breaches *per se* have not been regarded as breaches of international law[11].

38. Feller comments to similar effect:

> The overwhelming weight of opinion, both of writers and tribunals, has been...to the effect that international responsibility for a breach of contract does not arise until there has been a 'denial of justice,' i.e., until the alien has applied to the local authorities and courts and adequate redress has been denied him[12].

39. The United Kingdom's counter-case in the *Ambatielos* case is a further example in international pleadings. In that case, the United Kingdom confirmed:

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9. The American Law Institute's Restatement (Third) of the Foreign Relations Law of the United States, paragraph 172 is an example.

10. Brownlie, Ian, Principles of Public International Law (Clarendon, Oxford University Press) 5th edition, 1998, at pages 550-551.

11. Amerasinghe, C.F., State Responsibility for Injuries to Aliens (Clarendon, Oxford University Press) 1967 at page 77. The author makes the point that those cases which have been taken to support the position that a breach of contract can be advanced in an international tribunal have had broad grants of jurisdiction, such as in the Rudloff Case, where the tribunal had the jurisdiction to hear "all claims...not settled by diplomatic agreement or arbitration". The arbitrator himself in that case explicitly recognized that States ordinarily have a right to intervene on behalf of their nationals in the case of contracts only where there was a "denial of justice", and explained that the *compromis* in his case gave the tribunal exceptional jurisdiction. See pages 82-83.

12. Feller, A.H., The Mexican Claims Commissions: 1923-1934, (New York: The MacMillan Company) 1935 at page 74.

> It is generally accepted that, so long as it affords remedies in its Courts, a State is only directly responsible, on the international plane, for acts involving breaches of contract, where the breach is not a simple breach...but involves an obviously arbitrary or tortious element, e.g., a confiscatory breach of contract –where the true basis of the claim is the confiscation, rather than the breach *per se*[13].

40. Thus, the weight of authority and commentary by qualified publicists supports the proposition that a breach of contract claim cannot be elevated to the international level without cogent evidence of a denial of justice or an expropriatory act such as the substantial amendment of the law governing the contract that deprives the contractor of his rights.

41. The single case cited by the Claimants in the relevant section of their Reply legal submissions[14], the *Schufeldt Claim*, was based on a set of facts in which the "additional element", discussed above, clearly existed. That claim was advanced by the United States against Guatemala after a concession-holder (P.W. Schufeldt), a U.S. national, suffered economic injury as a result of a 1928 Legislative Decree of the Assembly of Guatemala No. 1544, by which the National Assembly expressly disapproved a 1922 contract for the extract of chicle. Schufeldt had been performing the concession for some years by expending large sums of money, building the necessary appliances and roads, etc. The legislative act of the National Assembly and an executive act pursuant thereto which expressly abrogated his concession provided the requisite "additional element" discussed by the commentators above[15].

42. There is no evidence of any additional element that can elevate the instant Claim to the international level:

a) In the instant case, the Municipality did not promulgate a regulation or take other legislative action changing the state law pursuant to which the concession was granted. (Under Mexican law it had no legislative authority to do so.) Therefore, no amendment to domestic law or regulation was made in order to deprive the Claimant's company of any rights retroactively.

b) Rather, the Municipality sought legal advice and followed it, invoking an administrative procedure prescribed by pre-existing state law.

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13. See paragraph 269 from the United Kingdom's counter-case cited in Sir Gerald Fitzmaurice, "Hersch Lauterpacht, The Scholar as Judge", 1961 BYIL XX at page 64.

14. See the Reply at Section III, paragraph 66.

15. Amerasinghe specifically discusses the *Schufeldt Claim* and concludes at page 101:

> Breach of contract by legislative act will *ipso facto* be a breach of international law, if the legislative act is not accompanied by the factors required by international law for the taking of property. A legislative act purporting to change contractual rights would *prima facie* be a breach of international law, unless the presence of the other required factors can be shown.
>
> Support for this view is found in the *Schufeldt Claim*. A legislative decree of the Assembly of Guatemala by which a contract-concession was declared annulled, was treated as an act of taking away property rights as a result of which the government 'ought to make compensation for the injury inflicted and cannot invoke any municipal law to justify their refusal to do so.'

c) It was sued in a domestic court.

d) The Municipality willingly submitted to the court's jurisdiction.

e) The Municipality defended its actions successfully in three separate proceedings.

f) The record evidence in this proceeding is extensive and uncontradicted as to the opportunity afforded to DESONA to make its case and the evidence that both parties put before the different courts.

g) The Claimants have now admitted that they do not assert a denial of justice. They cannot, therefore, identify the principal necessary "additional element" cited by the commentators that would elevate their claim to the international level.

43. They also do not adduce any evidence of expropriation. They initially alleged that the Municipality intended to expropriate the concession so that it could be assigned to a Mexican company. When evidence was adduced showing that the Municipality resumed providing the service, this allegation was dropped.

44. It is legally insufficient to label the termination of the concession as an expropriation. Mere assertion that an expropriation or that a breach of Article 1105 occurred without clear identification of the additional element and cogent proof thereof cannot suffice to raise the claim to the serious level of an act that engages Mexico's international responsibility. This is particularly the case where, as here, the Claimants have recognized the three domestic court proceedings that afforded them a remedy but simply offer a blanket denial of the legal and factual relevance of those proceedings.

45. It is a general principle of international law that a State's municipal legislative, administrative, and judicial activity toward foreigners is to be presumed to comply with international law[16]. The corollary to this is that "[t]he international responsibility of the State is not to be presumed"[17]. The Respondent submits that the Claimants' evidence does not indicate even a *prima facie* case.

46. This applies equally to the pre-existing legislation permitting the Municipality to nullify the Concession in appropriate circumstances, as well as the act of nullification and the later decision of the Respondent's courts confirming the validity of the nullification. The Claimants' case is simply one of breach of contract and has already been adequately dealt with by the Respondent's courts.

47. In the face of the extensive evidence that was adduced before the Mexican courts and which it now simply denies, the Reply asserts: "The City had no valid reason for repudiating the

16 Freeman, A., International Responsibility of States for Denial of Justice, 1938 (reprinted 1970), at page 75. See also Bin Cheng, General Principles of Law, at pages 304-06. Cheng quotes, *inter alia*, the Umpire in the German-Venezuelan Mixed Claims Commission (1903): "*Omnia rite acta praesumuntur.* This universally accepted rule of law should apply with even greater force to the acts of a government than those of private persons".

17 *Spanish Zone of Morocco Claims* (1923), 2 RIAA, page 615.

Concession Contract with DESONA. As has already been discussed, DESONA was substantially in compliance with its obligations under the Concession Contract"[18]. Its legal argument simply reiterates the arguments that were advanced and rejected in its domestic legal proceedings[19].

C. The Claimants' Admissions Regarding the Legal Proceedings Undermine Their Claim in this Proceeding

48. The Claimants formulated their Reply so as to avoid addressing in detail the fact that after notice of the *Ayuntamiento's* intention to hold a hearing at which the nullification of the concession would be considered, it resorted to the domestic courts. They admitted that legal proceedings took place as the Respondent described them. However, they have denied the evidence that was adduced in the proceedings and Dr. Dávalos' testimony that explains the proceedings in detail.

49. In the Respondent's submission, the Claimants' admissions that there was no denial of justice and that there is no challenge to the correctness of the decisions of the Mexican courts permit the Tribunal to put certain matters aside. However, the admissions do not render the legal proceedings irrelevant. To the contrary, they are highly relevant and dispositive of the Claim.

50. It is also observed that, having admitted to the domestic legal proceedings, the Claimants then assert that: "All evidence submitted by the Municipality's Counsel during the Mexican Legal proceedings is denied". Nevertheless, no evidence has been adduced to contradict Dr. Dávalos' extensive and documented testimony as to the conduct of those proceedings, the evidence that was adduced by the Municipality and the company's failure to do the same.

51. With respect to the significance of the domestic legal proceedings, the Claimants wrongly describe the Respondent's argument as being one of *res judicata*. They also confuse how Article 1121 relates to this proceeding.

52. With respect to the Claimants' *res judicata* and Article 1121 points, as set out in detail below, the fact of the domestic proceedings is relevant not only to show that there was no denial of justice and that there was no error of domestic law, points now conceded by the Claimants, but also to prove that during the course of the proceedings DESONA had ample opportunity to adduce evidence on many of the same issues that it now seeks to raise before this Tribunal. Moreover, the factual findings of the Mexican courts should be deemed controlling – not because of the *res judicata* principle, but rather because the findings of the Mexican courts are part of the record evidence being reviewed by this Tribunal to determine whether there was a NAFTA breach, and they stand uncontradicted.

53. NAFTA Article 1121 requires that a would-be claimant make a choice of forum. It precludes the simultaneous or even sequential pursuit of damages claims in the domestic courts and before a NAFTA Tribunal. As noted in the Counter-Memorial, the Respondent does not

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18. Reply at Section III, paragraph 66. This is an important concession. Even DESONA admits that it was not in full compliance with its contractual obligations.

19. See Reply at Section III, paragraphs 21-49

assert that the existence of the domestic proceedings legally precluded the Claimants from presenting a NAFTA Claim. Rather, it asserted that the fact of the proceedings, their instigation by DESONA, how the proceedings unfolded, the evidence was adduced (or not adduced), and the courts' findings are directly relevant to the allegation of a NAFTA breach.

54. The proceedings were invoked by DESONA itself. DESONA had the burden of proof to show that the Municipality acted contrary to the State law. Dr. Dávalos' evidence, is that on key questions of fact, notwithstanding that they were given the opportunity to adduce evidence, the Claimants did not do so in the proceedings which they themselves initiated.

55. Dr. Dávalos testifies specifically that questions of fact as well as law arose in the proceedings. He testifies that the Claimants were asked to adduce evidence on, for example, the origins of the various corporate forms of DESONA and the confusion flowing therefrom, the failure to perform the concession adequately, the capital that they claimed to have contributed to the Concession, and so on.

56. The Claimants have sought to obscure this fact by simply making a blanket denial of Dr. Dávalos' testimony as to what occurred before the courts. Yet the Claimants do not adduce any evidence of their own to contradict his detailed and documented testimony.

57. It is respectfully submitted, therefore, that in the absence of detailed and specific evidence that contradicts Dr. Dávalos' testimony, the Claimants' blanket denial of the facts asserted in his declaration cannot be sustained. The record evidence supports not only the findings that the Mexican courts made, but also the way in which they made them and the evidence that was put before them.

58. The importance of this point is illustrated by the commentary in the Restatement (Third) of the Foreign Relations Law of the United States.

59. In the Restatement's discussion of its expropriation rule's specific application to a state's repudiation or breach of a contract with a national of another state, comment *j* to section 712 states that:

> *Economic injury and denial of justice*. Economic injury to foreign nationals is often intertwined with a denial of domestic remedies. If no effective administrative or judicial remedy is available to the alien to review the legality under international law of an action causing economic injury, the state may be liable for a denial of justice, as well as for the violation of economic rights…In the case of repudiation or breach of a contract with an alien, Subsection 2(b), an impartial determination is required to review the adequacy of the asserted justification for the repudiation or breach and to assess damages if appropriate. [emphasis added]

60. The point made in the Restatement is relevant to the instant case. DESONA availed itself of the impartial remedy available to it. However, it failed to participate fully in the proceeding and in fact declined to adduce evidence on, for example, its expenditures in connection with the operation of the concession.

61. The following summarizes the Respondent's allegations concerning the domestic legal proceedings in its Counter-Memorial and sets out the Reply's Admissions or Denials:

Counter-Memorial:

Paragraph 31 of the Counter-Memorial addressed the fact that DESONA was given notice and summoned to a hearing of the *Ayuntamiento* to provide explanations and proof to the contrary in response to the *Ayuntamiento*'s findings of irregularities.

Reply:

"Desona took the position that it was not required to comply with the Municipality's demand to provide explanations, as this was outside the contract provisions. Instead, Desona initiated legal action as described in ¶ 95-96 of Respondent's counter Memorial, supra."[20]

"¶ 33 through ¶ 38: Respondent's text omitted."

Counter-Memorial:

Paragraphs 33-38 noted that Mr. Azinian admitted in his first statement that there were domestic legal proceedings and went on to introduce Dr. Dávalos' testimony of the legal proceedings commenced by DESONA, observing that "while he adduced extensive evidence in defense of the Municipality's actions, Global/DESONA did not". Paragraphs 37-38 noted that three separate hearings were held, two in the State courts and one in the Federal Court.

Reply:

"All issues related to the Mexican Legal Proceedings are addressed by Claimants in the Legal Argument Section of this reply. All evidence submitted by the Municipality's Counsel during the Mexican Legal proceedings is denied."

Counter-Memorial:

In paragraph 95 the Respondent alleged that instead of responding to the *Ayuntamiento*'s request for a response to the notice of irregularities, DESONA initiated legal proceedings before the State Administrative Tribunal

Reply:

"The above was done on the advice of DESONA's Mexican counsel Lic. Ortega Arenas given at the time".

The State Administrative Tribunal Proceedings

"¶ 100 through ¶ 107 Respondent's text omitted."

20. Claimants' Admissions and Denials, responses to paragraphs 100-107.

Counter-Memorial:

Paragraphs 100-107 set out DESONA's complaint to the State Administrative Tribunal, the Tribunal's acceptance of jurisdiction, DESONA's amended complaint, its response to the 27 irregularities upon which the *Ayuntamiento* based its decision to nullify the concession, the Municipality's response, the court's rejection of DESONA's argument that this was a matter of contract and not administrative law, and the fact that on May 14, 1994 while the court proceedings were getting underway, the Municipality entered into an agreement to purchase 25 Mercedes Benz trucks to resume the garbage collection service.

Reply:

"Claimants admit that proceedings at Mexican Courts took place."

Counter-Memorial:

"The Tribunal Proceedings Continue": page 26

Reply:

"¶ 117 through ¶ 134 Respondent's text omitted."

Counter-Memorial:

Paragraphs 117-134 set out in detail the procedural attempts by the Municipality to introduce evidence of a *Cabildo* meeting and evidence of the criminal complaint against Mr. Goldenstein filed by Dr. Palacios (its motion was later denied), the Municipality's arguments in defense of its action (with extensive references to the company's misrepresentations), the filing of the Municipality's evidence from its accounting expert which concluded that the Municipality's expenses had not diminished, the filing of another report on the company's failure to perform the concession, the State Administrative Tribunal's ruling on the complaint and its reasons therefor, the company's appeal therefrom to the Superior Chamber, the dismissal of the appeal, the reasons given by the Superior Chamber (the 9 irregularities that it found), the appeal to the Federal Circuit Court, that court's denial of the requested *amparo*, and a summary of the legal proceedings which directed the Tribunal to Dr. Dávalos' testimony that DESONA had ample opportunity to adduce evidence in support of its position but failed to do so, whereas the Municipality did file substantial evidence.

Reply:

"See answer to above ¶ 100 through ¶ 107." ["Claimants admit that proceedings at Mexican courts took place."]

62. No evidence has been adduced to contradict Dr. Dávalos' extensive and documented testimony as to the conduct of those proceedings, the evidence that was adduced by the Municipality and the company's failure to do the same.

63. The Respondent is of the view that the Tribunal should address this issue at the outset of the hearing. Given that there is no cogent evidence of any element that would suffice to elevate the "wrongful repudiation" claim to the international level, the Claim should be dismissed with costs awarded to the Respondent.

64. Without prejudice to the argument just advanced, the Respondent will address the other allegations of fact and legal arguments asserted in the Reply.

PART THREE: THE CONTINUED RELEVANCE OF THE DOMESTIC LEGAL PROCEEDINGS

A. The Domestic Legal Proceedings Afforded DESONA Ample Opportunity to Make its Case

65. One of the issues that was before the Mexican courts and has been put in issue in this proceeding is whether the rights and obligations of the parties are governed by the terms of a simple contract, as the Claimants contend, or whether a wider body of law applicable to the granting and termination of concessions applies, as the Respondent contends.

66. The grant of a concession for the performance of a public service is a legal act arising under Mexican law. Therefore, it is Mexican law that determines its legal nature and effect[21].

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21. Article 1.4 (Mandatory rules) of the UNIDROIT Principles of International Commercial Contracts, for example, provides:

> "Nothing in these principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law."

The comments of the UNIDROIT to the Principles state:

> "1. Mandatory rules prevail
>
> Given the nature of the Principles, they cannot be expected to prevail over applicable mandatory rules, whether of national, international or supranational origin. In other words, mandatory provisions, whether enacted by States autonomously or to implement international conventions, or adopted by supranational organizations, cannot be overruled by the Principles." [emphasis added]

Even in the case that the Principles are incorporated in the contract by agreement of the parties or if they are the law governing the contract, they do not overrule mandatory rules. The comments of the UNIDROIT continue:

> "2. Mandatory rules applicable in the event of mere incorporation of the Principles in the contract
>
> In cases where the parties' reference to the Principles is considered to be only an agreement to incorporate them in the contract, the Principles will first of all encounter the limit of mandatory rules of the law governing the contract, i.e. they will bind the parties only to the extent that they do not affect the rules of the applicable law from which parties may not contractually derogate...
>
> 3. Mandatory rules applicable if the Principles are the law governing the contract

67. Concessions are complex legal acts that consist of three distinct elements: a regulated element that is established in the law and cannot be changed by any party to the concession; an administrative element through which the public authority grants the concession and defines its terms; and a contractual element that is subordinated to the first two elements.

68. The grant of concession of a public service (such as waste collection) is an act of public law that involves the *intuitu personae* transfer of certain powers and property of a public authority to the concessionaire for a fixed period of time, subject to various powers and reversionary rights being retained in the grantor.

69. The purpose of the grant of concession is to enable a private party to provide a public service in a superior manner than the government authority is able to do, owing to the state's lack of economic or technical capability. Accordingly, the concessionaire must have the proper legal, technical, financial and moral attributes for the performance of the object of the concession, and the concession cannot be sold or transferred without the express approval of the authority that granted the concession[22].

70. The government authority granting the concession remains responsible for performance of the service. Therefore, the state retains the power to control, inspect and audit the service provided. The state also retains the power to approve applicable fees, as well as the power to impose sanctions on the concessionaire and to terminate the concession, through various means, upon proper legal grounds. One of the forms of termination of a concession is through the administrative declaration of nullity due to defects that vitiate the essential elements of the concession's valid and effective existence.

71. In a concession, the agreement or consent of the parties is "a *sine qua non* and indispensable condition" that must exist as a matter of law. Error, misrepresentation or violence can vitiate it. Accordingly, the civil code of the State of Mexico provides that the agreement of the parties is not valid when it has been reached in error or upon violence, or has been induced by misrepresentations.

72. Error *in persona* (which has serious consequences when it occurs in an *intuitu personae* contract) is an error regarding the identity or attributes of the concessionaire. Likewise, misrepresentation (which is frequently identified with bad faith) is understood as an artifice by one party to induce the other to mistake.

73. When there has been an error as to the identity or attributes of the concessionaire or the granting of a concession has been induced by misrepresentation, the proper remedy to invoke is administrative nullification. Indeed, the applicable law provides that this is mandatory in such

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> Yet even where, as may be the case if the dispute is brought before an arbitral tribunal, the Principles are applied as the law governing the contract, they cannot prejudice the application of those mandatory rules which claim application irrespective of which law is applicable to the contract (*lois d'application nécessaire*)." [emphasis added]

22. Counter-Memorial, Expert Report of the *Institutio de Investigaciones Juridicas*, Section 6 – "The Legal Nature of the Public Service Concession".

circumstances. Article 167 (formerly Article 101) of the Municipal Organic Law of the State of Mexico provides:

> The agreements, concessions, permits, or authorizations granted by municipal authorities or public officials lacking the necessary authority for that purpose, or those issued upon error, misrepresentations or violence that prejudices or affects the rights of the Municipality over their public domain property, or upon any other matter, shall be nullified through an administrative procedure after providing a hearing to the interested parties.[23] [emphasis added]

74. The history of the nullification proceedings initiated by the Municipality on March 7, 1994 is described in detail in the Counter-Memorial (at paragraphs 84-88, 93-134) and in the witness statement of Lic. Carlos Felipe Dávalos Mejía (at paragraphs 13-70). The following is a summary of the salient aspects of the proceedings.

75. On March 7, 1994, after considering the Municipal President's report on Lic. Dávalos' findings and advice, the *Ayuntamiento* unanimously approved two proposals:

a) that the *Primer Síndico* should notify DESONA of the irregularities found with regard to the company's capacity and standing (as required by the Mexican Constitution, and the State Constitution) and of violations of the Municipal Organic Act and disclose the findings to the company in a hearing at which a date should be set for the company to respond and submit evidence in defense; and

b) to empower the *Primer Síndico* to (i) determine precisely which provisions of the law have been violated, (ii) give notice to DESONA in strict compliance of the law; and (iii) prepare an administrative report of the hearing which discloses the irregularities found by the *Ayuntamiento* and puts the company on notice that if it fails to file a response and evidence in defense within the stated time limit that it will lose the right to do so.

76. DESONA was served with notice of the proceeding on March 8, 1994. On March 10th, the *Primer Síndico* met with Mr. Davitian of DESONA and Lic. Edgar Lozada of Baker & McKenzie who initially appeared as DESONA's legal counsel[24]. DESONA was given formal notice of the 27 irregularities and was informed that it must respond and provide evidence in its defense by March 17, 1994.

77. On March 15, 1994, instead of responding to the *Ayuntamiento's* findings, DESONA filed a claim before the State Administrative Tribunal seeking nullification of the *Ayuntamiento's* resolution of March 10, 1995 on the grounds, *inter alia*, that (i) the *Ayuntamiento* and the company had entered into a concession contract on November 15, 1993 setting out the rights and

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23. Counter-Memorial, Expert Report of the *Institutio de Investigaciones Juridicas*, Section 9-F– "Nullity of the public service concession".

24. Also present was Mike Carolan, a broker whose name appears in documents supplied to counsel by Mr. Sam Maphis that indicate that Mr. Carolan was seeking an investor or buyer for the DESONA principals and Bryan A. Stirrat. See Exhibit T to the Affidavit of J. Cameron Mowatt filed with the Counter-Memorial.

obligations for both parties; and (ii) that the parties had agreed in clause 34 of the contract that in celebrating the contract, there had been no error or any other cause of nullity;

78. On March 21, 1994, the *Ayuntamiento* resolved unanimously to nullify the concession[25]. Lic. Dávalos confirms that DESONA did not provide evidence by March 17 or at any time before March 21, even though it was open for it to do so until the *Ayuntamiento* resolved to nullify the concession. Instead, DESONA challenged the *Ayuntamiento's* actions in the State Administrative Tribunal and committed itself to be bound by the outcome of those proceedings[26].

79. On March 23, 1994, the *Ayuntamiento* notified DESONA that the concession had been nullified[27]. Mr. Goldenstein received and signed the notice at 9:00 A.M. At 11:00 A.M. the Municipality took possession of the Rincón Verde landfill. The report noted that DESONA retrieved all of its equipment, including the money in the cash register in the amount of 1,835 new pesos[28].

80. On April 11, 1994, DESONA amended its claim to seek nullification of the March 21, 1994 resolution of the *Ayuntamiento*. DESONA's claim was based on two premises: (i) that the Municipality had arbitrarily nullified the concession and (ii) that because the concession was a contract, the dispute should have been taken before a civil court judge and dealt with on the issue of non-compliance with the contract and not on the basis of administrative nullification.

81. On June 1, 1994, in response to a request from DESONA, the *Ayuntamiento* met in an extraordinary *Cabildo* session to hear DESONA's response to the various issues raised in the nullification procedure. Mr. Goldenstein was given a full opportunity to address the *Cabildo* and answer questions from the *Ayuntamiento*.

82. The hearing of DESONA's claim in the State Administrative Tribunal took place on June 14, 1994[29]. Mr. Dávalos gives describes the extensive evidence he adduced in the proceeding and the lack of evidence adduced on the part DESONA at paragraphs 36 to 43 of his witness statement. In brief:

a) DESONA never proved that the concession was legally valid or that what had been annulled was a simple bilateral contract as opposed to an administrative award of a concession;

b) The Municipality provided substantial evidence in support of its finding that there was legal error in the award of the concession as a result of fraud and

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25. Counter-Memorial, Exhibit 9, Minutes of the *Cabildo* session, March 21, 1994.

26. Counter-Memorial, witness statement of Carlos Dávalos at paragraph 34. The Claimants admitted that Desona refused to respond to the Ayuntamiento's finding of 27 irregularities on the advice of its legal counsel. See Claimants' Admissions and Denials, response to paragraph 95.

27. Notice of nullification of concession to DESONA, March 23, 1994. See Counter-Memorial Exhibit 15.

28. Report concerning the repossession of the Rincón Verde landfill, March 23, 1994. See Counter-Memorial Exhibit 16.

29. Counter-Memorial, witness statement of Carlos Dávalos at paragraph 35. (Note the English translation erroneously states that the hearing occurred on July 14.)

misrepresentation on the part of DESONA. For example, in support of its finding on irregularity number 12 —that DESONA was incapable of providing the services required under the concession— the Municipality tendered 39 documents, evidence of two on-site inspections, three expert reports, three testimonial statements and two statements against interest, none of which were called into question through evidence adduced by DESONA;

c) The Municipality's three expert reports consisted of an assessment of the Municipality's damages, an opinion on the viability of the Rincón Verde landfill, and an opinion on the financial capacity of DESONA. These reports comprised a total of 47 pages of text and 590 pages of exhibits. DESONA presented evidence of three experts (two appointed by DESONA and one appointed by the court) whose reports consisted of a total of 7 pages of text and two exhibits consisting of some photographs and a pamphlet;

d) In order to determine DESONA's true financial capacity and the amount of its investments, the Tribunal requested DESONA to produce certain financial records, such as payroll documents, financial statements, bank statements, receipts documenting the payment of taxes and social security, accounts payable records and rental contract for its offices but DESONA consistently refused to provide such documents[30];

e) The Municipality's written legal submissions analyzed each of the five legal requirements for administrative nullification, all of which were supported by evidence tendered by the Municipality. DESONA did not make written legal submissions.

83. In the legal proceeding before the State Administrative Tribunal, DESONA had a full opportunity to adduce evidence in response to the findings of the *Ayuntamiento* that formed the basis of the nullification procedure, but it declined to do so, even when asked to produce such evidence by the court.

84. The decision of the State Administrative Tribunal was rendered on July 4, 1994, less than five months after the action was commenced, upholding the validity of the *Ayuntamiento's* resolutions of March 7 and March 21, 1994 which resulted in the administrative nullification of the concession.

85. In its reasons for judgment, the court stated:

> … in the present case, there is not a [private law contractual right] given that the concession pertains to a public service, that is to say, it is a discretionary administrative

30. The Tribunal is directed to paragraph 4 of the Respondent's Request for Directions dated June 8, 1998 wherein the Respondent describes the Claimant's refusal to produce the same financial records, quoting its responses variously that the documents were "...irrelevant," "too voluminous to produce", that they "may be in Mexico and may be in storage and will take too long to retrieve".

act though which the authority so empowers an individual to establish and exploit this service within the limits and conditions that are set out in the law.

86. The court also held that:

> ...the concession should be awarded to a person or company that has the technical and economic capacity to provide the waste collection service ... efficiently and consistently. The aforementioned obliges the Concessionaire to have the necessary technology and economic capacity; that is to say the financial resources to secure technological advances. This is an essential element for the company to comply with...

87. DESONA failed to adduce evidence to satisfy the court of first instance that it had the technical or financial capacity to perform the services required under the concession. Significantly, it did not contend that it had the backing of any of the putative sponsors, such as BFI, Sanifill, Western Waste Management, and Northside Steel Fabricators, whom it now claims were ready, willing and able to provide the capital it needed to acquire the "new and modern equipment". It also did not argue that it had the experience and expertise it had promised for the proficient collection of waste in the relevant residential, as well as the public, commercial and industrial sectors of the Municipality.

88. On July 14, 1994, DESONA filed an appeal in the Superior Chamber of the State Administrative Tribunal. As described by Mr. Dávalos, this appellate body "reviews the legality of the process and corrects the weighing of facts and evidence made by the lower court judge".

89. The Superior Chamber rendered its unanimous decision on November 17, 1994, about four months after the decision of the court of first instance. After thoroughly reviewing: (i) the grounds for appeal, the evidence and allegations of both parties, the application of the law to the case and the legal basis of the decision, it held that nine of the 27 irregularities identified by the Municipality individually constituted sufficient grounds to nullify the concession (it also held that six of the 18 remaining irregularities were sufficient grounds for claiming non-compliance with the concession).

90. The Superior Chamber held that the first ground of nullification (the incorporation of DESONA with entities that were different from those which were promised at the November 4, 1992 *Cabildo* session) "is sufficient on its own to support the administrative nullification of the concession which did not have the necessary technical and economic capacity and management experience to provide the public waste collection service in an adequate, opportune and efficient manner...".

91. On December 10, 1994, DESONA filed an *amparo* in the Federal Circuit Court. This is a constitutional remedy that protects individuals (including corporations) in the territory of Mexico from acts of governmental authority that are alleged to breach constitutional protections of their rights to equality, liberty, security and due process. DESONA claimed that: (i) the Municipality had undertaken the administrative nullification procedure without a proper legal basis and the two state courts had not given reasons; (ii) the Municipality had cancelled a contract without following the legal procedure to rescind a contract and the two state courts had held that the concession was not a contract but an administrative act that was properly the subject of

administrative nullification; and (iii) the state appellate court had not analyzed all of the evidence and arguments presented by DESONA in the two state courts.

92. On May 18, 1995 (about fourteen months after the administrative nullification was initiated) the Federal Circuit Court rendered its unanimous decision, holding that the arguments presented by DESONA were without merit. In its reasons it said that:

> the analysis of the State Superior Administrative Tribunal which concluded that in entering into an administrative concession there existed so many errors which vitiated the [Municipality's] consent (both misrepresentation and fraud)... that the decisions passed on March 7 and March 21, 1994 must be declared correct.

93. In answer to DESONA's argument that what DESONA and the Municipality had entered into was a simple contract, the Federal Circuit Court held that:

> in accordance with Articles 126 and 128 of the Municipal Organic Law, it was perfectly clear that this was an administrative concession... [and that] it is unquestionable that the administrative act cannot be considered a contract[31].

94. It can thus be seen that the same legal argument that the Claimants have made in this proceeding —that the Municipality unlawfully nullified the concession instead of applying the concession contract and initiating a judicial procedure for breach of contract, to the exclusion of Mexican law applicable to administrative nullification— was rejected by the court of first instance and by the unanimous decisions of the appellate court, as well as that of a Federal Circuit court in an *amparo* proceeding.

95. By the Claimant's argument in essence that the dispute between the parties should be revisited *de novo* and judged by this Tribunal under the terms of the "concession contract", this Tribunal is being asked:

a) to override or ignore well-established principles of Mexican administrative and civil law (including statutory law) applicable to granting and nullifying a concession granted by a public authority to perform a public service, and the existence and validity of contracts and other legal acts[32].

b) to override or ignore findings of the Mexican courts on the very point that the Claimant now urges on the Tribunal find in its favor —that the concession was properly nullified under applicable law, in light of the evidence of

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31. Counter-Memorial, witness statement of Carlos Dávalos at paragraph 62

32. It is observed that the NAFTA did not purport to change the Party's bodies of law, except in very limited circumstances, and then, only by express reference. For instance, Annex 1904.15 requires that specific changes be made to certain statutes of the three NAFTA Parties. The Claimants are asking this Tribunal to rule that NAFTA Chapter Eleven and "an international law of contract" make Mexican civil and administrative law governing concessions and contracts, in particular, the well-established theory of nullities, inapplicable or render it inconsistent with the NAFTA itself.

misrepresentations and other irregularities, which the Claimants failed to challenge successfully[33];

c) to declare irrelevant the Mexican domestic law[34], notwithstanding that the subject matter of the claim is the grant of a concession in Mexico by a Mexican local government authority to a Mexican corporate entity to provide a public service in Mexico;

d) to make different findings of fact, five years after the events in question, than those made by the Mexican courts on the evidence as presented within five months of the events in question, on points that DESONA has already failed to prove or disprove; and

e) to find, in effect, that investors of the other NAFTA Parties are not subject to a body of law of general application to which all other investors in Mexico, including Mexican nationals, must submit.

B. The Concession was Properly Nullified Under Mexican Law

96. As has already been discussed, the *Ayuntamiento* annulled the concession on basis of 27 irregularities, nine of which were ultimately upheld by three different courts. The Claimants are asking the Tribunal to disregard the determination made by the *Ayuntamiento*, as well as the findings of the domestic courts over these same issues, and to conduct a *de novo* review of the circumstances giving rise to the annulment proceeding.

97. However, the Tribunal should not overlook the fact that the Claimants refused to address the *Ayuntamiento*'s findings regarding the 27 irregularities and to provide evidence that would contradict them, both before the *Ayuntamiento* itself, as well as before the courts. Indeed, while denying that DESONA failed to address the irregularities and to provide explanations and proof to refute the *Ayuntamiento*'s findings (which is contradicted by DESONA's response submitted to the *Ayuntamiento* on March 16[35], its failure to produce evidence following the request of the State Administrative Tribunal[36], but more significantly by its own admission in this arbitration proceeding that "Desona took the position that it was not required to comply with the Municipality's demand to provide explanations"[37]) and instead resorted to the State

33. And some of which are now admitted, albeit with an attempt to excuse.

34. The Claimants cite the *Shufeldt Claim* (U.S. v. Guatemala), 2 Reports of International Arbitral Awards 1079 (1930) for the proposition that a government waives its right to assert a breach when it has not given appropriate notice of its complaints. Reply at Section III, paragraphs 31-32. The *Shufeldt Claim*, however, was an arbitration between two governments (brought by the United States against Guatemala), the arbitrator was authorized to resolve all issues arising from the claim, and the Guatemalan government had continued to recognize the validity of the contract and received benefits under it for three years after the alleged breach. The *Shufeldt Claim* has little relevance to the instant dispute.

35. Counter-Memorial, Exhibit 12.

36. See Counter-Memorial, witness statement of Dr. Carlos Dávalos at paragraph 41

37. Claimants' Admissions and Denials, response to paragraph 31.

Administrative Tribunal, the Claimants have admitted that they did so "on the advice of Desona's Mexican counsel, Lic. Ortega Arenas given at that time"[38].

98. Thus, given DESONA's failure to adduce any evidence that would refute its findings, the *Ayuntamiento* was fully entitled to annul the concession. Article 167 of the Municipal Organic Act of the State of Mexico provides :

> The agreements, concessions, permits or authorizations granted by municipal authorities or officials that lack powers to issue them, or that were issued based on error, misrepresentations or duress, and that affect or restrict the rights of the Municipality over its public property, or any other rights, shall be nullified through an administrative procedure by the Ayuntamiento, following a hearing with the interested party.

99. The concession was, therefore, properly nullified. The Mexican courts so confirmed. In fact, the Federal Circuit Court concluded that DESONA had manifestly omitted to challenge the central part of the decision of the Superior Chamber of the State Administrative Tribunal, namely, the validity of nine of the 27 irregularities that gave rise to the nullification of the concession which had been specifically analyzed by the Superior Chamber, leading it to conclude that, in awarding the administrative concession, there had been errors and elements that vitiated the *Ayuntamiento*'s consent[39].

100. The Claimants now ask the Tribunal to consider "evidence" that DESONA, following the advice given "at the time" by its Mexican counsel, then refused to produce, and to conclude *ex post facto* that the *Ayuntamiento* and the domestic courts should have arrived at a different outcome. This proposition cannot be sustained.

C. The *Ayuntamiento* Did Not Breach its Obligations Under the Concession Contract

101. The Claimants' argument implicitly acknowledges that DESONA itself breached the concession contract, but asserts that because the *Ayuntamiento* allegedly did not attempt to settle its differences through negotiation and did not give DESONA 30 days to correct such breaches, the *Ayuntamiento* breached the concession contract in turn.

102. The Respondent does not concede that the *Ayuntamiento* did not attempt to resolve the problem with DESONA in good faith. Mr. Piazzesi testifies that the incoming mayor, Mr. Jacob Rocha, and he met with the DESONA principals beginning as early as December 1993, and met as many as seven times between January and February 1994. He testifies that he repeatedly informed DESONA that performance of the concession was inadequate. Because the situation did not improve as a result of his discussions with the Claimants, and the Municipality's investigations uncovered evidence that ultimately led it to find 27 irregularities, a nullification process was initiated.

38. Claimants' Admissions and Denials, response to paragraph 95.

39. Counter-Memorial at paragraph 132.

103. DESONA's argument that the *Ayuntamiento* breached the concession contract because it (and the domestic courts) failed to consider the text and scope of the contract entered into with the *Ayuntamiento*, which is essentially the same argument advanced before this Tribunal, was found by the Mexican courts to be without merit. The Superior Chamber concluded that:

> [T]he ability [of the *Ayuntamiento* to nullify the concession] is not affected by Clause Thirty Second of concession contract of November 15, 1993... which establishes that the parties shall submit to the jurisdiction of the courts of the State of Mexico regarding the interpretation, compliance and execution of the obligations contained in said legal instrument, because we are not in the presence of issues concerning the interpretation, compliance or execution of that contract, but rather of its administrative nullity due to the existence of error in having granted it.[40]

104. Thus, as a matter of law, there was no breach of contract, because in light of the fundamental misrepresentations made, and other irregularities committed by DESONA, the contract was declared to be null *ab initio*. In other words, in light of the nature of the misrepresentations and other irregularities, the concession as a whole (including the concession contract) was rendered invalid —and consequently inapplicable— from its inception.

105. The Claimants have admitted that they "are not asking the Tribunal to evaluate the correctness of the Mexican courts' decisions on the issues of Mexican law"[41], and have thus consented to the appropriateness not only of the domestic proceedings, but also of the courts' decisions.

106. The Claimants in effect are asking this Tribunal to sit as a court of appeals, and overturn the unchallenged domestic courts' decisions, by making a determination that international law forbids the annulment of a concession (or of a concession contract), and then make a *de novo* review in order to find that, despite the fact that DESONA itself breached the concession contract, the *Ayuntamiento* in turn breached it by not following a specific course of action: entering into negotiations and allowing DESONA 30 days to "cure" its breaches.

107. Moreover, the Claimants should now be estopped from making such an argument before this Tribunal, having failed, indeed refused, to adduce evidence that would contradict the Municipality's findings. The Tribunal should give full force to the nullification process, as reviewed by the Mexican courts, and decline the Claimants' argument for a *de novo* review.

PART FOUR: THE FACTS AFTER TWO ROUNDS OF PLEADING

108. The Claimants' Reply did not contain a statement of facts.

109. The Claimants' admissions and denials were for the most part unresponsive: in some instances they denied facts that they later admitted in their further comments, in others they

40 Decision of Superior Chamber of November 17, 1994 at page 13 (Counter-Memorial, witness statement of Dr. Carlos Dávalos, Exhibit 17 (Spanish version)).

41. Reply at Section III, paragraph 30.

argued with statements not actually made by the Respondent, and in still others they denied well-documented facts without explanation.

110. Annex 2, "Analysis of Claimants' Admissions and Denials", addresses the Claimant's admissions and denials in detail.

A. The Reply's Response to the Respondent's Pleadings of Fact

111. The Reply filed second witness statements from Mr. Azinian, Mr. Davitian, and Mr. Stirrat. No reply statement from Mr. Goldenstein was filed, although in previous responses to motions and the Memorial, Mr. Goldenstein was presented as the financial and administrative director of Global Waste Industries, Inc. and Global/DESONA.

112. Much of the testimony of witnesses adduced by the Respondent goes completely unanswered in the Reply. <u>There is no reference whatsoever to most of this evidence</u>.

The Statement of Dr. Palacios

113. The Respondent adduced the evidence of Dr. Oscar Palacios, who described the Claimants as "swindlers" and testified that he became a shareholder of DESONA I after negotiations with the DESONA principals, particularly Mr. Goldenstein, induced him to do so. He testified that he contributed cash and steel containers to the project and that they did not make the capital contributions that they had promised to make. He testified further that after the State approved the concession, the concession was assigned to DESONA B without his consent. He testified further that he tried to confront Mr. Goldenstein at the June 1, 1994 *Cabildo* meeting requested by DESONA but that he left the meeting when it was opened up to Dr. Palacios and others. He also testified that he swore out a criminal complaint against Mr. Goldenstein[42].

114. The Reply contains no evidence aimed at contradicting Dr. Palacios' testimony other than to assert, without evidence, that he was not a shareholder in DESONA but rather a creditor thereof. (No explanation is given of DESONA I's deed of incorporation attached as Exhibit 2 to Dr. Palacios' statement.) There is no reply evidence at all from Mr. Goldenstein.

The Statement of Mr. Sánchez Serrano

115. The Respondent adduced the evidence of Mr. Emilio Sánchez Serrano, who testified that he was involved in the Integral Solution Project in 1991-92. He testified that he was the person who actually paid for the municipal officials' visit to Los Angeles in early 1992. He said that he covered the expenses of the trip at Global's request, and they were to repay him. They did not. He testified further that during the visit to Los Angeles, "the manner in which these people [Messrs. Azinian, Goldenstein and Davitian] sought to convince the Municipal officials to award them the concession was inappropriate"[43]. Mr. Sanchez withdrew from the project when the

42. Counter-Memorial, witness statement of Dr. Oscar Palacios.

43. Counter-Memorial, witness statement of Emilio Sánchez at paragraphs 13-19.

three Global principals did not reimburse him for the expenses and after having Global investigated by a business associate, Mr. Bruno de la Mata[44].

116. The Reply contains no testimony aimed at contradicting Mr. Sánchez's testimony.

The Litigation Records of Messrs. Azinian and Davitian

117. The Counter-Memorial adduced evidence of Messrs. Azinian's and Davitian's litigation records. Numerous civil judgments, including default judgments, have been taken against them.

118. Neither Mr. Azinian nor Mr. Davitian testify that the evidence taken from California State court records is incorrect. There is rather simply a blanket denial to ¶ 32 e), f), and g) stating that: "The information contained in (e) through (g) above is misleading, incomplete, and inaccurate." However, neither Mr. Azinian or Mr. Davitian sought to explain how that is the case.

The Absence of Financial Records

119. The Memorial made a weak attempt to certify DESONA's "financial records" by having Mr. Goldenstein testify that he had been the custodian of the company's records[45]. The Respondent pointed the absence of documentary support for the Claimants' assertion that they had made an investment in Mexico.

120. The Reply contains a "reconstructed" income statement and a set of receipts without detail listing so as to connect them to the alleged investment. No witness attests as to how the document was prepared or as to the relevance of the receipts to this proceeding.

The Different Versions of DESONA

121. In the Counter-Memorial the Respondent alleged that three different versions of DESONA were in play. It provided a set of financial statements with Mr. Goldenstein's name on the cover page in which Messrs. Pulido Garcia and López Martinez were listed as shareholders.

122. The Reply asserts that these names "no longer appear in the balance sheet of October 31st, as the error was corrected". No witness testifies to this alleged error. There is no reply evidence from Mr. Goldenstein on the balance sheets that bore his name.

The Purported Evidence of Contract Negotiations

123. In the Memorial witness statements, Mr. Goldenstein testified that: "I performed the task of negotiating the Concession Contract with the City"[46]. In addition, Mr. Azinian testified that: "I only was involved in the actual negotiations of the contract itself where money matters were

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44. Counter-Memorial, witness statement of Emilio Sánchez.

45. Memorial witness statement at page 2: "I was the custodian of all of the exhibits furnished herein and will certify as to their accuracy, except for those provided by the Respondent. Please refer to my Affidavit furnished in connection with the Reply to the Motion for Directions".

46. Memorial, Goldenstein witness statement at page 1.

concerned, such as time tables and payment schedules. Mr. Goldenstein actually did the contract negotiations"[47]. Notwithstanding the absence of any evidence from Mr. Goldenstein as to what was said during the concession contract negotiations, the Claimants now make specific allegations as to the knowledge of municipal officials[48]. There is no record evidence on these issues.

B. Facts Now Admitted by the Claimants

124. The Claimants have admitted the following facts:

125. The Claimants now admit that Mr. Azinian and Mr. Goldenstein held themselves out as owners of Global Waste Industries, and that Mr. Azinian held himself out as the President of that company. They acknowledge (quoting their own document) that they informed the Respondent and this Tribunal that Messrs. Azinian, Goldenstein and Davitian each "owned" 33% of Global. They do not deny the Respondent's evidence that Mr. Goldenstein and Mr. Azinian owned no shares of Global, and that Mr. Azinian held no position with the company. Their response is (i) to assert that the word "owners" does not mean "shareholders," and (ii) that it was "convenient" for Mr. Azinian to claim to be the president of Global because he is fluent in Spanish[49]. The Claimants therefore have acknowledged that they knowingly made misstatements to the Municipality, to the Respondent, and to this Tribunal regarding their ownership and positions with Global.

126. The Claimants admit that Global was in bankruptcy proceedings, but describe the proceedings as a "reorganization" rather than a liquidation.[50] The Claimants nonetheless do not allege that Global was not insolvent, or even assert that it emerged from reorganization. The Claimants also do not dispute that Mr. Azinian entered personal bankruptcy in 1989.

127. The Claimants admit that Sunlaw withdrew from the Memorandum of Understanding (MOU), and that Sunlaw stated the following to Global (in fact the Claimants quote this statement themselves):

> Please note that Sunlaw strongly objects to Global's failure to deliver documents, data and other information in a timely way despite repeated requests; failure to disclose material financial and trade information; and, unauthorized disclosure to competitors of highly sensitive and confidential data considered proprietary by Sunlaw and marked as confidential to Global. In addition, very serious communication problems require that alternative approaches for moving forward be implemented.

128. The Claimants assert that this language does not suggest that Sunlaw was unhappy with them in any way, and that Sunlaw withdrew from the MOU only for technical reasons.[51] The Claimants' interpretation of their relationship with Sunlaw is not credible.

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47. Memorial, Azinian witness statement at page 4.
48. See Reply at Section III, paragraph 33-49.
49. Claimants' Admissions and Denials, responses to paragraphs 10 and 32(c).
50. Claimants' Admissions and Denials, response to paragraph 32(b).
51. Claimants' Admissions and Denials, response to paragraph 13.

129. The Claimants alleged in their Memorial that they personally made loans [in unspecified amounts] to DESONA. Now they have admitted that they did not do so[52].

130. In their Memorial, the Claimants asserted, with precision, that their "pre-nullification investment" totaled 2,790,000 dollars. Yet in their Reply, the Claimants' "reconstructed" income statement for DESONA shows total expenses as 2,164,294.09 Mexican pesos. It should be noted that the "reconstructed" income statement purports to be for the period January 29, 1993 (nine months before the concession agreement entered into force) through May 13, 1994. The peso-dollar exchange rate through 1993 and 1994 was around 3 pesos to the dollar. This means that the total expenses, *as alleged by the Claimants themselves*, were less than 1 million dollars.

131. The Claimants therefore have acknowledged that the expenditure figures they initially presented in the Memorial were false. The asserted expenses remain largely undocumented, and the Respondent does not admit that any of the DESONA entities in fact spent even that much money; the point, however, is that the Claimants themselves have abandoned the investment figures presented in their Memorial.

132. The Claimants do not deny that there were at least three versions of "DESONA," each with different shareholders. They previously argued that they were encouraged by municipal officials to incorporate a Mexican corporation to hold the concession, but did not allege that they were asked to create multiple versions. In their Reply, the Claimants now state:

> Even if were [sic] true that DESONA did not technically hold the Concession Contract, Mexico should not be allowed to plead technical non-compliance with its internal law as a defense when the City authorities clearly knew that it was the Claimants, operating through DESONA, who were performing the Concession Contract[53].

This argument is belied by the facts (i) that a Mexican shareholder of one of the versions of DESONA filed a criminal complaint against the Claimants, (ii) that *none* of the Claimants was a shareholder in DESONA I, the only one of the corporations that legally held the concession at the time it was approved by the *Ayuntamiento*, and (iii) that the practices of the Claimants in shuffling the different corporate forms of DESONA was one of the principal grounds upon which the Mexican courts affirmed the Municipality's nullification of the concession contract.

133. The Claimants admit that they received substantial funds and contributions of equipment from Dr. Palacios that they used for the operation of DESONA, and that they have not repaid him. They acknowledge owing Dr. Palacios 333,614.14 pesos, although they argue that his funds were a loan, and not a capital contribution.

134. Also, the Claimants do not dispute: (i) that Dr. Palacios made his contribution/loans to DESONA I, (ii) that he owned 30% of the shares of DESONA I, and (iii) that they used the funds to operate DESONA rather than DESONA I (it remains unclear whether the operating

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52. Reply at Section III, paragraph 12.

53. Reply at Section III, paragraph 8.

company was "DESONA A" or "DESONA B"). *None* of the Claimants were shareholders or investors in DESONA I[54].

135. The Claimants admit that the Mexican court proceedings took place as the Respondent described them. The significance of this admission has already been discussed .

136. The Claimants do not dispute the authenticity of the balance sheets and financial statement obtained by the Respondent for a DESONA entity, and therefore acknowledge that such documents exist.[55] They nonetheless have refused to produce a complete set of financial records for the various DESONA companies[56].

C. Facts in Contention

137. The following factual issues remain in contention:

138. *Investment in trucks*: The Claimants still assert that DESONA "acquired the trucks it was contractually responsible to introduce."[57] The Claimants also include in their "reconstructed" income statement (Appendix A to their Reply) a category purporting to show that DESONA spent precisely 134,669.43 pesos on the purchase of trucks[58]. More specifically, the Claimants have asserted that DESONA purchased two trucks from the Canadian company Northside Steel Fabricator Ltd.[59]. The Respondent answers as follows:

a) The Claimants have not produced any evidence that they ever purchased or owned any trucks, whether through DESONA or otherwise.

b) The bank statements and associated receipts submitted by the Claimants do not indicate that a purchase of trucks for 134,669.43 pesos was made.

c) According to the Claimants themselves, the two trucks at issue cost a total of 249,000 dollars[60]. The sum of 134,000 pesos would not be enough to purchase even one of them.

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54. The only shareholders of DESONA I were Dr. Palacios and Goldenstein.

55. Claimants' Admissions and Denials, response to paragraph 143-144.

56. In the Claimant's Response to Request to Produce Documents, at page 7, the Claimants replied to the Respondent's requests for DESONA's daily journal or ledger, payroll, and accounts payable and receivable by stating: "This request is for irrelevant material that is not in issue before the Tribunal and it is burdensome and oppressive in nature." The Claimants similarly refused to produce financial statements and tax returns for DESONA. The Claimants nonetheless have submitted an informal, unaudited, unsigned and undated "reconstructed" income statement for DESONA as purported evidence of an investment.

57. Claimants' Admissions and Denials, response to paragraph 63.

58. The Respondent notes that the "Income Statement" is not certified, or even signed and dated. It has no probative value as evidence, except to the extent it contains admissions against interest.

59. See witness statement of Basil Carter of Northside Steel, Exhibit 9 to section II of the Claimant's Memorial.

60. See the Claimants' Answers to Requests for Particulars at p. 7.

d) The Claimants have admitted that all of the other trucks they used belonged to the Municipality.

e) The Claimants have not indicated what happened to the trucks they allegedly purchased. It is apparent that the trucks either never belonged to them and therefore were returned to their owner, or were sold[61].

139. *Investment in garbage containers.* The Claimants include in their "reconstructed" income statement an entry showing the purchase of containers for 104,109.50 pesos. Yet they expressly admit that one of Dr. Palacios's contributions to DESONA was 60 waste containers valued at 95,816.40 pesos, and further admit that they never paid or otherwise compensated him therefor[62]. In addition, the Claimants have not indicated what happened to the containers. The Respondent believes that any containers in the possession of DESONA were in fact sold to Sanifill, and in any event that they belonged to Dr. Palacios.

140. *Other alleged investments.* The Claimants allege that DESONA borrowed money from BFI and Western Waste, and that they are personally responsible for those loans. Respondent reiterates its position that the Claimants have still not produced probative evidence that DESONA actually received funds from either of these companies[63].

141. *Alleged Personal Guarantees.* The Claimants also have produced no probative evidence that they are personally liable for any loans. In the case of Western Waste, they simply assert that Mr. Azinian gave a personal guarantee "orally."[64] In the case of BFI, the guaranty agreement submitted by the Claimants states that 15% of the equity shares of DESONA were to serve as BFI's collateral, and that those shares were to come from those owned by Mr. Azinian. The Respondent noted in its Counter-Memorial that Mr. Azinian has remained in possession of

61. Mr. Carter stated that the two trucks actually were imported into Mexico for a trade show in the "summer of 1993" – which was several months before the Claimants assert they acquired them. It seems apparent that, having already imported the trucks into Mexico on a temporary basis for the trade show, Mr. Carter then lent them to the Claimants. To keep the trucks in Mexico after the trade show, it would have been necessary to apply for a permit to keep the trucks in Mexico on a permanent basis, which apparently was done that fall.

62. In their Memorial, the Claimants asserted that Mr. Davitian contributed "rolling stock and equipment valued at over 100,000 dollars." In their Answers to Request for Particulars at page 15, the Claimants stated that this figure was arrived at by adding the value of a single 18 year old truck to the value of "between (25) and (30)" containers, "valued at an average of $350 to $500 per container", as well as certain unspecified and unvalued "welding equipment, casters and tools." The Claimants concede that the truck was never imported into Mexico or otherwise delivered to DESONA. Even assuming an average value of 425 dollars per container, and that there were 30 containers, the maximum total value of Mr. Davitian's "contribution" would be 12,750 dollars. Still, the Claimants have not produced evidence that Mr. Davitian actually owned any such containers or ever delivered them to DESONA.

63. The Claimants have produced check stubs indicating that Western Waste issued checks totaling 100,000 dollars with the notation "loan." There is no evidence, however, that the checks were made out to DESONA or even to the Claimants. Similarly, the Claimants have produced an agreement under which BFI agreed to loan money to DESONA, but have refused to produce evidence that such money ever reached DESONA. To the contrary, *the Claimants' own "reconstructed" income statement does not allege that any loans were received from Western Waste or BFI; the only loan recorded is from EPYCSA (Dr. Palacios's company).*

64. Claimants' Answers to Requests for Particulars at p. 15.

all of his shares, which is inconsistent with the notion that he owed money to BFI. The Claimants derided the Respondent for making this point, stating:

> As inconceivable as may [sic] seem to Respondent, BFI never demanded to physically hold the share certificates that were pledged as guarantee[65].

142. The Respondent submits that this is indeed inconceivable, as the Guaranty and Security Agreement itself provides in paragraph 3:

> In furtherance of the security interest granted herein, each Guarantor has delivered, simultaneously with the execution and delivery of this Agreement to BFI all instruments and stock certificates representing the Collateral, together with stock powers duly executed in favor of BFI[66].

If the stock certificates were never delivered to BFI, as the Claimants state, it is reasonable to infer that no money was ever loaned and that the agreement is not authentic.

143. *Mr. Stirrat's role*. The Reply contains a witness statement from Mr. Stirrat attesting that he did not hold an ownership interest in DESONA Significantly, however, he does not deny that he instructed Mr. Mike Carolan, in March 1994, to seek a buyer or investor for the waste collection concession as indicated in documents provided to the Respondent by Mr. Sam Maphis.

144. *Alleged experience of Global and Messrs. Azinian, Goldenstein and Davitian in waste management*. The Respondent adduced evidence that Messrs. Azinian, Goldenstein and Davitian had falsely represented to the *Ayuntamiento* that Global Waste had more than 40 years of experience in waste management, and was "considered to be a leading company in the industry". In their Reply, the Claimants did not attempt to defend their claim that Global – a company incorporated only 16 months before they appeared before the *Cabildo*, which had annual revenues of $30,000, and which was already in bankruptcy proceedings – was a "leading company in the industry." They nonetheless assert that a statement that "[t]he main officers of GWI have more than 40 years of experience in waste collection" was intended to refer only to Mr. Davitian, and that Mr. Davitian "had experience of over three generations in the waste collection business" – that is, that the experience of Mr. Davitian's father and grandfather should be imputed to him[67]. The Respondent submits that no reasonable person would have interpreted Global's description of its experience in this manner, and that the Claimants' description can only be described as calculated to mislead.

145. *Notification to DESONA of proposed nullification.* The Claimants assert that "there is no written evidence of any complaint registered by the City and delivered to DESONA or its representatives of any material breach of the written contract." The Respondent, addressed this issue in detail in paragraphs 93 through 96 of the Counter-Memorial, explaining that on March 8, 1994, formal notice was hand-delivered by the Municipality to Mr. Davitian as the representative of DESONA, that a hearing was held with representatives of DESONA on March 10 during

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65. Claimants' Admissions and Denials, response to paragraph 166.

66. Exhibit 16 to the Claimants' Response to Request for Production of Documents.

67. Claimants' Admissions and Denials, response to paragraph 32(a).

which a document setting out the 27 irregularities was presented to them, and that Mr. Goldenstein submitted a response on behalf of DESONA to that document on March 16. Copies of the formal notification and Mr. Goldenstein's response thereto were included as Exhibits 11 and 12 to the Counter-Memorial.

D. Additional Facts - Representations made to the State Legislature

146. The misrepresentations made to the *Ayuntamiento* by the Claimants were repeated and amplified during the hearings conducted by the State Legislature's "joint committees" on July 22 and July 29, 1993 which lead to the State Legislature's approval, on August 3, 1993, of the concession granted by the *Ayuntamiento* on November 4, 1992. The particulars and evidence of the statements made to members of the State Legislature by proponents of "The Integral Solution Project" are provided in Annex 1.

PART FIVE: OBSERVATIONS CONCERNING THE STATEMENT OF LAW IN THE CLAIMANTS' REPLY, AND THE RESPONDENT'S STATEMENT OF LAW IN ANSWER THERETO

A. The Claim is Not a NAFTA Claim

147. As noted in Part Two, the Respondent submits that the preliminary objection set out at the beginning of this Rejoinder is dispositive of this Claim. It believes that it is unnecessary to even hold a hearing on the alleged breach by this Municipality because the evidence on the record, combined with the Claimants' admissions, demonstrate that even if the Municipality breached the concession contract (which is denied), there is ample admitted evidence to support the *Ayuntamiento's* decision to nullify the concession and no evidence on the record to support the elevation of this breach of contract claim to the international level.

148. The Respondent therefore reiterates the submissions made in Part Two.

149. In addition, the Respondent will make legal submissions on the pending issues of standing, on the distinctions between claims brought under NAFTA Article 1116 and Article 1117, and on Articles 1105 and 1110.

B. None of the Claimants Has Standing

150. From the time that this proceeding was first initiated, the Respondent has raised concerns regarding whether any of the Claimants had standing to pursue this claim. The Respondent made its first presentation on this issue at the preliminary hearing held on September 26, 1997, and then in its Motion for Directions on the Issue of Standing, submitted on October 6, 1997.

151. In its Interim Decision Concerning Respondent's Motion for Directions dated January 22, 1998, the Tribunal declined to rule on the matter at that time, but issued the following Directions:

> The pleadings summarized above raise a number of complex issues which may have the effect of restricting the competence of the Tribunal. Nevertheless, they seem unlikely to eliminate altogether the need to consider the merits. In considering whether anything

would be gained by making definitive interim determinations with respect to any of these issues, the Tribunal has been mindful of the following factors:

There are some matters of fact and law about which the Tribunal would be likely to ask for additional submissions before deciding any of the issues raised by the Motion. In other words, they do not appear mature for decision at this stage…

If it is true that part of Mr. Azinian's claim is made by him as an impermissible surrogate for Mr. Goldenstein, that may be determined by the Arbitral Tribunal at a later stage. It would affect the quantum, but not Mr. Azinian's standing *pro se*.

If it is true that Mr. Davitian was not a shareholder at the material time(s), this might defeat his standing but would not obviate consideration of the merits; nor would, it seems, his provisional presence as a claimant complicate the facts to be tried on the merits.

If it is true that Messrs. Azinian and Davitian are seeking to introduce claims outside the Arbitral Tribunal's jurisdiction as established by the NAFTA and the various Notices articulated in this case, the Tribunal can also deal with that in due course, e.g., in dismissing claims that are in effect *ultra petita*.

Whatever may be said about DESONA A and DESONA B, neither of them is a claimant. The complications relating to the incorporation, formal actions, and treatment by Mexican administrative and judicial authorities of DESONA (in any of its alleged versions) seem to be part and parcel of the merits, it being noted that the Claimants have identified the entity harmed by the allegedly wrongful actions of the Respondent as the one they define as "DESONA B." [Emphasis added]

1. The Claimants Have Brought Their Claim As Individual Investors, and Not On Behalf of DESONA B

152. The Claimants' right to submit a claim to arbitration is governed by Section B of Chapter Eleven of the NAFTA. The pertinent provisions are as follows:

Article 1116: Claim by an Investor of a Party on Its Own Behalf

1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under… Section A [of Chapter Eleven]… and that the investor has incurred loss or damage by reason of, or arising out of, that breach…

Article 1117: Claim by an Investor of a Party on Behalf of an Enterprise

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under… Section A… and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach…

3. Where an investor makes a claim under this Article and the investor or a non-controlling investor in the enterprise makes a claim under Article 1116 arising out of the same events that gave rise to the claim under this Article, and two or more of the claims

are submitted to arbitration under Article 1120, the claims should be heard together by a Tribunal established under Article 1126, unless the Tribunal finds that the interests of a disputing party would be prejudiced thereby...

Article 1121: Conditions Precedent to Submission of a Claim to Arbitration

1. A disputing investor may submit a claim under Article 1116 to arbitration only if:

(a) the investor consents to arbitration in accordance with the procedures set out in this Agreement; and

(b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:

(a) consent to arbitration in accordance with the procedures set out in this Agreement; and

(b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

3. A consent and waiver required by this Article shall be in writing, shall be delivered to the disputing Party and shall be included in the submission of a claim to arbitration.

153. These paragraphs require the following:

a) With respect to a claim by the Claimants brought under Article 1116 for loss or damage to their interest in DESONA B, the Claimants must submit a waiver. In addition, if they own or control that company, both the individual Claimants *and* DESONA B must provide waivers.

b) With respect to a claim by the Claimants brought under Article 1117 on behalf of DESONA B, both the Claimants and DESONA B must provide waivers[68].

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68. Annex 1120.1 provides an *additional* limitation for claims brought against Mexico, prohibiting an investor, or an investment of an investor, from alleging violations of the NAFTA in both domestic legal proceedings and

154. Although the Claimants purported to waive their rights to initiate domestic legal proceedings regarding the measures at issue (albeit in a questionable format), no waiver was executed by DESONA B and submitted with the claim to arbitration[69].

155. The ICSID itself recognized the absence of the required waiver. In a letter dated March 17, 1997 to Mr. St. Louis acknowledging receipt of the Notice of Claim, Mr. Antonio Parra, the Legal Adviser of the ICSID, wrote:

> Please note that we understand that the Notice is submitted by the Claimants on their own behalf and not on behalf of Desechos Solidos de Naucalpan S.A. de C.V.

156. The Claimants did not take issue with this statement or otherwise comment on it.

157. To similar effect, in its January 23, 1998 Interim Decision, the Tribunal found: "Whatever may be said about DESONA A and DESONA B, neither of them is a Claimant."

158. In the Respondent's view, the issue had been settled: ICSID registered a claim by the Claimants as individual investors, and not as claimants on behalf of DESONA. No claim brought under Article 1117 is therefore properly before this Tribunal[70]. The Claimants may pursue their claim only under Article 1116.

159. This is not a trivial issue. These provisions are not mere technical nuances. NAFTA's procedural requirements are binding on the Parties to the Agreement, the disputing investors, and tribunals, and may not be derogated from. They must be given full force and effect, as required by the NAFTA.

2. The Distinctions Between the Various DESONA Companies Determine Whether Any of the Claimants Have Standing

160. As noted by the Tribunal, the Claimants have identified the allegedly harmed entity as "DESONA B." Consequently, if DESONA B did not validly hold the concession, none of the Claimants have standing, because DESONA B would not even arguably have been damaged by the nullification of the concession.

NAFTA arbitration, even where the domestic legal proceedings do not involve the payment of damages. This additional limitation is necessary because the NAFTA, as a treaty, is self-executing under Mexican domestic law. Annex 1120.1, however, in no way relaxes the conditions precedent of Article 1121.

69. A letter to the ICSID from Mr. St. Louis dated November 24, 1996 entitled "Preliminary Notice of Intention to File a Claim and Consent of Investors" contained the following statement:

> "Said U.S. investors [Azinian, Davitian and Baca], hereby agree to arbitrate their claim in accordance with Article 1120, 1.(b) of N.A.F.T.A. and hereby formally waive their rights to further court or administrative proceedings regarding this claim pursuant to Article 1121 1. and 2."

70. Indeed, given Claimants' assertion that they own and control DESONA B, their failure to provide a waiver from DESONA B should also preclude consideration of their claims under Article 1116. Nonetheless, since the Respondent's position is that it is unclear whether the Claimants validly own and control DESONA B, the Respondent will not press this point.

161. The Respondent has presented substantial evidence that the State Legislature approved the award of the concession to DESONA I, and that the concession was not properly transferred from it to another company[71]. DESONA I's shareholders were Mr. Goldenstein and Dr. Palacios, neither of whom are claimants (and neither of whom could have standing to bring a claim —Mr. Goldenstein because he is of Argentine citizenship, and Dr. Palacios because he is of Mexican citizenship).

162. The Respondent also has presented convincing evidence, of the Claimants' own making, showing that the actual operating company was DESONA A[72]. Mr. Azinian was a shareholder in that company, along with Mr. Goldenstein and two Mexican nationals – Jose Humberto Pulido and Epifanio López. Mr. Davitian was never a shareholder of that company, so no interest therein could be assigned to Ms. Baca. Moreover, all of the Claimants, including Mr. Azinian, have denied the existence of DESONA A and are not bringing their claim in connection with that company.

163. Even if the Tribunal were to decide that DESONA B had been a valid existing company, and that it legally obtained the concession, several issues of standing would remain:

a) First, the Tribunal would have to determine whether it would permit Mr. Goldenstein, who is not a national of a NAFTA country, to assign his shareholding interest in DESONA B to Mr. Azinian for the purpose of pursuing this NAFTA claim. As noted previously, the Respondent submits that this is a transparent effort to evade the clear intent of the NAFTA Parties that the benefits of the NAFTA be granted only to nationals of the NAFTA countries[73].

b) Second, the Tribunal would have to determine whether Mr. Davitian, who the Claimants admit is not a shareholder in DESONA B, could be considered a claimant on the basis of the fact that he allegedly was an employee of DESONA B. The NAFTA is clear on this point: an employee is not an "investor" and an "expectation" that he would share in the profits of the enterprise does not fall within the forms of investment interests defined in Article 1139.

c) Third, the Tribunal would have to decide whether Ms. Baca, who purportedly obtained Mr. Davitian's shares in DESONA B as part of a divorce settlement,

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71. See paragraphs 145-157 of the Respondent's Counter-Memorial.

72. Balance sheets prepared for DESONA's accountant for the months January through July 1993, which are included with a financial summary dated August 12, 1993 prepared by Mr. Goldenstein, indicate that Messrs. Pulido and López were shareholders, that their original capital contributions were subscribed, and that Mr. Pulido made substantial additional capital contributions. See paragraphs 142-144 of the Counter-Memorial. In addition, the municipal government discovered during its 1994 nullification proceedings in 1994 that the public deed for DESONA A – not DESONA B – had been filed with the Municipality in 1992. See the Respondent's Motion for Directions dated October 6, 1997 at page 8.

73. It is well-established that "no claim falls within a treaty which is not founded upon an injury or wrong done to a citizen of the claimant State. Such claim must have remained continuously in the hands of the citizen of the Claimant State until its presentation before the [arbitral tribunal]". *In re: Captain W. H. Gleadell*, 5 Annual Digest of Public International Law Cases 190, 191 (H. Lauterpacht ed. 1929-30).

holds an interest in view of the irregular circumstances under which the shares allegedly were assigned[74].

d) Finally, in light of the fact that the balance sheet for "DESONA" as of October 31, 1993 prepared by its accounting firm shows that EPYCSA, the company owned by Dr. Palacios, had made a capital contribution, the Tribunal would need to determine what portion of DESONA B was owned by EPYCSA.

3. Mr. Azinian Does Not Have Standing to Collect All of the Damages Allegedly Suffered by DESONA B

164. In their Reply, the Claimants argue:

> ... Respondent's objections concerning Mr. Davitian, Ms. Baca, and Mr. Goldenstein miss a larger point. It is undisputed that Mr. Azinian is an investor and has standing to bring these claims not only on behalf of himself under Article 1116 but also on behalf of the enterprise DESONA under Article 1117. Under Article 1117, Mr. Davitian [(sic) probably intended to say Azinian] is entitled to recover on behalf of DESONA all of the damages suffered by DESONA as a result of the City's wrongful repudiation, which the claimants may divide as they see fit. In other words, even if the Tribunal were to conclude that Mr. Davitian or Ms. Baca lack standing ... or that Mr. Azinian's claims under Article 1116 should not reflect the shares received from Mr. Goldenstein, Mexico remains fully liable for all of the damages sustained by DESONA under Article 1117.

165. The Respondent strongly disagrees with the assertion that: "It is undisputed that Mr. Azinian is an investor and has standing to bring these claims not only on behalf of himself under Article 1116 but also on behalf of the enterprise DESONA under Article 1117." Specifically:

a) Mr. Azinian has not shown that he made an investment, if he has not done so, he is not an "investor".

b) Mr. Azinian has claimed to own shares only in DESONA B. The evidence indicates that DESONA B never legally held the concession, and that the corporation was not legally constituted.

c) As discussed above, there is no claim under Article 1117.

166. In any event, if a claim were brought on behalf of a Mexican corporation for damages suffered by that corporation, any damages would be payable to that corporation. The Claimants are incorrect in asserting that damages could be paid to a single investor so that he and some of his colleagues could "divide them as they see fit"[75].

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74. According to the Claimants, Mr. Davitian signed a loan agreement with BFI certifying that he owned shares in DESONA three days after the shares purportedly were issued to Ms. Baca. See Counter-Memorial at paragraphs 158-165.

75. Compare *Housing and Urban Services International, Inc. v. Government of Islamic Republic of Iran*, Award No. 201-174-1, pages 24-25 (22 Nov. 1985), *reprinted in* 9 Iran-U.S. C.T.R 313, in which the tribunal stated:

4. The Claimants Do Not Have Standing Because They Have Not Made An Investment

167. The Respondent reiterates its position that since none of the Claimants, including Mr. Azinian, have demonstrated that they actually invested any capital or other resources in DESONA B, therefore that they are not "investors" within the meaning of the NAFTA. The available evidence indicates that the funds used to operate "DESONA" (whether DESONA A, DESONA I, or DESONA B) were misappropriated from Dr. Palacios and others.

C. The Claimants Have Not Described Any Violation of the NAFTA

168. As set out at length in Part Two, the Claimants' argument that "the City's wrongful repudiation of the Concession Contract constitutes an expropriation of contract rights in violation of Article 1110" or, in the alternative, "a breach of contract in violation of Article 1105"[76] is unsustainable in proceedings before the Tribunal given its special jurisdiction. The Respondent nevertheless discusses below the specific reasons why there are no breaches of Articles 1105 and 1110.

1. The Concession's Nullification Was Not An Expropriation or a Measure Tantamount to Expropriation Under NAFTA Article 1110

169. As previously discussed, there was no "wrongful repudiation of the concession contract"; to the contrary, the termination was properly grounded and motivated, and, more importantly legally required in view of the DESONA's failure address the *Ayuntamiento's* findings and later to successfully challenge them. There is no basis for a claim of expropriation.

170. Moreover, in the instant case, there is no claim nor evidence on the record that the nullification was discriminatory. It was also not arbitrary. It was grounded on the Municipal

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> " ... 'international tribunals have had little difficulty in disaggregating the interests of partners and in permitting' partners to recover their *pro rata* share of partnership claims." [footnote omitted]

76. Reply, Section III, at paragraph 64. At paragraph 64 of the Reply, the Claimants state that international tribunals have allowed concession holders to pursue alternative claims for repudiation of a concession contract as an expropriation of contract rights or a breach of contract, citing *Phillips Petroleum Co. v. Islamic Republic of Iran*, 21 Iran-U.S. Claims Tribunal Reports 79 (1989) in support of this proposition.

In *Phillips Petroleum Co. v. Islamic Republic of Iran*, the Claimant did present alternative arguments and the Tribunal did not address the issue of whether this was appropriate. Instead, the Tribunal simply stated that the arguments were presented as such by the Claimant and as the argument based on expropriation was more appropriate to the case at hand, the tribunal opted to address that argument only.

It is also crucial to note that Article II(1) of the Iran-U.S. Claims Settlement Declaration specifically conferred that Tribunal with jurisdiction over "claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim which arises out of the same contract, transaction or occurrence that constitutes the subject matter of that national's claim...".

Thus the Tribunal had a more extensive jurisdiction than this Tribunal.

Organic Act of the State of Mexico and other applicable legal provisions, on the basis of a number of irregularities, which DESONA failed to disprove by submitting evidence to the contrary, and which it also failed to challenge successfully before the domestic courts (the Tribunal should keep in mind that DESONA has admitted that the proceedings before the domestic courts did not constitute a denial of justice, and has consented to the correctness of their decisions).

171. The Reply cites the UNIDROIT Principles of International Commercial Contracts in support of its argument. Although not directly applicable, the UNIDROIT Principles may still offer some guidance to this Tribunal. They state:

> Article 3.5 (Relevant mistake)
>
> (1) A party may only avoid the contract for mistake [defined in Article 3.4. as an erroneous assumption relating to the facts or to law existing when the contract was concluded] if, when the contract was concluded, the mistake was of such importance that a reasonable person in the same situation as the party in error would only have concluded the contract on materially different terms or would not have concluded it at all if the true state of affairs had been known; and
>
> (a) the other party made the same mistake, or caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error...
>
> Article 3.8 (Fraud)
>
> A party may avoid the contract when it has been led to conclude the contract by the other party's fraudulent representation, including language or practices, or fraudulent non-disclosure of circumstances which, according to reasonable commercial standards of fair dealing, the latter party should have disclosed.

172. The evidence before this Tribunal supports the conclusions arrived at by the *Ayuntamiento*. Under domestic and international legal standards, the concession was properly nullified.

173. Further, the Respondent has not nationalized or expropriated, directly or indirectly, any of the three DESONA entities, nor the equity shares of those companies, nor the interests of any persons in those companies. There has been no governmental restriction on the ability of any of those companies, including DESONA B, to do business in Mexico. Further, there is no evidence that that DESONA B had any physical assets, or if it did that is was unable to receive full compensation for them from purchasers[77]. If the Claimants decided that they no longer wish to continue the operations of that shell company, that was their decision, but it does not give rise to liability under the NAFTA.

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77. The Respondent emphasizes that the contract itself cannot be deemed an "investment" within the meaning of the NAFTA; indeed, Article 1139 expressly excludes contracts from the definition of "investment." Thus, notwithstanding whether certain types of contracts have sometimes been treated as a property interests under the specific circumstances of other cases, the NAFTA does not permit a simple alleged breach of contract to be considered an expropriation within the meaning of Article 1110. In any event, all of the cases cited by the Claimants on pages 11 and 12 of Section V of the Memorial are easily distinguishable.

174. The Claimants have focused on arguing that they had "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory" to support their view that they had an investment that should be deemed as having been expropriated when the contract was nullified[78]. In the Respondent's submission, the Claimants have not submitted any credible independent or contemporaneous evidence that they made any commitment of capital or other resources. Instead, they are asking the Tribunal to rely on their own testimony and on reconstituted summaries of expenses and capital contributions that they prepared only for the purpose of this proceeding. At the same time, they have expressly admitted that contributions of money and containers were made by Dr. Palacios, and that they never repaid him. The Respondent has also produced evidence, in the form of balance sheets prepared by DESONA's own accountant, showing that the Claimants accepted capital contributions from Mr. Pulido as well. Thus, the evidence is that DESONA was capitalized with contributions not from the Claimants, but from others [79].

175. The Claimants sought to establish a connection between their claim and the NAFTA by citing Section 712(2)(a)(ii) of the Restatement of Foreign Relations Law of the United States[80] and arguing, without supporting evidence, that the nullification of the contract by the Municipality was motivated by noncommercial considerations:

a) In the Memorial, the Claimants asserted that the Municipality nullified the contract in order to award it to another company, Tribasa[81]. After the Respondent demonstrated in the Counter-Memorial that the Municipality had in fact taken back control of waste collection services from DESONA, and had continued to provide that service ever since, the Claimants abandoned the Tribasa theory.

b) In the Reply, the Claimants now suggest that the municipal government that took office in January 1994 lacked the ability to handle the collection of waste that remained its responsibility, and that the government blamed DESONA for its own problems. The Claimants state:

> It is ...implausible to think that the City's repudiation of the concession Contract was motivated by commercial

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78. In fact, none of the DESONA entities owned even a single truck, or made any investments in fixed assets. In the view of the Respondent, the nature of the expenses shown in the bank records produced by the Claimants, such as the costs of setting up an office, and of travel and dining, are not the type of "commitment of capital" encompassed by Article 1139 – regardless of who was the source of the funds. The *de minimis* nature of the DESONA operation simply does not amount to an "investment."

79. As explained above, the Claimants did not bring a claim on behalf of DESONA B pursuant to Article 1117. In any event, DESONA B, as a Mexican corporation, could not have a claim for expropriation under Article 1110 arising out of the nullification of the contract. A contract between a Mexican corporation and a Mexican Municipality is not an "investment of an investor of another Party."

80. A restatement of U.S. law of course cannot be deemed directly controlling in this dispute. Assuming that Section 712(2)(a)(ii) is consistent with international law, the principle it sets out, by its terms, applies to contracts between a state and "a national of another state." DESONA was a Mexican corporation, and the contract was not international in nature. It is therefore, at best, highly questionable as to whether the principle of law has any relevance to this dispute.

81. Memorial, Section 4, page 6.

> considerations when DESONA was substantially in compliance with its obligations under that contract and when the City afforded DESONA no opportunity to cure its alleged breaches as required by that contract[82]. This very statement undermines the claim. If the Claimants can only assert that DESONA was "substantially in compliance with its obligations" they admit that it was not in full compliance. If it was not in full compliance, the Municipality acted reasonably in questioning its ability to perform the concession.

c) In its "Conclusion" to the Reply, the Claimants add:

> However, there was one development that Claimants could not foresee or guard against. That was becoming a political scapegoat for an administration incapable of solving its own internal problems. Rather than appreciating the long term benefits that the project would have brought, they elected instead to blame the outsiders for those problems[83].

176. The Respondent reiterates the facts, presented in the Counter-Memorial, that the Municipality re-assumed control of waste collection and has continued to provide that service to date — over five years since the nullification of the DESONA contract. There is no evidence of expropriatory motivation, intent or action.

177. Where the nullification of a contract by a government is based on material misrepresentations by the contractor and well-grounded concerns about the contractor's capacity to perform, the repudiation must be considered to have been motivated by commercial considerations. DESONA had recourse to an impartial forum to determine its claim for "repudiation". It has admitted that there was no denial of justice in that process[84].

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82. Reply, at Section III, paragraph 68.

83. Reply, Conclusion, page 1.

84. Comment *h.* to section 712(a)(2) of the Restatement (Third) of the Foreign Relations Law of the United States states:

> "[N]ot every repudiation or breach by a state of a contract with a foreign national constitutes a violation of international law. Under Subsection (2), a state is responsible for such a repudiation or breach only if it is discriminatory, Comment *f*, or if it is akin to an expropriation in that the contract is repudiated or breached for governmental rather than commercial reasons and the state is not prepared to pay damages. <u>A state's repudiation or failure to perform is not a violation of international law under this section if it is based on a bona fide dispute about the obligation or its performance, if it is due to the state's inability to perform, or in nonperformance is motivated by commercial considerations and the state is prepared to pay damages or to submit to adjudication or arbitration and to abide by the judgement or award.</u>
>
> With respect to any repudiation or breach of a contract with a foreign national, a state may be responsible for a denial of justice under international law if it denies to the alien an effective forum to resolve the dispute and has not agreed to any other forum..." [emphasis added]

2. The Claimants Have Not Identified Any Breach of Article 1105

178. Assuming hypothetically that DESONA B was a properly constituted corporation, validly held the concession, and that at least Mr. Azinian had made a capital contribution to it, the remaining issue under Article 1105 would be whether DESONA B had been accorded "treatment in accordance with international law, including fair and equitable treatment and full protection and security"[85].

179. The Claimants acknowledge there has been no denial of justice by the Mexican courts. Rather, they are arguing that the Tribunal should apply an international law of contracts, completely independent of Mexican law, to hold that: (i) DESONA B was in compliance with the contract and (ii) the Municipality of Naucalpan did not give the company adequate notice of and an opportunity to cure defects in the performance of the contract.

180. In making this argument, the Claimants have not described an alleged violation of Article 1105, which deals with "minimum standards of treatment" in international law. The Counter-Memorial, described the concepts of "fair and equitable treatment" and "full protection and security." In response, the Claimants have not attempted to identify any aspect of the treatment of DESONA B by the Municipality that was not in conformity with the obligations imposed by international minimum standards of treatment. Instead, they simply allege that the Municipality breached the contract[86]. The Respondent has already addressed above why a claim that the *Ayuntamiento* breached its obligations cannot be sustained, that the Claimants are estopped from making such an argument and, in any event, why a simple breach of contract claim is not within the Tribunal's jurisdiction.

181. The Reply asserts that the "Claimants reasonably believed DESONA was not bound by other terms approved by the City Council that were not expressly incorporated in the Concession Contract"[87]. Given that even a cursory examination of Mexican law would show that the terms

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Comment *j.* further states:

> "Economic injury to foreign nationals is often intertwined with a denial of domestic remedies. If no effective administrative or judicial remedy is available to the alien to review the legality under international law of an action causing economic injury, the state may be liable for a denial of justice, as well as for a violation of economic rights... In the case of repudiation or breach of a contract with an alien, Subsection (2)(b), an impartial determination is required to review the adequacy of the asserted justification for the repudiation or breach and to assess the damages if appropriate. Such a determination might be made by an independent domestic tribunal, an *ad hoc* or previously agreed arbitration, or an international tribunal..."

85. Under Article 1116, the question posed is whether the Claimants have "incurred loss or damage by reason of, or arising out of," a breach of Chapter Eleven. Therefore, applying Article 1105, the Claimants must show that they as individuals have incurred damage as a result of Mexico not treating their "investment" – DESONA B – in accordance with international law.

86. The Claimants simply state, without further explanation, that "the City's wrongful repudiation of the Concession Contract constitutes ... a breach of contract in violation of Article 1105." Reply at page 17, paragraph 64.

87. Reply at Section III, paragraph 18.

approved by *Ayuntamiento* were indeed binding, and that various provisions of the contract were illegal and unenforceable, the Claimants' assertion of reasonable reliance is unsupportable[88].

182. The Respondent further notes that the Claimants had access to Mexican legal counsel — as reflected in the three court proceedings they initiated in connection with the dispute— yet they have offered no evidence that they performed any type of due diligence examination of the contract before signing it. The NAFTA does not mandate that a government take responsibility for providing legal advice to a foreign investor, or an investment of a foreign investor. That was not among the duties of any Municipal official. Indeed, Article 21 of the Mexican Federal Civil Code provides that "[i]gnorance of the laws does not excuse compliance with them … ." The Respondent submits that this is a principle common to all of the NAFTA Parties, and that it is fully consistent with international law.

PART SIX: COMMENTS ON THE CLAIMANTS' STATEMENT OF DAMAGES

183. The Respondent's expert, Mr. Schwickerath, has addressed in detail the "Response to Section IV of the Expert Report of David A. Schwickerath" prepared by J.R. Ahn of Ernst & Young that was submitted with Claimant's Reply. Mr. Schwickerath's Rebuttal Report is attached as Annex 4.

184. Further comments are set out below.

A. The Claimants and Mr. Ahn Have Made Misstatements Concerning the Information Relied On In the Preparation of the Limited Scope Analysis

185. The Claimant's Response to Request to Produce Documents included what was purported to be the complete set of documents and notes relied upon by Mr. Ahn in preparing his "limited scope valuation analysis" in 1994. Those documents were provided to it's the Respondent's expert, Mr. Schwickerath, to use in evaluating Mr. Ahn's analysis.

186. There were very few documents, but among them was a letter from Mr. Ahn to Mr. Goldenstein dated July 9, 1994, in which Mr. Ahn invited Mr. Goldenstein to "fill in" the revenue and cost projections that Mr. Ahn would use in preparing the analysis.

88. The Claimants' main argument in this regard is that the municipal president had the "apparent authority" to enter into the contract. However, the decisions of international tribunals they cite as precedents are easily distinguishable (for example, most of those cases involved situations in which there was no dispute that the claimant had delivered goods and services, and the respondent state had refused to pay).

187. In their Reply, the Claimants now assert that some of the figures came from a "feasibility study" of the municipality dated March 1992, which they submit for the first time with their Reply —although no evidence is presented regarding the identity of the author of the study, or when or how it was given to the Claimants[89]. Mr. Ahn, in his written statement, now says that he relied on "conversations with Desona management and information provided to Desona from the Municipality of Naucalpan dated July 1992 … "[90]. Mr. Ahn further refers to "information provided to Desona from BFI (customer revenue summary)" and "an analysis prepared by BFI and provided to Ernst & Young LLP by Desona."

188. The Respondent notes that although the Claimants purported to give the Respondent all the documents and notes relied upon by Mr. Ahn in preparing the limited scope analysis, none of the above documents or Mr. Ahn's supporting notes were included, and have never been provided. This leads to two possible alternative conclusions:

a) Either Mr. Ahn and/or the Claimants were in possession of the additional documents and did not disclose them; or

b) Mr. Ahn did not in fact rely on these additional documents and notes when the limited scope analysis was prepared —which seems more likely, given that Mr. Ahn's July 9, 1994 letter asked Mr. Goldenstein to provide the numbers..

B. The Claimants' Expert Opinion Evidence of Fair Market Value Lacks a Factual Foundation

189. The Tribunal has twice cautioned that each party is responsible for the completeness of its case and that each party should expect any failure to present proper evidence to be noted and exploited by the other party. In response to the Respondent's first request for directions for production of documents the Tribunal noted:

> …each party is in all senses of the word responsible for the presentation of its case; its opponent is not only entitled but indeed expected to call attention to any shortcomings in that presentation…

89. The Claimants assert that the "assumptions" underlying their original financial projections were supplied by "the City staff," and then state that "[t]hose assumptions are now being challenged by Respondent who not only furnished them to Claimants but also solicited and entered into a contract with Claimants based upon those assumptions." Reply, Section IV, page 4. The Respondent —the United Mexican States— did not furnish any "assumptions" to the Claimants and did not enter into a contract with them. Moreover, the Claimants themselves, in arguing that the decisions of the Mexican courts should not be given *res judicata* effect, emphasize that their present claim has not been brought against the municipality, but rather against a different party, the "Federal Government of Mexico." Reply, Section III, page 16. This is yet another example of the many inconsistencies in the Claimants' position.

90. Because the Claimants' purported feasibility study is dated March 1994, it appears that Mr. Ahn either has a different document or had still not actually seen the feasibility study at the time he prepared his witness statement in January 1999.

190. The Tribunal expressed similar sentiments were expressed on July 22, 1998 when it declined to direct the Claimants to produce financial records that they complained were "too voluminous to produce":

> The Claimants have been afforded a full opportunity to present their written evidence and arguments; to the extent that they are imprecise, inconclusive, or incomplete, the Respondent will have a full opportunity to comment on such perceived deficiencies in its Counter-Memorial, or to ask an expert to expose them.

191. In the Counter-Memorial, the Respondent noted that the Claimants' expert opinion evidence of the fair market value of DESONA was not based on facts that had been determined by its expert witnesses (or facts within their knowledge by reason of their expertise), nor was it based on facts in evidence that had been adduced in the Memorial. It is obvious that expert opinion evidence has no probative value (if it is admissible in evidence at all) unless the facts upon which it is based are disclosed and can be seen to be reliable. In the absence of facts that the expert was able to ascertain through his or her special expertise, or facts (particularly contentious facts) that have been proven in evidence, there can be no factual foundation for the opinion offered.

192. Not surprisingly, Mr. Ahn of Ernst & Young calls his report a "limited scope valuation analysis" and stipulates several limiting caveats, chief among them that his opinion was based largely on "discussions with DESONA management". The report prepared by Mr. Richard Carvell suffers from the same limitations. Both relied entirely on hypothetical facts. Neither took into account DESONA's actual revenues or costs during the period that it operated. Neither made any independent assessment of the Mexican waste collection industry to ascertain these important factors.

193. Notwithstanding that the Respondent and its expert witness exposed these deficiencies in the Counter-Memorial, the Claimants have failed to cure the central problem with their valuation evidence – they have failed to adduce evidence that provides a proper factual foundation for the opinions proffered by their experts.

194. Moreover, notwithstanding that the Respondent has repeatedly asked the Claimant to produce financial records that would enable it to ascertain DESONA's <u>actual</u> revenues and operating costs, the Claimants have refused to comply and have failed to adduce such evidence in the Reply.

195. When the Claimants applied to the Tribunal for directions to file a Reply they stated that they had managed to "reconstruct" DESONA's operating journals and wished to enter these in evidence, purportedly to comply (albeit belatedly) with the Respondents' requests that such documents be produced. All that has been produced in the Reply is a "reconstructed" income statement that it is not supported by any original documentation and is not verified by the testimony of any witness. It tells us little of DESONA's actual revenues and costs during the period it carried on its commercial and industrial waste collection operations.

196. The Respondent therefore submits that the Ernst & Young and Carvell reports should be accorded little or no weight in the Tribunal's assessment of the fair market value of DESONA (or any interest therein) and, further, that it would be proper for the Tribunal to infer that

DESONA's actual operating revenues were substantially lower that those projected by Mr. Goldenstein, BFI or anyone else whose estimates may have been taken into consideration by Ernst & Young or Carvell.

C. The Claimants Still Have Not Provided Evidence of An Investment

197. The Respondent previously has commented on the Claimants' inability to produce reliable evidence that any of them actually made an investment.

198. The only additional point that the Respondent will now make on this subject relates to the extraordinary statement that "[t]he funds advanced by BFI and WWI ... were capitalized by Claimants as a contribution to the project"[91]. The Claimants submitted as Exhibit 3 to Section 6 of the Memorial a document purporting to demonstrate that BFI had made a loan to DESONA, which some of the Claimants allegedly had personally guaranteed. They also said that WWI had made a loan to DESONA, which they allegedly had personally guaranteed. The Claimants now assert that these alleged loans to DESONA were *capital contributions*. If the funds were indeed advanced, and were indeed treated as capital contributions, then BFI and WWI would be shareholders in DESONA, along with Dr. Palacios and Mr. Pulido[92]. The Tribunal should note that the alleged loan from BFI was made to Desechos Sólidos de Naucalpan, S.A. de C.V., not to Messrs. Azinian, Davitian and Goldenstein, so they could not have capitalized the funds in their favor, and DESONA cannot be its own shareholder (whether Messrs. Azinian, Goldenstein and Davitian were guarantors of such loan is irrelevant). Moreover, if the money allegedly received from BFI and WWI were capital contributions to DESONA, rather than loans, then BFI and WWI would have no basis for pursuing the "personal guarantees" the Claimants say they gave to those companies.

199. It is not necessary for the Tribunal to determine the exact circumstances of the "loans"; the point is that the Claimants have presented differing, and conflicting, versions of the facts surrounding the loans.

D. The Claimants Still Refuse to Disclose the Amount Recovered in the Sale to Sanifill

200. In its motion for directions dated June 8, 1998, the Respondent asked the Tribunal to direct the Claimants to disclose the details of the sale of DESONA's industrial and commercial waste collection operation to Sanifill. The Tribunal declined to issue the directions sought and the Claimants declined to produce the information requested.

201. In the Counter-Memorial the Respondent noted that the Claimant's failure to adduce evidence of the terms of sale to Sanifill should be treated with suspicion as it appeared that the Claimants had attempted to conceal the fact that they had recovered all or part of their investment upon the sale of DESONA's equipment and commercial contracts to Sanifill.

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91. Reply at Section IV, page 3.

202. The Claimants did not address the sale to Sanifill in the Reply. They did not take issue with the Respondent submissions in the Counter-Memorial, nor did they adduce evidence to indicate that they did not recover the value of their alleged investment in DESONA. The Respondent therefore submits that it would be proper for the Tribunal to infer that the sale of DESONA's equipment and commercial contracts to Sanifill (i) is an accurate measure of DESONA's fair market value at the material time and (ii) that such value was recovered by the Claimants from Sanifill upon payment of the agreed consideration.

E. The Claimants Have Failed, in Two Rounds of Pleadings, to Meet the Burden of Proving Their Claim for Damages

203. In the Counter-Memorial the Respondent identified following shortcomings in the Claimants' evidence on damages issues:

a) their valuation evidence was based solely on hypothetical facts;

b) there was no evidence of DESONA's actual operating revenues and operating expenses;

c) there was not documentary evidence of amounts of money (or money's worth) contributed by any of the Claimants;

d) there was no documentary evidence of the "pre-nullification expenditure" they claimed to have incurred; and

e) there was no evidence to support the contention that any of the Claimants were personally obliged to make good DESONA's alleged debts to Western Waste or Bryan A. Stirrat & Associates.

204. The Claimants have failed to rectify these shortcomings in the Reply. Although they have submitted a unverified "reconstructed" income statement and copies of receipts for certain expenses that DESONA allegedly incurred in the course of its business, there are no actual financial statements, ledgers or operating journals that would enable the Tribunal to assess DESONA's revenues or operating costs, nor are there any cancelled checks, bank drafts or receipts that would allow the Tribunal to assess what amount of money the Claimants individually or collectively invested in DESONA or the "Integral Solution Project".

205. It is entirely reasonable for the Respondent to expect these documents (that are kept in the ordinary course of any business) would be adduced in evidence or produced at the Respondent's request. The absence of such documents has impeded the Respondent's efforts to put in a positive defense to the claim for damages. Their absence will now impede the Tribunal's efforts to assess the proper fair market value of DESONA (or an interest therein), whether by reference to DESONA's going concern value or to the amount (if any) the Claimants individually or collectively have invested.

206. The Respondent therefore submits that it would be proper for the Tribunal to dismiss the claim for damages, or to hold that the Claimants' damages are nominal, regardless of whether a breach of Chapter Eleven of the NAFTA has occurred.

RELIEF REQUESTED

207. The Respondent repeats its request for the dismissal of the claim and the award of costs.

All of which is respectfully submitted

Hugo Perezcano Diaz

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