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

METALCLAD CORPORATION.,
CLAIMANT

VS.

THE UNITED MEXICAN STATES,
RESPONDENT

ICSID Case No. ARB(AF)/97/1

RESPONDENT'S POST-HEARING SUBMISSION

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POST-HEARING SUBMISSION

PART I: INTRODUCTION

1. The Claimant Has Not Proven its Central Allegation

1. The burden of proof rests on the party asserting a proposition or fact. In *Evidence Before International Tribunals*, Sandifer commented:

> While there are no technical rules such as those found in Anglo-American law, there is a primary burden on him who asserts to prove his assertion, and that rule should be maintained, especially in claims commissions[1].

2. The Claimant has not made out its central allegation of detrimental reliance on exclusive federal jurisdiction.

3. Mr. Neveau claimed:

> "...we didn't believe that the Municipality had any authority over the construction of the Site at all"[2].

4. Mr. Kesler testified:

> "But as far as a construction permit to build a hazardous waste landfill, the permit was issued by the federal government alone. Indeed, it was one expert's opinion that we didn't even need a state land use permit, that in this area of environment, reflected by the 1988 Law on Ecology, it filled the area and took jurisdiction in that area to the exclusion of the state and the local community"[3].

5. After that statement, President Lauterpacht asked Metalclad to give references to the advice that it sought and obtained on the subject of federal jurisdiction[4]. Counsel did not respond to that request.

6. The testimony quoted above was not the written advice Metalclad received from federal officials or from its Mexican lawyers, and it is not the evidence of Mexican law before this Tribunal.

7. Metalclad's application for the municipal construction permit, made after legal advice with respect to the applicable statutory provisions, stated:

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1. *Durward v. Sandifer, Evidence Before International Tribunals*, University of Virginia Press, (1975) at p. 130.
2. Transcript, Vol. VII, p. 138.
3. Transcript, Vol. V, at pp. 244-245.
4. Ibid. at p. 245.

"...it is necessary to request the municipal construction licence, at any place in the entity, where the constructions or works will generate a significant impact in the influenced area and environment due to its dimensions and necessities of infrastructure, services and transport, so as in the case of risks it may generate[5]." [Emphasis added]

8. The record evidence does not support the Claimant's assertion that it believed that the federal government had exclusive jurisdiction over the project.

2. The Issue Before This Tribunal is the Lawfulness of the Respondent's Actions at International Law, Not the Question of Legal Correctness in Domestic Law

9. This is an arbitration based on an international treaty. The Tribunal's decisions on its jurisdiction and the content given to the Treaty's substantive obligations have important ramifications. The NAFTA Parties have a long-term interest in a reasonable interpretation of the Treaty.

10. The Tribunal must examine the facts closely to determine whether the measures complained of give rise to international responsibility under the NAFTA.

11. In relation to questions 6 a and b posed to the parties at the Hearing, the Claimant alleged that the Municipality acted in excess of jurisdiction[6]. The Respondent is prepared to demonstrate that, on the evidence, the Municipality had the jurisdiction to refuse the permit application on all of the grounds specified, including its views on the project's impact on the local environment. The Respondent will also submit that the proper question with respect to the permit issue is not the correctness of the Municipality's determination of its powers under Mexican law, but rather the lawfulness of its actions at international law, a question which includes consideration of the domestic remedies that were available to Metalclad[7].

12. The point has been made by the former President of the International Court of Justice, Eduardo Jiménez de Arechaga, in discussing the concept of denial of justice. The learned author points out that only in the most exceptional circumstances would a decision by a domestic court that is contrary to domestic law be found to be contrary to international law. He cited three cumulative requirements: the decision had to be a "flagrant and inexcusable violation of municipal law", it had to be a decision of a court of last resort, all remedies available having been exhausted, and a subjective factor of bad faith and discriminatory intention on the part of the courts had to have been present[8]. If such strict requirements exist before an incorrect decision of a domestic court can be found to attract international responsibility, analogous requirements must exist for the act of a local body which is subject to judicial review.

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5. Permit application of November 15, 1994, Exhibit 88 to the Counter-memorial.

6. See Mr. Pearce's closing speech at Transcript, Vol. VIII, at p. 8.

7. *Case Concerning Elettronica Sicula S.P.A. (ELSI), United States of America v. Italy*, 1989 I.C.J. 15.

8. Eduardo Jiménez de Arechaga, 'International Law in the Past Third of a Century", 159 Receuil des Cours I, p.i at p.281.

13. In its closing argument, the Claimant accused the Respondent of invoking the "immaturity" of its legal system as a defense to the claim[9]. This was a mischaracterization of the Respondent's argument. Litigation involving division of powers is a permanent feature of federal legal systems. Like the other NAFTA Parties, Mexico has well-established judicial procedures to determine the legality of governmental action.

14. Although the Respondent's position is that the law regarding the permitting requirements of the three levels of government was made clear and well known to Metalclad, it is true that there are no final decisions of the Mexican courts concerning the interaction of the General Law for Ecological Equilibrium and Protection of the Environment and San Luis Potosí's Ecological and Urban Code. Unresolved issues on environmental matters is commonplace in federal states. The means to achieve a final court decision was Metalclad's; its legal challenge of the specific interaction in this case was abandoned in favor of negotiations.

15. Ironically, when it acquired COTERIN, Metalclad specifically contracted for the domestic court resolution of the municipal permit issue: if a permit was issued to COTERIN, Metalclad would pay the remaining 1.5 million dollars of the 2 million dollar purchase price. Alternatively, COTERIN could obtain a "definitive judgment in a writ of *amparo* that allows [the company] to legally proceed with the building of such confinement"[10]. Again, Metalclad would then pay the outstanding 1.5 million dollars. If neither event occurred, Metalclad was not obliged to pay any further sum of money.

16. Metalclad did not follow its own contract. Although months before it commenced construction it publicly declared that it respected the Municipality's "autonomy" — a term of legal and constitutional significance— and "requirements", Metalclad ignored the permit issue because it did not want to "raise awareness" of the issue. (It had already told its investors that it had a permitted facility[11].)

17. Only after it commenced construction and received a shut down order from the Municipality did it apply. In constructing without applying, it put itself at risk of a denial —a situation of legal jeopardy that a project proponent in any of the three NAFTA Parties could expect. This is not attributable to the Respondent.

18. When it did apply, it had legal advice from local counsel who outlined the means to go directly to court to resist the Municipality's assertion of jurisdiction. It declined to do so and thereby declined to follow the second contractually-specified means to "legally proceed". This too is not attributable to the Respondent.

19. Moreover, in disregard of any decision that would be made by the Municipal Council, Metalclad took advantage of the change of administrations to speed up and complete construction before the Municipality responded.

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9. Transcript, Vol. VIII, at p. 57.

10. Exhibit 2 to the Counter-memorial.

11. See Metalclad's announcements regarding its Mexican ventures listed in Mr. Dages' Counter-memorial report at p. 13f. See, in particular, the company's Form 10-K for the transition period ending May 31, 1993, at p. 9.

20. The Municipality's response to Metalclad's actions, particularly given the Site's history —a legally relevant fact according to the *ELSI* case— was reasonable and predictable.

21. Domestic remedies were available. After the permit was denied, Metalclad appealed but did not seek relief at the appropriate court. Its appeal was dismissed. Its erroneous choice of forum is not attributable to the Respondent.

22. A further appeal to the Mexican Supreme Court was abandoned in favor of direct negotiations with the Municipality. The abandonment of domestic remedies is not attributable to the Respondent.

23. Thus, with respect to the first of the three measures —the alleged excess of municipal jurisdiction— the Tribunal is deprived of the best evidence of Mexican law because Metalclad forewent the method set out in its own contract to deal with the municipal permit issue. However, the Tribunal does have another source of evidence available to it: the concrete advice given to the Claimant by its legal counsel[12]. That advice shows full awareness of the issues now claimed to confuse Metalclad.

24. There is an inconsistency in the Claimant's position regarding the municipal permit issue. If Metalclad is correct that a Mexican court would have found that the Municipality acted without jurisdiction, the denial of the permit is no legal impediment to it. If it did have jurisdiction, the Claimant would have to regularize its position in relation to its unauthorized construction. In any event, the permit's denial was superseded by the abandonment of the permit litigation in favor of negotiations and then, when the negotiations showed that the Municipality would agree only to the operation of an industrial (not hazardous) waste landfill, resort to this arbitration.

25. The second measure complained of —the Municipality's legal action challenging the federal government's decision to enter into the *Convenio*— was based on a legitimate legal question, namely, whether the federal decision to permit simultaneous hazardous waste operation and remediation was consistent with its earlier resolution to require remediation first.

26. The proposition that a local government's mere resort to the domestic courts is a breach of international law should be viewed skeptically, particularly when there is no evidence that there was a denial of justice. The proper view must be that just as Metalclad was entitled to invoke the assistance of the domestic courts, the Municipality was entitled to commence legal action to determine whether PROFEPA's earlier resolution prevailed.

27. On October 2, 1996, when the Claimant first formally alleged that an expropriation had occurred[13], negotiations with the Municipality were on-going, Metalclad's legal challenge of the permit denial was ongoing, and the Municipality's lawsuit against SEMARNAP had been underway for nine months. Three months later, Metalclad abandoned the negotiations in favor of this arbitration.

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12. See the exchange between President Lauterpacht and counsel for the Respondent at Transcript, Vol. IX, at pp. 150-152.

13. The Notice of Intent to Submit a Claim to Arbitration is dated September 28, 1996.

28. Neither the permit denial nor the injunction amounts to an expropriation or a denial of fair and equitable treatment.

29. The ecological decree, promulgated in September 1997, one year after the Claimant alleged its investment had already been expropriated, is treated separately due to the jurisdictional issue, but in any event, does not give rise to a NAFTA breach.

3. Metalclad Did Not Present This Claim in Good Faith

30. In legal disputes between states, the claimant state has a duty to advance its claim in good faith. As Bin Cheng stated in his text, *General Principles of Law*:

> "A State, first of all, has a right to expect from another that 'no claim will be put forward that does not bear the impress of good faith and fair dealing on the part of the claimant'"[14].

31. The same duty should apply to private claimants who are afforded the direct right of action to enforce treaty rights conferred by NAFTA Chapter Eleven.

32. The misstatements, omissions, and falsehoods in the Claimant's pleadings and witness statements cannot be ignored. Their relevance goes beyond issues of credibility. The Tribunal, and in fairness, the Respondent, both have the right to expect that claimants will act in good faith and will not abuse the arbitral process they invoke.

33. There is also extensive record evidence of violations of U.S., English and Mexican law concerning securities regulation[15], foreign corrupt practices[16], breach of fiduciary duty[17], tax evasion[18], and the like. This evidence is relevant to the obligation to present the claim in good faith, to certain facts at issue (in particular, the market capitalization claim), and to credibility.

34. The principal indicia of the Claimant's lack of good faith are the following:

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14. Bin Cheng, *General Principles of Law*, at page 159.

15. See Annex One to the Rejoinder: Detailed *Prima Facie* Evidence of Securities Law Violations.

16. See the evidence relating to Metalclad's relationship with Humberto Mr. Rodarte Ramón and his wife Lucía Rátner González and the Counter-memorial testimony of Lic. de la Garza with respect to Mr. Kesler's request that he arrange the payment of a 1 million dollar bribe to Governor Sánchez Unzueta. See also the Transcript, Vol. V, at pp. 217-218 for Mr. Kesler's repudiation of Mr. Neveau's account of the circumstances surrounding the termination of Metalclad's local counsel. It is evident that Mr. Kesler thought that his repudiation of Neveau's written evidence was significant enough to require him to coach Mr. Neveau in breach of the Tribunal's order excluding witnesses as to fact. See the Transcript. Vol. V, at pp. 155-158.

17. See the evidence relating to Metalclad's overpayment for the ETI and Química-Omega acquisitions, the claiming of bonuses for events relating to the COTERIN project (under a consulting contract relating to the Santa María del Río project), and Mr. Kesler's suggestion to Jorge Hermosillo that they establish a company that would sub-licence the use of Molten Metal Technology's technology to Metalclad. This was addressed in Mr. Kesler's cross-examination.

18. See Mr. Kesler's third witness statement for its description of why 700,000 of the 840,000 shares he received were unrelated to his actual interest in ETI but were issued so that he could avoid paying US income tax. See also the Transcript, Vol. V, at p.52-55.

First, it did not comply with the parties' agreement, accepted by the Tribunal and embodied in its directions, to file a complete case in the first round of pleadings[19].

Second, it filed a Memorial, attendant witness statements, and expert's reports that were materially deceptive and false.

Third, it omitted to include material evidence. Much of this evidence was wholly within Metalclad's possession and was not easily discoverable by the Respondent.

Fourth, it attempted to establish arbitrariness through pleadings replete with allegations of corruption and malfeasance leveled against an array of officials and ordinary citizens[20]. The Respondent refuted all these allegations.

Fifth, in its Reply, the Claimant: (1) filed admissions and denials that obscured rather than narrowed the facts at issue; (2) refused to admit statements made in its own SEC filings relating to facts at issue; and (3) declined to admit that it had no evidence of serious allegations advanced previously. The Claimant ought to have formally abandoned the unproven allegations.

Sixth, in its Reply, the Claimant: (1) continued to withhold material evidence such as its legal advice; (2) filed misleading evidence from its chief financial officer; and (3) materially restated the alleged cause of the project's failure.

In the Reply, the culprit was Greenpeace, not RIMSA, and the federal government —previously said to be supportive and energetic— was alleged to have failed to stand up to Greenpeace[21]. This change in the causation theory was one of many. The Claimant's theory has evolved throughout this proceeding. Every time that the Respondent deals with the latest set of allegations, the gravamen of the complaint changes.

Seventh, the Claimant engaged in misconduct at the Hearing such as coaching excluded witnesses and misstating material record evidence in cross-examination and in its closing argument.

35. During Mr. Kesler's cross-examination, Mr. Civiletti commented, "I'm well aware that the credibility of witnesses whose testimony is directly relevant and material to the issues in the case is of utmost importance in these proceedings..."[22]. He noted further that the relevance of missteps or imprecision or inaccuracies or "worse" must be shown[23]. The Respondent showed the relevance of the evidence in its Closing and will devote a section of this Submission to the issue.

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19. Agreed by the parties at the First Session of the Tribunal.

20. The Memorial's exclusion of federal officials from its corruption allegations against State and local officials can now be seen as a tactic to divert attention from the improper relationship between Mr. Humberto Rodarte and Grant Kesler dating back to Mr. Kesler's first venture in Mexico.

21. Reply, at paragraph 333 *et seq.*

22. Transcript, Vol. V, at p. 163.

23. Ibid.

36. As Part VII of this Submission will show, the obligation to act in good faith is fundamental to all international proceedings and fundamental to the operation of Chapter Eleven. The Tribunal is the guardian of this process and must protect its integrity by dismissing a claim which amounts to an abuse of the process.

PART II: THE FINDINGS OF FACT OPEN TO THIS TRIBUNAL

37. In preparing for the Hearing, the Respondent adhered to the President's direction that it was not necessary to contradict a witness on points of evidence that were already addressed in the written materials:

> "In this framework, the function of cross-examination is only to enable one party to raise doubts as to the general veracity of a witness relied upon by the other party or to achieve the contradiction of a specific statement of fact asserted by a witness in a manner more conclusive, if necessary, than the denial of that fact achieved by the filing of relevant documentary evidence[24]."

38. Consequently, the Respondent refrained from cross-examining the Claimant's witnesses on testimony which had already been contradicted by relevant documentary evidence.

39. In highlighting only the following facts, the Respondent has focused on those that inform the questions posed by the Tribunal[25], and has not repeated its earlier pleadings which responded thoroughly to earlier allegations. The Tribunal is directed to the comprehensive Chronology filed with the Rejoinder as Volume 1 of the Exhibits.

1. The Three Events Now Alleged to be "Measures"

40. Chapter Eleven applies to "measures" adopted or maintained by a Party relating to investors of another Party or to their investments[26].

41. In its Memorial, the Claimant identified a long list of alleged measures which allegedly interfered with its investment.

42. The Reply specifically identified only two events as measures:

1) the February 1996 injunction obtained in the suit of the Municipality against SEMARNAP[27]; and

2) the ecological decree of September 20, 1997[28];

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24. Letter dated June 10, 1999 from the President to the parties.

25. See the Transcript, Vol. VIII, at p. 90, for the President's comments to Professor Coe in this regard.

26. NAFTA Article 1101.1.

27. Reply, paragraph 427.

28. Ibid.

43. In its closing, the Claimant added a specific allegation that the Municipality's denial of a construction permit in December 1995 was a denial of fair and equitable treatment and a measure tantamount to expropriation[29].

44. There are then three alleged measures:

1) the December 1995 denial of the municipal construction permit;

2) the February 1996 injunction; and

3) the 1997 ecological decree (if the Tribunal has jurisdiction over this measure — the Respondent says it does not).

2. The First "Measure": The Denial of the Municipal Permit Issue

A. There Was Substantial Opposition to the Use of the Site for the Disposal of Hazardous Waste Starting in 1991

45. In the fall of 1990, SEDUE authorized the Site's use as a transfer station, not a landfill, and COTERIN began to receive hazardous waste at the Site. The waste was "hazardous" (not "diverse") and was not "stored" (as was misleadingly asserted in the Memorial[30]) but rather dumped onto the ground without separation or treatment. The Memorial minimized the Site's contamination. The Respondent displayed photographs showing the extensive amount of hazardous waste that was dumped and then buried at La Pedrera[31]. The audit found that burying this organic and inorganic waste without proper treatment or separation constituted a significant risk to health and the local environment[32].

46. The dumping stimulated opposition by local residents, their elected leaders and those of surrounding municipalities, leaders of *ejidos*, a complaint to the National Human Rights Commission, an investigation by the UASLP Faculty of Medicine, and numerous federal inspections[33]. After 11 months of continued dumping, a federal closure order was issued. (See Chronology of the Dumping of Hazardous Waste 1990-1991[34].)

47. From 1991 onwards, State and municipal authorities, non-governmental organizations and municipal residents sought remediation of the Site and opposed any further introduction of

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29. This had not been specifically identified as a measure, but the Reply had pleaded that: "With the Municipality's decision not to issue a construction permit, however tardy, the project's viability ended. No measure of federal support was competent to revive it..." Reply, paragraph 396[5].

30. As alleged in the Memorial at p.1 of the chronology and p. 53 (paragraph 19).

31. See the photographs attached to the Rejoinder witness statement of Dr. Fernando Díaz Barriga in this regard. These were displayed in the Respondent's Opening.

32. Exhibit 98 to the Counter-memorial; paragraphs 508 *et seq.* of the Counter-memorial.

33. See Counter-memorial at paragraphs 206-220.

34. Presented by the Respondent in Closing Submissions on September 9, 1999, Tab B2.

new hazardous waste to the Site. (See Chronology of Selected References to Opposition Arising From Contamination of The Site and Proposal to Introduce New Waste to the Site[35].)

48. In 1992, the Municipality appointed an Ecology *Regidor* to deal with this specific issue[36].

49. Metalclad's Memorial ignored and obscured the fact of substantial opposition based on the contamination.

B. Metalclad's Due Diligence Revealed the Municipal Permit Issue

50. A previous application for a municipal permit and its denial were matters of "corporate record" (admitted by the Reply[37]) and discovered by Metalclad in its due diligence prior to exercising its option to purchase COTERIN. Metalclad Board member Alan Borner opposed the COTERIN acquisition because of the prior contamination[38].

51. This evidence of prior application and consideration of the permit disproved the Memorial's deceptive pleading that: "No construction permit from the Municipality of Guadalcázar was sought or required, nor has the lack of such permit been timely raised by any government authority"[39].

52. Metalclad's awareness of the need to proceed legally was also reflected in its amendments to the Option to purchase COTERIN that deferred payment of three-quarters of the purchase price pending:

1) obtaining authorization from the government of San Luis Potosí through the then-Governor to proceed with construction; and

2) "the Municipal permit for the building of the aforementioned confinement has been obtained by COTERIN, or as the case may be, definitive judgment in a writ of *amparo* that allows [the company] to legally proceed with the building of such confinement"[40]. [Emphasis added]

53. In another material omission, the Claimant did not file this document with the Memorial[41]. It was provided only after the Respondent requested it; Mr. Pearce protested that it

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35. Presented by the Respondent in Closing Submissions on September 9, 1999, Tab B3.

36. The appointment shows that the Municipality saw its jurisdiction as including ecological matters.

37. Reply, paragraph 73.

38. Rejoinder witness statement of Alan Borner at paragraph 9.

39. Memorial, paragraph 17.

40. Exhibit 3 to the Counter-memorial at page 7. The Respondent does not depend upon this agreement for its legal effect; it recognizes it was subsequently amended. It is used here as proof of the falsity of the claimed lack of awareness. In addition, Metalclad's own SEC filing during the summer of 1993 stated that COTERIN anticipated receiving "state and municipal land use authorizations by September 1993". Form 10-K for the transition period ending May 31, 1993, p. 9.

41. It also warrants noting that the evidence shows that Mr. Kesler did not disclose the amendments to the option agreement to his own Board. See the Rejoinder witness statement of Alan Borner and the Board

Footnote continued on next page

was "irrelevant"[42]. That, of course, was quite wrong. The amended option agreement demonstrated Metalclad's true knowledge of the situation when it acquired this investment.

54. The same due diligence disclosed the Municipality's view as to the scope of its authority. The August 15, 1991 COTERIN application discloses the applicable statutory provisions.

55. The October 1, 1991 denial by the *Cabildo*, and the January 20, 1992 resolution by the new administration disclose that the Municipality considered that it had the authority, when considering a permit application, to review the project's impact on the local environment, health and safety concerns, previous unauthorized conduct of the applicant, and the social interests of the Municipality as evidenced by residents' opposition. It was clear that the Municipality did not consider that it was obliged to issue the permit once federal approval had been given or that its role was purely administrative. The Claimant did not include these documents in the Memorial.

C. Metalclad's Other Proposed Venture in SLP Obtained Municipal Permits in 1992

56. Prior to COTERIN's acquisition, Metalclad's other subsidiary in San Luis Potosí, Eco-Administración, had applied for and obtained municipal construction permits before commencing any construction of a proposed hazardous waste incinerator at Matehuala (April 20, 1990) and Santa María del Río (September 19, 1992)[43].

57. Metalclad obscured the fact of its previous three ventures in Mexico in its pleadings and witness statements and thereby avoided disclosing its true knowledge of municipal permitting in San Luis Potosí[44]. Mr. Jorge Hermosillo, the General Director of all three previous ventures testified that he obtained municipal permits for two different locations for the Eco-Administración incinerator project prior to any construction[45].

Footnote continued from previous page

minute reviewed with Mr. Kesler during his cross-examination which show that Mr. Borner's recollection, not his, is to be preferred. Witness statement of Alan Borner at paragraph 13. See also Transcript, Vol. V, at pp. 122-125.

42. Letter dated November 18, 1997 from Mr. Pearce to Mr. Perezcano.

43. See the witness statement of Mr. Jorge Hermosillo at paragraphs 45-46 and Exhibits 23 and 24 thereto in this respect. This was explored in Mr. Kesler's cross-examination. See Transcript, Vol. V, at p. 169.

44. This was addressed in Mr. Kesler's cross-examination. See Transcript, Vol. V, at pp.73-75.

45 Witness statement of Jorge Hermosillo at paragraph 46. During the Hearing, President Lauterpacht inquired as to the documents that were submitted by Mr. Hermosillo to the two municipalities. They are not on the record.

D. The Federal and State Permits Issued in 1993 Did Not Purport to Be Exclusive

58. Mr. René Altamirano, the official who actually issued the federal permits, noted that the first federal permit issued to COTERIN on January 27, 1993, approved an Environmental Impact Study of a landfill with an annual capacity of 36,500 tonnes[46]. Clause 10 provided:

> "This authorization is issued without prejudice to the holder's need to apply for and obtain other authorizations, concessions, licenses, permits or such, that are necessary to conduct the works as a result of this authorization, or its operation or other stage of the project, pursuant to other laws and regulations that shall be applied by the Secretariat of Social Development and/or by other federal, state or municipal authorities." [Emphasis added].

59. The second federal permit issued on August 10, 1993 provided:

> "COTERIN, S.A. DE C.V. shall comply with the provisions established by the statement issued by the *Dirección General de Normatividad Ambiental*, in its letter F00.DGNA-00056 of January 27, 1993, issued in response to the company's proposal filed with the *Dirección General*. As well, the company shall notify the National Institute of Ecology five days in advance of the initiation of operations.
>
> This authorization is issued under the *Ley General del Equilibrio Ecológico y la Protección al Ambiente* [Federal Environmental Act] and its Regulations on Hazardous Waste Matters. Thus, COTERIN, S.A. DE C.V. shall comply with all of the provisions established in these legal instruments, and with the standards applicable to the activities covered by this authorization." [Emphasis added].

60. Mr. Altamirano testified:

> "29. However, I was always careful in my position as General Director to ensure that the powers conferred on the federal authority to grant permits were fully exercised, but never invading the local government's sphere of jurisdiction...[he refers to the fact that the law was new and points to the express language of the permit]...This meant that the authorization could not be considered as an authorization satisfying all legal requirements the company had to meet in order to establish a hazardous waste landfill. In other words, it meant that this authorization did not superseded (sic) other federal, state or municipal authorizations the applicant, in addition, needed to obtain to construct and operate the hazardous waste landfill[47]. [Emphasis added]

61. Although Mr. Altamirano characterized the federal permit as a "construction permit" (and it was necessary for construction to occur), he made it clear that it was not sufficient.

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46. The only Environmental Impact Study ever done for this Site.

47. Counter-memorial witness statement of René Altamirano at paragraphs 29-30.

62. The May 11, 1993 State land use permit (which referred back to the January 27, 1993 federal permit) did not purport to authorize construction. It provided:

> "...this license ...does not authorize works, constructions or the functioning of business or activities."

E. Metalclad Received Legal Advice That the Municipal Permit Was Required

63. The Memorial falsely represented that a State land use permit was "the only non-federal permit Metalclad [was] instructed to obtain"[48].

64. Metalclad retained at least three law firms: Bufete García Barragán, Bufete Torres Corzo (a local SLP firm owned by Governor Sánchez Unzueta's predecessor, Teofilo Torres Corzo, which obtained the State land use permit in the last days of his administration[49]), and Bufete de la Garza (which succeeded the Torres Corzo firm).

65. The Memorial did not disclose any of the legal advice provided on the local permits issue. Nor did Metalclad disclose this advice to the Respondent when so requested[50].

66. The Reply did disclose a letter dated September 16, 1993, from Mr. Deets to Dr. Reyes Luján. In the letter, Mr. Deets noted:

> "Our law firm in San Luis Potosí believes that a municipal manifest may be needed for construction[51]."

67. Mr. Kesler's testimony at the Hearing gave further insight into the company's state of knowledge at the time that it exercised the option:

> "So it explains —really, the reason for the amendment to the Aldrett contract was, to the extent there was any risk at all, we wanted him to share that risk. He [the vendor] was representing it —they don't issue permits, and if they did, they

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48. Memorial Chronology: Event dated May 13, 1993.

49. See the witness statement of Horacio Sánchez Unzueta at page 22.

50. In the Company's February 12, 1996 Offering Memorandum offering stock to U.K. institutional investors, Metalclad had stated at p. 6 that, "The Company has...obtained legal opinions from competent Mexican counsel asserting that the Company is in compliance with all applicable State and local laws relating to the construction and operation of the landfill". This statement prompted the Respondent's request. See letter of February 9, 1998 from Mr. Perezcano to Mr. Pearce. The Claimant's response to this specific request was as follows: "You were earlier provided with information from Claimant's Mexican counsel, García Barragán. We are not aware of copies of further written legal opinions". [Emphasis added] The Respondent had not previously been provided with any legal opinion by Bufete García Barragán on Metalclad's compliance with "applicable State and local laws relating to the construction and operation of the landfill".

51. Letter from Mr. Deets to Dr. Reyes Luján dated September 16, 1993.

would have to for the payment of a few pesos. So we said, fine, take that risk with us[52]."

68. Metalclad's second local counsel, Bufete de la Garza, also advised that a permit was required and in August 1994 set out how the application should be made. Thus, the evidence actually proves the opposite of Metalclad's assertions of exclusive federal jurisdiction.

69. Metalclad's local Mexican lawyer, Lic. García Leos, testified:

> "From the beginning of our relationship with Metalclad and even more so after the meeting of January 28, 1994 with the Governor, I informed Metalclad of the requirement of obtaining the municipal construction permit in order to carry out the works at La Pedrera[53]."

70. Metalclad went further than simply obscuring its knowledge of permitting issues in this proceeding. One of its "expert's report" on Mexican law stated falsely that the company was unaware of this requirement. The report's conclusion stated:

> "...we opine that, if [a municipal construction permit] was required, it was reasonable and even highly likely that METALCLAD, diligently acting in good faith, would have been unaware of this requirement[54]."

71. Mr. Kesler admitted that he had reviewed the case before it was filed[55]. In short, he approved the filing of a Memorial and expert's reports whose central factual premise he knew to be false[56].

F. Metalclad Publicly Acknowledged the Municipal Requirements Were Valid

72. During January 1994, Metalclad acknowledged publicly that it recognized "municipal requirements". In an advertisement published in local newspapers, Metalclad stated:

> "We agree ... to guarantee to future generations a healthy environment.
>
> We agree with you [Governor Sánchez Unzueta] that the consensus of the population of Guadalcázar is required in order to be able to construct and operate such a facility ...
>
> We are in the best position to comply with all of the requirements that the State Co-ordination of Ecology requests in order to observe any...municipal requirements.

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52. Transcript, Vol. V, at p. 245.

53. Mr. García Leos' statement at paragraph 46.

54. Report of Centro Jurici, Lack of Clarity in Mexican Environmental Legislation 1988 to 1996, at page 8.

55. Transcript, Vol. V, at pp. 36-37.

56. There were other major errors of fact in the Centro Jurici reports. They are set out in Part V below.

We recognize the ... autonomy of the Municipality of Guadalcázar[57]."

G. The Evidence Does Not Support the Claimant's Pleading of Good Faith Reliance on Federal "Oral Assurances"

73. The Memorial repeatedly pleaded that "federal officials" gave assurances of federal primacy on which Metalclad in good faith "detrimentally relied"[58].

74. There is no contemporaneous documentary evidence of such alleged oral assurances (such as a letter confirming oral advice from federal officials) on the record. The Claimant has not even produced internal memoranda memorializing what it now claims were crucial representations upon which it relied.

75. The relevant federal officials when Metalclad acquired COTERIN were: Dr. Sergio Reyes Luján, the President of INE, René Altamirano, the INE official who signed the permits, and Mr. Mr. Humberto Rodarte Ramón, the Special Advisor to Dr. Reyes Luján[59].

76. Mr. Pearce asked the Tribunal to draw an adverse inference because the Respondent had not called Dr. Reyes Luján as a witness[60]. In fact, he was Metalclad's witness, although Metalclad obscured this fact by omitting to file his short statement with either the Memorial or the Reply[61].

77. Dr. Reyes Luján's short statement did not include any of the assurances that Metalclad alleges in argument. Rather, he noted that a project proponent had to obtain "all licenses, permits and authorizations required by the corresponding federal and State laws"[62]. (As noted below, State law describes the municipal permit requirements.) His statement does not support the contention of exclusive federal jurisdiction[63]. The Respondent did not find it necessary to cross-examine him.

78. The Respondent did file a lengthy statement from the federal official who actually issued the federal permits. Mr. Altamirano's witness statement specifically denied the allegation that he

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57. Metalclad Press Release dated January 13, 1994; Exhibit 2 to the Counter-memorial, quoted in the Counter-memorial at paragraph 356.

58. See Memorial at paragraph 179.

59. The Memorial alleged that other officials such as Santiago Oñate made representations to the Claimant. Ambassador Oñate provided a witness statement that set out the very limited extent of his dealings with Metalclad. He specifically challenged Mr. Rodarte's testimony that senior officials such as the late Donaldo Colosio made the kind of statements that Mr. Rodarte alleged. See Counter-memorial witness statement of Santiago Oñate at paragraphs .

60. Transcript, Vol. I, at p. 29.

61. It was not provided until requested by the Respondent after it belatedly noted a bracketed reference ot it in the Memorial. Metalclad disclosed it on March 23, 1999.

62. Ibid.

63. Nor does he admit to making the statement that Mr. Deets says he made after Metalclad exercised its option.

gave oral assurances of federal exclusivity and directs the Tribunal to the language of the permits. Mr. Altamirano testified:

> "27. I direct the Tribunal's attention to the matters concerning the language in which we communicated because I am absolutely certain that I discussed the issues regarding federal jurisdiction with the Metalclad representatives. I remember that I specifically said that the authorization granted only referred to the approval of the conditions of the site and of the technology planned to be used there[64]. This authorization did not mean that the Federal Government could approve land usage, because that was an issue concerning the State and the Municipality. I have no doubt that I made this clear in my discussion with the Metalclad representatives"[65]. [Emphasis added]

79. Metalclad neither filed a witness statement, nor adduced any other evidence to respond to Mr. Altamirano's testimony. Mr. Pearce ignored it in his closing speech to the Tribunal.

80. The evidence of federal assurances then rests on the testimony of Mr. Humberto Rodarte. The testimony of Mr. Altamirano, the federal official who actually issued the permits, is instructive on this point:

> "28. I also remember that Mr. Rodarte Ramón gave the impression that he believed that they would prevail over the State and municipal concerns. He thought the influence of the Federal Government could tilt the decision in favor of the project[66]."

81. The evidence demonstrates that there was no reasonable reliance on Mr. Rodarte's statements as a federal official. Mr. Rodarte was in a conflict of interest whilst a federal government official from 1991-1993, given his wife's shareholding, first, in Eco-Administración and then in Metalclad, and his "commission" payable by the Aldretts if he arranged the successful sale of COTERIN[67].

82. Mr. Rodarte had been affiliated with Metalclad for over eighteen months when he introduced COTERIN to it. To the extent that Metalclad relied upon him to influence federal approvals[68], it knew that he was acting improperly on its behalf and cannot be taken to have reasonably relied on any advice that he may have given.

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64. This description of the federal approval was entirely consistent with Secretary Carabias' testimony at the Hearing.

65. Witness statement of René Altamirano at paragraph 27. See also paragraph 6 and paragraphs 27-30 of his statement (Counter-memorial Annex Two, Volume 1, Exhibit F).

66. Ibid. This statement was filed with the Counter-memorial before the Respondent discovered (in December of 1998) the true extent of Mr. Mr. Rodarte's relationship with Mr. Kesler and Metalclad. It sheds light on Mr. Mr. Rodarte's expansive views of federal jurisdiction. He was self-interested and stood to be paid $100,000 if the COTERIN acquisition was successfully consummated. See Transcript, Vol. V, at pp. 112-113.

67. This was explored during Mr. Kesler's cross-examination. Transcript, Volume V, at pp. 99-112.

68. See the Lucía Rátner-Eco-Metalclad Stock Exchange Agreement concluded by Grant Kesler on February 25, 1993. Rejoinder, Exhibit 18.

83. Mr. Kesler testified that he did not meet Mr. Rodarte prior to 1993 and that when he met him he "seemed" to be like any other federal official, the implication being that he had no previous contact with him[69]. The weight of the evidence indicates that Mr. Kesler's testimony was false. Mr. Hermosillo testified that Mr. Kesler was fully aware of and approved of Lucía Rátner's holding the Eco-Administración shares on Mr. Rodarte's behalf[70]. Mr. Hermosillo was present in Washington and available for cross-examination. The Claimant had the opportunity to cross-examine him and chose not to[71].

84. Mr. Rodarte's evidence is completely unreliable. His two accounts of the June 11, 1993 meeting with the Governor contradict each other. His character evidence that Mr. Kesler would not engage in acts of corruption is belied by the documentary evidence of direct payments to Rodarte's wife on the issuance of federal environmental permits[72].

H. The May 27, 1994 Agreement With the State Recognized the Need for Municipal Consent

85. Discussions between the State and the Claimant in the first months of 1994 culminated in the announcement of an agreement at the State Palace on May 27, 1994. The day before, Dr. Medellín sent a letter to the company's local counsel addressing the desirability of moving the proposed landfill to another site with the State's assistance and stating further that any decision to open the La Pedrera Site for commercial operation would depend upon: (1) convincing State and municipal authorities that the facility could operate with high safety standards, and (2) the community accepting its operation, such acceptance being assessed jointly by the State, municipal authorities and the company[73].

86. The Memorial had accused the State of breaching the May 27, 1994 agreement but did not describe its terms[74]. After the Respondent filed Dr. Medellín's letter setting out the terms of the State's proposal, Mr. Neveau testified that, to the best of his knowledge, no one in the company had ever seen Dr. Medellín's letter[75].

87. Mr. Neveau's evidence was contradicted by the testimony of Lic. García Leos, Metalclad's former counsel, who testified that, upon receipt, the letter was immediately given to a local Metalclad employee[76]. During cross-examination, Mr. Neveau was directed to

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69. Third witness statement at paragraph 34. Transcript, Vol. V at pp. 99-112.

70. Rejoinder witness statement of Jorge Hermosillo at paragraph 10.

71. Transcript, Vol. IV, at pp. 108-110.

72. See Mr. Rodarte's Reply statement at paragraph 39. See also Mr. Deets' testimony in re-cross-examination where he retreated from his initial written testimony upon realizing that Mr. Ronald Robertson had also provided written testimony about the June 11, 1993 meeting, which testimony was that the meeting was far shorter and more perfunctory than Mr. Deets' Reply statement had claimed. See Vol. VII, at pp. 64-78.

73. Exhibit 72 to the Counter-memorial.

74. Memorial, paragraphs 69-70.

75. Reply, Exhibit 18, witness statement of Daniel Neveau at paragraph 29.

76. See Rejoinder witness statement of Lic. García Leos at paragraph 37.

Metalclad's draft pleadings which showed that Metalclad had to be aware of the May 26, 1994 letter since it cited it in the draft NAFTA complaint[77].

88. The letter is further proof of the State's view that the Municipality's consent was required and Metalclad's awareness of that fact.

I. Metalclad Has Never Alleged a Representation of Exclusive Federal Jurisdiction Made by the Municipality

89. There is nothing on the record that the Municipality ever represented that it had no authority over the siting of a hazardous waste landfill within its territory.

J. When Metalclad Commenced Work Without its Consent, the Municipality Objected in June 1994

90. In May of 1994, Metalclad commenced work at the Site without obtaining local approval. On June 6, 1994, the Municipality objected to the work at the Site and issued a stop work order. Mr. Neveau agreed to stop work, although he asked to do some preventative maintenance work[78].

91. The Claimant pretended that this did not happen. It omitted this event from the Memorial's account of events. Mr. Kesler testified that from May-August 1994, construction proceeded "fairly smoothly"[79].

92. After the first municipal stop work order, Mr. Neveau wrote directly to the Municipality proposing a "host community" agreement as follows[80]:

> "...let's go forward finding solutions satisfactory to the community that permit regional development in full compliance with municipal, State and federal dispositions[81]." [Emphasis added]

93. On August 17, 1994, Metalclad's local counsel, Mr. García Leos wrote to Mr. Javier Guerra (a new director of Metalclad) describing how Metalclad should apply for a municipal permit.

94. Counsel's advice was not that the permit's issuance was a mere formality. In fact, Mr. García Leos advised that since:

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77. Transcript, Vol. VII, at pp. 117-120. Mr. Neveau's second witness statement, filed after the Tribunal permitted Metalclad to file additional evidence in reply to the Rejoinder before the Hearing, did not respond to Rejoinder paragraph 292 where Metalclad's awareness of the May 26th letter was discussed.

78. Exhibit 18-3 to the Reply.

79. Memorial witness statement at p. 8. This was addressed in Mr. Kesler's cross-examination. Transcript, Vol. V, at pp. 172-174.

80. Exhibit 18-3 to the Reply.

81 Letter from Mr. Neveau to Municipal President Carrera, June 13, 1994. Exhibit 75 to the Counter-memorial.

"...the fact that this was already mentioned some time ago to you [i.e., before construction commenced] with the additional information that the building license was applied for by COTERIN and denied [in 1991] and for such reason there is no certainty of the results if we proceed [to the courts] as mentioned[82]."

95. Mr. Neveau replied on September 9, 1994. Fearing a negative response from the Municipality since Metalclad had already commenced construction and his earlier proposal had been rejected, he advised Mr. García Leos to "ignore this problem rather than raise it to a level of awareness"[83].

96. Both documents were omitted from the Memorial and the Reply. They demonstrate that it was Metalclad's actions that put it in legal jeopardy.

K. Metalclad Suppressed its Legal Advice and Knowledge of the Permit Issue When it Sought the US Embassy's Assistance

97. When Metalclad invoked the assistance of the US Embassy, it omitted to inform it that COTERIN had previously applied for and had been denied a municipal permit. Mr. Kevin Brennan, the company's primary contact at the Embassy, told the Respondent's counsel that he had been advised that the permit issue had not previously arisen and he did not know that local opposition had started in 1991; he was given to understand that opposition started after 1994[84].

98. Metalclad also did not inform the Embassy that it had no prior experience in the hazardous waste disposal business[85], that it had previously announced but abandoned three other Mexican ventures, and that its true intentions were to simultaneously introduce hazardous waste and remediate the Site. Mr. Brennan recalled that he was told in his first meeting with Mr. Kesler, the latter stated that the company planned to remediate before accepting new hazardous waste; Mr. Brennan said that this was repeated to the Ambassador on several occasions[86]. His recollection that this was discussed several times is to be preferred to Mr. Kesler's denial[87].

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82. Letter of August 17, 1994 from Lic. García Leos to Javier Guerra, Exhibit 3 to the witness statement of Lic. García Leos.

83. Exhibit 2 to the witness statement of Lic. García Leos.

84. See Mr. Brennan's second witness statement which annexes the letter from Mr. Perezcano recording the interview held with Mr. Brennan and filed with the Tribunal on August 17, 1999.

85. A fact admitted by Mr. Deets notwithstanding Mr. Kesler's attempt under cross-examination to assert that the company had "tremendous experience in hazardous waste" (Transcript, Vol. V, at p. 145). It is noteworthy that in Mr. Deets' Reply witness statement, which sets out the Metalclad "team of experts", there is not a single person listed there from Metalclad's industrial insulation or asbestos abatement business.

86. Second Brennan statement at paragraph 5 and 13 of the letter dated May 5, 1999 from Hugo Perezcano to Kevin Brennan.

87. Transcript, Vol. V, at p. 184.

99. Acting on its incorrect understanding of the events, the Embassy pressured the Mexican federal authorities[88].

L. The Audit

100. Also during this time, the federal environmental audit of the contamination was initiated.

101. There is evidence (from the company's SEC filings) that Metalclad sought to influence the conduct of the audit by seeking to appoint the head of the audit team to its Board of Directors. Dr. Ortega Rivero refused the appointment stating that in light of his responsibilities it would be "impossible" for him to accept Mr. Neveau's offer[89]. Nonetheless, Metalclad announced his appointment. Secretary Carabias expressed concern about this act in her first witness statement[90].

M. In October 1994, the Municipality Issued a Second Shut-down Order

102. On October 26, 1994, the Municipality sent a delegation to the Site. They issued another shut down order. The Memorial referred to the shut down order and claimed: "This was the first indication by any government official that a municipal construction permit was essential..."[91]. As noted, this claim has been proven false.

N. After the Second Shut-down Order, Federal Officials Again Told the Company to Apply for the Municipal Permit

103. In addition to what Metalclad discovered through its own due diligence, the express wording of the permits, and the advice of counsel, on November 9, 1994, federal authorities responded to a letter from Metalclad's subsidiary indicating that the federal authorities did not object to Metalclad's proposal to perform work related to the audit and future remediation at the Site on "the understanding that your company shall obtain the corresponding construction permits for the described works from the municipal and State authorities in accordance to their respective jurisdiction"[92]. [Emphasis added]

104. Metalclad's Ariel Miranda had previously written to Lic. Zaragoza (PROFEPA-SLP) in September to ask whether PROFEPA would find it "inconvenient" if the company constructed certain works necessary for the conduct of the environmental audit and to carry out any remedial work required by the audit.

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88. When interviewed by counsel, Mr. Brennan admitted that the Embassy had never sent representatives to the local community other than one official who attended the Grand Opening/facilities tour. See paragraphs 11 and 54 of Mr. Perezcano's letter summarizing the Brennan interview.

89. Exhibit 6 to the Counter-memorial witness statement of Dr. Ortega Rivero. This was reviewed with Mr. Neveau during cross-examination. See Transcript, Vol. VII, at pp. 133-135.

90. See her Counter-memorial witness statement at paragraph 7.

91. Memorial, paragraph 80.

92. Exhibit 86 to the Counter-memorial, Exhibit 16-4 to the Reply.

105. The same written advice given by Mr. Zaragoza was repeated on November 14, 1994:

> I do not omit to mention that your represented company shall obtain the corresponding permits and authorizations from the competent State and municipal authorities[93]. [Emphasis added]

106. In November 1994, after the Municipality had issued a second shut-down order (in October 1994), Metalclad applied for a municipal construction permit.

107. In its Reply, Metalclad alleged that federal officials downplayed the need for a municipal permit at this time[94]. The federal officials identified in its pleadings, Jaime de la Cruz Nogeda and Ramiro Zaragoza, both entered specific denials with the latter annexing the two letters cited above to his statement[95].

108. In his closing speech, Mr. Pearce mischaracterized this evidence, asserting that "the evidence is that the federal representative in the State of San Luis Potosí instructed the company that the local permit was not needed at all, but to continue construction and, as a matter of respect for the community and of political comity, to make application for the permit"[96]. Mr. Pearce did refer to the contradictory testimony of the two witnesses or to the contemporaneous documents that supported such testimony.

O. COTERIN Then Applied for the Municipal Construction Permit

109. Metalclad's decision in November 1994 to apply for a municipal construction permit was taken after specific legal advice that it was open to the company to attempt to challenge the Municipality's jurisdiction by an *amparo* against the October 1994 closure order issued by the Municipal Ecology *Regidor*. COTERIN (Metalclad) decided not to challenge the municipal closure order[97]. Mr. García Leos testified that by this permit application, according to Mexican law, the company accepted the legitimacy of the municipal permit requirement[98].

110. COTERIN's (Metalclad's) November 15, 1994 application for a municipal construction permit reflected the terms of the applicable law and demonstrated acquiescence in the view that

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93. Exhibit 11 to the Rejoinder witness statement of Ramiro Zaragoza. An event omitted from the Memorial's account where Mr. Kesler testified that construction proceeded "relatively smoothly."

94. Reply, paragraphs 217, 499-500.

95. Counter-memorial witness statement of Ramiro Zaragoza at paragraphs 18-19 and Rejoinder statement of Pablo de la Cruz at paragraphs 6, 8, and 9.

96. Transcript, Vol. VIII, at p. 10. Mr. Pearce also mischaracterized the written testimony of Secretary Carabias, Leonel Ramos Torres and Attorney General Azuela on other subjects. See the Transcript, Vol. VIII, at pp. 13-14.

97. Rejoinder witness statement of Lic. García Leos, paragraph 51; letter of November 14, 1994, from Lic. García Leos to Mr. Mr. Rodarte.

98. Rejoinder witness statement of Lic. García Leos at paragraph 52.

the Municipality could consider the project's "impact in the influenced area and environment" and the "risks [the project] may generate"[99]. [Emphasis added.]

P. Metalclad Commenced Construction Prior to the Application For and Consideration of the Permit

111. Although it applied for the permit, COTERIN (Metalclad) had already commenced construction and did not stop pending the consideration of the application.

112. Metalclad completed construction in less that four months after it applied. On January 26, 1995 construction was "speeded up" and noted as 80 percent complete. Given Metalclad's announcements to its shareholders and opening announcements of March 6 and 11, 1995, construction must have been completed by March 1995[100].

Q. The Municipality's Initial Consideration of the November 1994 Permit Application

113. COTERIN's (Metalclad's) permit application was considered in December 1994 by the then outgoing Municipal President who determined to wait for the "new city council to decide"[101].

114. Mr. Leonel Ramos Torres, whose administration began January 1, 1995, made personnel changes upon taking office[102]. Nevertheless, the council decided on February 13, 1995 that any discussion of the landfill must be held in open council, and an Environmental Committee was formed to replace the Ecology *Regidor* of the previous administration. The same minute recorded continued local opposition to the introduction of more hazardous waste[103].

115. The delay in the new council's consideration of the permit is of no legal consequence because during the material period (January 1, 1995 to the end of February 1995) Metalclad simply continued and completed construction. Mr. Pearce's closing submission that the council had 12 opportunities to consider the application is belied by the facts: the application filed in November was considered initially in December, at which time it was deferred to be considered by the next administration.

116. As of the beginning of March 1995, construction was complete according to Metalclad's announcements[104]. In any event, the conditions for one of the reasons for the permit's denial (the unauthorized construction) were already in existence when the company applied for the permit.

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99. Exhibit 88 to the Counter-memorial.

100. Metalclad's Notice of Claim to this Tribunal also states that construction was completed by March 1995.

101. Exhibit 7 to the Rejoinder witness statement of Lic. García Leos.

102. Transcript, Vol. III, at p. 9.

103. Exhibit 91 to the Counter-memorial.

104. Transcript, Vol. V, at pp. 29-31.

117. On December 5, 1995 the Municipal Council considered and denied the application. Its stated reasons for the denial, were based, in part, upon the fact that Metalclad had commenced construction before applying. It also cited the reasons for the previous application's denial, the fact that the contamination had not yet been remediated, the fact that the State land use permit did not authorize construction and on its face was null if its terms were offended, and the evidence of local opposition. The Tribunal will recall that the evidence shows that there was a large turn-out of local residents for the *Cabildo* meeting[105].

R. After the Permit Was Denied, Metalclad Sought Judicial Review of the Denial

118. On February 9, 1996, COTERIN (Metalclad) petitioned the *Cabildo* for reconsideration of the permit's denial.

119. This petition occurred almost at the same time as the Municipality commenced its legal challenge against SEMARNAP's entering into the *Convenio* with COTERIN (Metalclad). It was this proceeding which resulted in the issuance of the injunction now complained of.

S. Metalclad Abandoned its Judicial Review Proceedings

120. In April 1996, the Municipality refused reconsideration of the permit denial and in May proceedings in Federal Court were filed by COTERIN. COTERIN failed first to exhaust existing remedies at the State Administrative Tribunal and in June 1996, its *amparo* was denied on that basis. COTERIN appealed from this denial to the Mexican Supreme Court.

121. On October 31, 1996, it abandoned that appeal in favor of direct negotiations with the Municipality. No basis for complaint has been alleged or shown with respect to any aspect of the Mexican domestic judicial remedies engaged in by Metalclad.

T. The Municipality Engaged in Good Faith Negotiations With the Company

122. Negotiations were conducted in 1996 between COTERIN and the Municipality[106]. In the Reply, Metalclad alleged that the Governor withheld his good offices and interfered in the negotiations[107].

123. The documentary evidence and admissions by witnesses called by Metalclad show that the Governor used his offices to promote the negotiations. In fact, in January 1997, he received a letter of thanks from Ambassador Jones for bringing the company and the Municipality together:

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105. Exhibit 4 to the additional Counter-memorial witness statement of Lic. de la Garza.

106. Mr. Carvajal testified that he visited the town of Guadalcázar for the first time in October of 1996. He had been retained in April 1996. Transcript, Vol. VI, at p. 11.

107. See, for example, the Reply at paragraph 294.

"I have recently received a copy of the memorandum of understanding reached between the parties to the Metalclad issue and I wish to thank you and your staff for your efforts so far, and to encourage further progress as soon as possible[108]."

124. The evidence also shows that the Governor attended, hosted or was responsible for convening at least 6 meetings between representatives of the Council and Metalclad between December 1995 and December 1996, in addition to attending various meetings with Secretary Carabias and Ambassador Jones, respectively, in an effort to resolve the La Pedrera issue[109].

125. During the Respondent's closing submissions, the President asked what the outcome of the negotiations was[110]. The sequence of events is as follows.

126. Meetings between the parties led to the signing of the *Acuerdo de Entendimiento* (Agreement of Understanding) on January 8, 1997. This was the document to which Ambassador Jones' January 14, 1997 letter referred. The *Acuerdo de Entendimiento* was an agreement to establish the framework for future negotiations between the *Ayuntamiento* and COTERIN.

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108. Counter-memorial Witness Statement of Horacio Sánchez Unzueta, Exhibit 28.

109. The history of Governor Sánchez Unzueta's attempts to promote settlement is as follows:

He met with Secretary Carabias on May 4, 1995 to try to resolve the La Pedrera issue;

He hosted a meeting on December 19, 1995 between Metalclad officers Messrs. Neveau and Guerra, and the Municipality's legal counsel Lic. Leonel Serrato.

His chief advisor, Mario de Valle, met with newly retained Gustavo Carvajal on May 9, 1996;

He attended a lunch meeting with Metalclad representatives on June 12, 1996 to discuss the framework for a negotiating a solution to the La Pedrera issue;

He attended Metalclad's tour of the BFI facility in Texas (at the State Government's expense) on July 6-7, 1996;

He attended a meeting (arranged at his request) with U.S. Ambassador James Jones at Los Pinos on August 15, 1996;

He attended other meetings with U.S. Ambassador Jones in August and September 1996 an effort to resolve the La Pedrera issue;

He agreed with U.S. Ambassador Jones on September 27, 1996 to try to resolve the dispute between Metalclad and the Municipality through negotiation or arbitration;

He arranged a meeting held of October 30, 1996 between representatives of the *Ayuntamiento* and Metalclad in an effort to resolve the La Pedrera issue;

He hosted a meeting on December 26, 1996 between Metalclad representatives and members of the *Ayuntamiento* to seek a solution to the La Pedrera issue; and

He wrote to U.S. Ambassador Jones on December 18, 1996, stating again his desire to find a resolution to the La Pedrera issue.

References to the evidence concerning the above events are in the Chronology filed with the Rejoinder.

110. Transcript, Vol. IX, at p. 134.

127. Two different versions of the *Acuerdo* were executed. In the first version, signed at a meeting of the parties on January 8, 1997, the recital stated that the parties recognized that, for technical and economic reasons, in order to remediate the site the company needed to receive and deposit non-hazardous industrial waste at the landfill[111]. The other version was signed the next day, when Lic. Carvajal contacted Mr. Ramos Torres and asked him to sign an amended version in which the words "non-hazardous" were deleted[112]. There is a dispute on the evidence as to why and how this occurred[113].

128. Mr. Ramos Torres testified that the Municipality recognized COTERIN's wish to generate revenue in order to pay for the remediation of the site and was willing to agree that COTERIN could operate the facility as a landfill for non-hazardous industrial waste while the remediation work was being carried out[114]. Lic. Carvajal testified that the words "non-hazardous" were removed because "by constraining the Agreement to non-hazardous waste we were precluding a whole set of alternatives of solution that could be agreeable for us"[115].

129. Mr. Carvajal's explanation is dubious given that the first version of the *Acuerdo* had been signed at a face-to-face meeting of the parties held the day before (on January 8, 1997). Mr. Ramos Torres testified that he did not object to the deletion of the words 'non-hazardous' the next day because Mr. Carvajal told him that Mr. Serrato had approved of the deletion and that, in any event, the term industrial waste did not encompass hazardous waste[116]. Mr. Serrato testifies that he was not consulted by Mr. Carvajal and did not consent to the deletion of the words 'non-hazardous' from the agreement[117].

130. The parties met again on January 25, 1997 for further discussions. However, as indicated in the Ambassador Jones' letter dated January 14, 1997, Metalclad had already submitted its Notice of Claim. In the Ambassador's words:

> "As you know, time is of the essence as the Nafta timetable for dispute resolution is fixed[118]... From my perspective, I see a window of opportunity to solve this longstanding issue, but it is a brief one[119]."

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111. See Exhibit 143 to the Counter-memorial; Exhibit 29 to the witness statement of Horacio Sánchez Unzueta; Exhibit 2 to the statement of Mr. Ramos Torres; Exhibit 1 to the statement of Leonel Serrato.

112. See the witness statement of Leonel Ramos Torres at paragraphs 10 and the Rejoinder witness statement of Leonel Serrato at paragraphs 8-9.

113. See (a) Memorial witness statement of Lic. Gustavo Carvajal at pages 15-19; (b) Counter-memorial witness statement of Leonel Ramos at paragraph 12 and Lic. Leonel Serrato at paragraphs 21-29; (c) Reply witness statement of Lic. Gustavo Carvajal at paragraphs 26-29; and (d) Rejoinder witness statement of Leonel Ramos at paragraphs 6-11 and Lic. Leonel Serrato at paragraphs 3-9.

114. See Counter-memorial witness statement of Leonel Ramos at paragraph 12 and Rejoinder witness statement of Leonel Ramos at paragraph 8.

115. See Reply witness statement of Lic. Gustavo Carvajal at paragraphs 26-29 (page 4).

116. Rejoinder witness statement of Leonel Ramos Torres at paragraph 10.

117. Rejoinder witness statement of Leonel Serrato at paragraphs 3-9.

118. The Ambassador was in error on this point. There is no time period specified in NAFTA for proceeding with the constitution of a tribunal (except that a minimum of 90 days must elapse) from the Notice of Intent.

131. In fact, Metalclad's Notice of Claim had been filed with the ISCID on January 2, 1997, five days before the *Acuerdo de Entendimiento* was signed, notwithstanding that the parties were negotiating a term which was included in the *Acuerdo* that each party would refrain from engaging in litigation that would frustrate the objective of the agreement[120].

132. Although there is a dispute on the evidence as to what transpired at the January 25, 1997 meeting, it is clear that the parties remained at odds on the question of whether COTERIN could operate a hazardous waste landfill while concurrently remediating the site[121]. This was the last time that the Claimant engaged in negotiations with the Municipality. Thereafter, it pursued its NAFTA claim.

133. The Municipality was most concerned with the remediation of the prior contamination. Its position, consistent with the August 30, 1994 PROFEPA resolution and clarification, was that the company should comply with its legal obligation to remediate the Site and could do so by engaging in non-hazardous industrial waste landfill operations at the Site. Metalclad's position was that it wanted the revenue from hazardous waste operations to finance the remedial work.

134. Although Metalclad had publicly represented in January 1994 that it had 5 million dollars to clean up the Site[122], the company was not able to put up the estimated 3 million dollar cost of remediating the Site[123].

U. Summary

135. In summary, the Claimant has not proven good faith detrimental reliance on exclusive federal jurisdiction. It had full knowledge of the history of the permitting issue and chose to put itself in legal jeopardy by avoiding raising awareness of the issue and simply commencing construction prior to approval. It enlisted the Embassy, without disclosing all the facts, in the expectation that 'top-down' pressure would force the opening of the Site. The Municipality denied the permit for good and valid reasons. That notwithstanding, the Municipality showed

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Footnote continued from previous page

119. Exhibit 28 to the Counter-memorial witness statement of Mr. Sánchez Unzueta.

120. Clause 2.5 of the agreement states that: the parties agreed "that as of the date of signature of this Agreement of Understanding they will cease all current legal actions relating to this problem object of this document (sic), that could put the discussions, the agreement, the protocol or their execution at risk".

121. See (a) Memorial witness statement of Lic. Gustavo Carvajal at pages 15-19; (b) Counter-memorial Witness Statement of Sr. Leonel Ramos at paragraph 12 and Lic. Leonel Serrato at paragraphs 21-29; (c) Reply Witness Statement of Lic. Gustavo Carvajal at paragraph "26-29" and Javier Guerra at paragraphs106-111; and (d) Rejoinder Witness Statements of Leonel Ramos at paragraphs 6-11 and Lic. Leonel Serrato at paragraphs 3-9.

122. See Exhibit 1 to the Counter-memorial.

123. Metalclad published a notice stating that it was "ready to treat and confine...[the contamination]...investing the amount of $5,000,000 to meet these ends...". In the same notice Metalclad stated that it had told the Governor "that this company planned to invest in the State of San Luis Potosí approximately $250 million". Quoted in the Counter-memorial at page 99. As Mr. Dages found in his first report, the company had nowhere near these amounts of money available. In fact, three months before it published this advertisement, Metalclad had to pledge all of its assets to obtain a 2.5 million dollar loan to finance the COTERIN acquisition, which loan had an effective interest rate of 45.5%. Counter-memorial Expert Report of Kevin Dages at paragraphs 7.10-7.

good faith by subsequently engaging in negotiations until January 1997 when they were broken off by Metalclad.

136. The contemporaneous documents show that in the end, the Municipality signed an agreement stating that it was willing to accept the Site's use as an industrial waste landfill and working out a means for jointly determining the level of community support for a hazardous waste landfill. This was hardly the act of an expropriator.

3. The Second "Measure": The 1996 Injunction Against the *Convenio*

A. The *Convenio*

137. The second measure alleged to be a breach of the NAFTA is the injunction obtained in the Municipality's court action aimed at holding the federal government to the terms of its August 30, 1994 Resolution that the Site had to be remediated before new hazardous waste could be accepted.

138. The *Convenio* was an agreement between the Federal Government and Metalclad which set out the conditions for the lifting of the federal closure seals on the Site. Neither the State nor the Municipality was a party. The proposed benefits for the Municipality were not negotiated on the Municipality's behalf; Secretary Carabias characterized them as an offer to the Municipality because "we were seeking consensus-based solutions"[124].

139. As Secretary Carabias testified, the agreement concerned, from the federal perspective, the remediation issue arising from the prior contamination, and the results of the federal audit of that contamination[125]. The Agreement contained a plan acceptable to the federal authorities to carry out that remediation. Contrary to the August 30, 1994 Resolution, the federal authorities now agreed to allow simultaneous remediation and the introduction of new hazardous waste[126].

140. The *Convenio* was not a sufficient authorization to operate. The federal press statement announcing the *Convenio* expressly stated:

> "Finally it is important to clarify that the federal authorities are a necessary requirement, but not a sufficient one, for the hazardous waste landfill operation. The company shall comply with the State legislation in this matter, whose interpretation and application is exclusively within the local authorities' jurisdiction[127]."

141. As shall be argued below, this statement forms part of the context for interpreting the *Convenio*.

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124. Transcript, Vol. I, at pp. 179-180.

125. Transcript, Vol. I, at p. 184.

126. This represented a change in the federal position from the August 30, 1994 PROFEPA administrative resolution.

127. The municipal permit requirement is outlined in State legislation, whose interpretation is exclusively within the Municipality's jurisdiction (subject to judicial review in the state and federal courts).

B. The Injunction

142. The Municipality argued that the *Convenio* was unlawful on the basis that the August 1994 federal resolution and clarification required Metalclad to remediate the Site *before* introducing new hazardous waste to the Site.

143. By administrative resolution of August 30, 1994, federal authorities had authorized the audit of the contamination at the Site. PROFEPA stated, however, that:

> "The introduction to the installation of any type of waste is strictly prohibited until the studies have been completed and the remediation works are carried out that could result from the audit mentioned in point 2 of the technical measures contemplated in Clause III[128]." [Emphasis added.].

144. The State supported the federal authorities' decision to require the Site to be remediated before receiving new waste[129].

145. On October 7, 1994, Metalclad wrote to federal authorities requesting clarification of the August 30th Resolution on this specific point. On November 14, 1994, federal officials responded:

> "...concerning your first request, I would like to clarify that the prohibition imposed as a technical measure in the above-mentioned administrative resolution against the introduction of any type of waste into the confinement until the necessary studies to know the actual status of the site, including the environmental, ecological and public health aspects of the place, have been completed, together with the necessary remediation activities, was the result of the unlawful activity in which the company that you represent incurred and that motivated the temporal shutdown of the confinement for confining hazardous waste before having the necessary permits or authorizations granted by the then competent authorities (1991)...
>
> Accordingly it is ratified that COTERIN shall not introduce any type of waste into the confinement until the prevailing situation of the site is known through the studies referred to and the corrective measures established and such audit are performed. Neither shall COTERIN operate the hazardous waste landfill until the total remediation of the site.[130]"

146. In the proceedings against SEMARNAP, Metalclad was given standing. Metalclad has not alleged nor identified any denial of access, denial of justice or denial of fair and equitable treatment by the Mexican domestic courts in those proceedings.

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128. Exhibit 83 to the Counter-memorial.

129. Letter from Dr. Medellín to the federal authorities expressing State's support for the August 30, 1994 resolution, referred to in the Counter-memorial, paragraph 459.

130. Exhibit 87 to the Counter-memorial.

147. On February 6, 1996, a Federal District Judge agreed to hear the Municipality's petition and granted an interlocutory injunction against the commencement of commercial operations by COTERIN (Metalclad), pending the resolution of the substantive merits of the proceeding.

148. During this time, Metalclad was engaged in another private placement of stock with U.K. institutional investors. Although Metalclad has alleged that the injunction was an expropriation, neither the Municipality's lawsuit against SEMARNAP, nor the issuance of the injunction was disclosed to Metalclad's would-be investors[131].

149. Before this Tribunal, Mr. Kesler attempted to obscure that the injunction had not been disclosed, by testifying that "[r]egrettably, a short time after we completed the February 1996 offering, a Mexican court awarded an *amparo* on behalf of the Community of Guadalcázar"[132].

150. Mr. Kesler's testimony was false. The injunction was granted on February 6, 1994 (and made a definitive interlocutory injunction on February 23, 1996). Metalclad's offering closed on February 28, 1996.

C. The Injunction was Dissolved

151. After several intermediary steps, on May 18, 1999, the Municipality's *amparo* was resolved on its merits and the Municipality's petition dismissed. With dismissal of the *amparo*, the interlocutory injunction granted in 1996 was dissolved and is no longer in effect.

152. During the Hearing, counsel for Metalclad stated that the injunction was still in effect. The dismissal of the *amparo* and dissolution of the injunction are a matter of record in the Mexican courts. The Respondent has complied with the President's direction that no further evidence be submitted. However, should the Tribunal wish to verify the status of the *amparo*, the Respondent can supply a copy of the court's decision.

153. Metalclad abandoned its efforts in respect of the landfill Site at the latest when it filed its Notice of Intent to Submit to Arbitration on October 2, 1996, three years after acquiring the investment. This is much less than the five to ten year timeframe established as usual in siting hazardous waste projects[133].

4. The Ecological Decree

154. The third measure that the Claimant has alleged constitutes a breach of the NAFTA is the Ecological Decree.

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131. At page 3 of his letter to Oakes Fitzwilliams' Mr. Howard Tisshaw, Mr. Kesler stated: "It may be at this point in everyone's interest to back away from the offering long enough to see if the landfill can truly operate at commercial levels safely without opposition and/or the BFI transaction can be concluded successfully." See Respondent's Closing Exhibit 31. Mr. Kesler's letter contradicts his testimony at the Hearing that there was no opposition to the landfill. See Transcript, Vol. V, at p. 138.

132. Second witness statement of Grant Kesler at paragraph 40. This was the offering in which three directors exercised options and sold 950,000 shares to U.K. institutional investors.

133. Williams report at paragraphs 46 and 54.

A. The Timing of the Decree

155. The Decree was promulgated on September 20, 1997, over 9 months after this arbitration was commenced (by the filing of the Notice of Claim on January 2, 1997)[134]. The September 28, 1996 Notice of Intent to Submit a Claim to Arbitration filed three months before the Notice of Claim stated that the investment had already been expropriated.

B. The Effect of the Decree

156. The only direct evidence before this Tribunal on the potential effect of this Decree is a letter from the State Ecology Coordination that the Decree need not affect this investment[135].

157. There is other evidence of the lack of effect[136]. Overall, the purpose of the Ecological Decree was to protect endangered species of cacti. According to the 1995 *Convenio*, the siting of a hazardous waste landfill was consistent with the protection of cacti. Indeed, the Convenio already required changes by Metalclad to its project so that cacti would not be affected by the Site: see the *Convenio*, Clause 5.

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134. Article 1120 of NAFTA permits a claim to be submitted to arbitration "provided that six months have elapsed since the events giving rise to a claim." Referring back to Article 1119, which sets out the procedure for filing a Notice of Intent to Submit a Claim to Arbitration, the would-be claimant must be in a position to identify "the issues and the factual basis for the claim" at the point of filing such a Notice of Intent.

135. Letter of the State Ecology Coordination filed with the Rejoinder at Exhibit 38.

136. The newspaper reports of the Governor's and Dr. Medellín's statements on the effect of the Decree were denied. Transcript, Vol. II at p. 104 and p. 180.

PART III: THE HAZARDOUS WASTE CONTEXT OF THIS DISPUTE

158. The Respondent observed in previous pleadings that a hazardous waste landfill is a very high risk investment[137]. It is useful to review the record evidence so as to have an understanding of the social dynamics that give rise to the narrow legal issues now presented to the Tribunal for decision. As shall be seen, the *ELSI* decision shows that social pressure upon local officials is a legally relevant fact.

1. General Factors

159. The Tribunal has before it extensive evidence as to the universal phenomenon of the NIMBY (the 'Not In My Back Yard') factor. It is illustrated perfectly here; in numerous letters cited in the Counter-memorial, the Municipality recognized the need for hazardous waste disposal facilities but in view of its experience with the contamination, urged that the facility be relocated elsewhere.

160. Mr. Kesler himself admitted the force of the NIMBY factor[138].

161. It is rational human behavior to not want substantial volumes of hazardous waste permanently deposited in one's community. As local resident Juan Romo testified, "They tried to convince me that the hazardous waste landfill was nothing dangerous. I asked them if the waste was not dangerous, why it was being brought to this place?"[139]

162. Litigation, and the delays attendant upon litigation, relating to local opposition are normal risks in the siting of hazardous waste landfill facilities in all three NAFTA Parties[140]. (See the Rejoinder at paragraphs 478-481 on this point.) The resort to litigation and the normal processes of court proceedings are not denials of fair and equitable treatment.

163. All three NAFTA Parties are federal states; they share certain some common characteristics (e.g., the allocation of powers to different levels of government) but vary as to issues of primacy, concurrency, and other matters relating to the interaction of the different levels of their respective governments. The relevant point is that project proponents in all three parties can expect local controls and potentially different points of view at different levels of government.

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137. First Marcia Williams report at paragraph 42. See also the excerpts from the academic literature cited in the Rejoinder at paragraphs 472-474.

138. Rejoinder, paragraphs 476-477.

139. Rejoinder witness statement of Juan Romo at paragraph 6.

140. See Rejoinder Exhibit 30, Michael B. Gerrard, "Fear and Loathing in the Siting of Hazardous and Radioactive Waste Facilities: A Comprehensive Approach to a Misperceived Crisis", 68 Tulane Law Review (May 1994) 1047.

164. In the United States, local governments, through authority delegated by the states, generally have "great power to control the location and operations of facilities within their jurisdictions"[141].

165. An American commentator has written of the U.S. law:

> "There is a paucity of case law discussing the respective rights of local and state governments in the regulation of hazardous waste operations. Despite this, a general trend is evident in judicial resolution of conflicts between local regulations and state permit programs that seems to endorse dual regulatory schemes. Indeed, only one opinion was found in which a court interpreted [the federal law governing disposal of hazardous waste] and the state qualifying plan to implicitly pre-empt local authority to regulate. In that instance, the state legislature quickly responded with legislation to nullify the court's holding... In the only decision to confront the issue of the authority of a local government to require hazardous waste landfill operators to comply with county ordinances, the court found in favor of the county[142]." [Emphasis added]

166. In Canada, the Supreme Court of Canada stated recently:

> "The environment, as understood in its generic sense, encompasses the physical, economic and social environment touching several of the heads of power assigned to the respective levels of government. Professor Dale Gibson put it succinctly several years ago in his article "Constitutional Jurisdiction over Environmental Management in Canada" (1973), 23 U.T.L.J. 54 at p. 85: "... 'environmental management' does not, under the existing situation, constitute a homogeneous constitutional unit. Instead, it cuts across many different areas of constitutional responsibility, some federal and some provincial. And it is no less obvious that 'environmental management' could never be treated as a constitutional unit under one order of government in any constitution that claimed to be federal because no system in which one government was so powerful would be federal."[143]
> [Emphasis added]

167. As noted by Larry A. Reynolds, "Environmental Regulation and Management by Local Public Authorities in Canada"[144]:

> "Legislative authority for environmental regulation and management by local public authorities in Canada may be found in a wide variety of provincial and

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141. Thomas F.P. Sullivan, *Environmental Law Handbook* (14th ed., 1997) at p. 5. Each State determines the extent of power over hazardous waste permitting its localities will wield, and in several States, local governments may reject a facility that has been approved by the federal and State governments: see Gary A. Davis and Mary English, *Statutory and Legal Framework for Hazardous Waste Facility Siting and Permitting* (March 1987), pp. 22-25.

142. Pamela Corrie, An Assessment of the Role of Local Government in Environmental Regulation, 5 UCLA J. Envtl. L.& Pol'y 145, 173 (1986).

143. *Friends of the Old Man River Society* v. *Canada (Minister of Transport)*, [1992] 1 S.C.R. 3, 88 D.L.R. (4th) 1 at 41 (D.L.R.).

144. 3 Journal of Environmental Law and Practice 41 at 50.

territorial legislation. It is submitted that the powers currently available to local public authorities for environmental regulation and management generally fall within one or more of six categories: 1. environment powers: 2. public health powers; 3. planning and zoning power; 4. business licensing and regulation powers; 5. dangerous substances powers; and 6. plenary powers."

168. Mr. Reynolds also points out at p. 72:

"...business regulation and licensing powers may be sufficiently broad to allow municipalities to regulate those businesses which may have a negative impact upon the environment."

169. An experienced American practitioner, Michael Gerrard, has written of the effects of local opposition in the U.S. experience:

"Despite scores of siting attempts and the expenditure of several billion dollars since the mid-1970's, only one radioactive waste disposal facility, only one hazardous waste landfill (in the aptly named Last Chance, Colorado), and merely a handful of hazardous waste treatment and incineration units are operating in the United States today[145]." [Emphasis added]

170. The Tribunal can take note of the fact that the hazardous waste industry is high risk with a characteristically high rate of failure and completely foreseeable risks of litigation and opposition.

2. Pre-investment Aggravating Factors

171. In 1991-92, COTERIN deceived the local community as to its intentions. The initial drilling was described as intended to see if there was sufficient water to grow tomatoes at La Pedrera[146].

172. COTERIN then dumped some 55,000 barrels of hazardous waste at the Site. It was buried without proper separation and treatment and, as the audit found, the Site is seriously contaminated[147]. Even at the Hearing, Mr. Kesler maintained that there was no real contamination and no real opposition[148]. Yet the audit report signed by COTERIN proves the opposite with respect to the contamination[149] and the company's own securities documents

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145. Rejoinder Exhibit 30, Michael B. Gerrard, "Fear and Loathing in the Siting of Hazardous and Radioactive Waste Facilities: A Comprehensive Approach to a Misperceived Crisis", 68 Tulane Law Review (May 1994) 1047 at 1051.

146. Counter-memorial witness statement of Salomon Ávila Pérez at paragraph 2, the statement of Juan Carrera at paragraph 4, and the witness statement of Hermilo Méndez at paragraph 5.

147. As noted in the Rejoinder, at footnote 40, p. 21, there is approximately the same volume of waste buried at La Pedrera as at Love Canal, New York, the site that led to the enactment of the Superfund Act in the United States.

148. Transcript Vol. V at pp. 195-196, at p.226 and pp. 236-237.

149. Exhibit 98 to the Counter-memorial; quoted in Counter-memorial at paragraph 509.

disclosed public opposition to the project[150]. Mr. Kesler himself wrote of the opposition in a letter to Oakes Fitzwilliams just before the February 1996 stock offering in the UK.: "It may be at this point in everyone's interest to back away from the offering long enough to see if the landfill can truly operate at commercial levels safely without opposition..."[151].

173. Marcia Williams' report noted that these previous acts and the residents' responses thereto gave rise to a "community relations deficit" when Metalclad took over COTERIN[152].

174. In addition, there was a reasonable and legitimate basis for concerns about human health and safety. In 1991, the UASLP Faculty of Medicine did a study of the health risks created by La Pedrera[153].

175. On May 16, 1992, for example, a local newspaper carried a statement from the President of the Technical Advisory Council of the Agrarian Communities and Peasant Unions League of the State in which he stated that: "People have complained about loss of hair, serious skin irritation, illness and vomiting according to those living in the region"[154].

176. Juan Romo was the resident of El Entronque (what Metalclad calls one of the "micro-communities" situated near the Site) who testified as to his meeting with Governor Sánchez Unzueta where he presented his encephalitic infant. Mr. Romo testified that around the time that she was born, three other children were born with the same condition[155]. It is fully understandable how four severe birth defects could occasion concern in the area.

177. Metalclad's own advertisement published in January of 1994 spoke of the "great risk to the inhabitants, flora, fauna of the area"[156] posed by the contamination now downplayed by Mr. Kesler[157]. The prior contamination was the reason why Board member Borner advised against the investment.

178. Although Metalclad is not directly responsible for the actions of the previous owners of COTERIN, the pre-investment circumstances are relevant to demonstrating the reasonableness of the municipality's attitudes towards the project. They also show that Metalclad would not have

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150. Metalclad's September 1994 Offering Memorandum at p. 5 states:

> "...there can be no assurance that public opposition to the operation of El Confin will not have a material adverse impact on its proposed operations and governmental support".

Exhibit 46 of Mr. Neveau's cross-examination materials, reviewed with Mr. Neveau during cross-examination.

151. Letter dated January 17, 1996. Exhibit 31 to the Respondent's Closing Argument. Exhibit 5 to Mr. Kesler's third statement, filed July 30, 1999.

152. Marcia Williams' Rejoinder report at paragraph 18.

153. See Counter-memorial at paragraph 214.

154. See Counter-memorial at footnote 160.

155. Rejoinder Witness statement of Juan Romo at paragraph 9.

156. See Counter-memorial at paragraph 348.

157. Transcript, Vol. V, at p. 226.

had a reasonable expectation of being able to quickly open a hazardous waste landfill at a contaminated site.

179. The Respondent wishes to point out that during his opening, Mr. Pearce asserted that the La Pedrera Site was chosen by the federal government, the implication being that the Claimant was instructed to develop and operate at this Site:

> "It was chosen by federal environmental officials in conjunction with San Luis Potosí State officials to solve the problem that had arisen with the Mexcatigue (ph) San Luis Potosí landfill"[158].

180. Mr. Pearce did not refer the Tribunal to any record evidence on this point and the only evidence that could support such an assertion comes from Mr. Rodarte's first statement (which is unclear on the point)[159]. The record evidence does not support his claim.

181. The more prosaic and compelling evidence on the record is that of Salvador Ávila Pérez, the municipal president in 1991, who testified that:

> "...I did not know of any such project for that site, however, as it belonged to a very entrepreneurial friend of mine, José Humara, I thought it was a development project, perhaps a mill. Afterwards, I learned that my friend had passed away intestate, and that his widow, Ms. Paulina, had inherited the site and sold it to the Aldrett León family."[160]

182. This account is corroborated by the testimony of R ne Altamirano, who testified:

> "...Mr. Aldrett requested that the federal authority, support him in establishing a new hazardous waste landfill at the site that he owned, known as La Pedrera."[161]

3. Post-investment Aggravating Factors

183. After purchasing COTERIN, although the Site was subject to a federal shut-down order and the Municipality had not been consulted, Metalclad published advertisements and news stories stating that its 'San Luis Potosí facility' would be opening soon[162]. Its Form 8-K filed with the SEC on October 7, 1993 stated that: "The company anticipates commencement of operations at the landfill in the first quarter of calendar 1994"[163]. (Note, the landfill had not even been constructed, the municipal permit remained unresolved, and a federal shut-down order was in place.)

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158. Transcript, Vol. I at p. 27.

159. Memorial witness statement at page 2.

160. Counter-memorial witness statement at paragraph 2.

161 Counter-memorial witness statement at paragraph 4.

162. See Counter-memorial at paragraphs 344-345.

163. Form 8-K dated October 7, 1993. See Mr. Dages' first Report at p. 2.

184. Metalclad belittled the technical objections to the Site as having no reasonable basis. Yet, the videotape of a meeting with local professors —withheld by Metalclad until the Tribunal ordered it to disclose it— shows Messrs. Rodarte and Deets admitting in January 1994 that the technical studies that were commissioned for the Federal Environmental Impact Study were poor and at best barely adequate[164]. It was reasonably foreseeable that this admission by company officials would be communicated to others in the local community.

185. In January 1994, Metalclad publicly announced that it recognized that "the consensus of the population of Guadalcázar is required in order to be able to construct and operate such a facility..." and the need to "observe any... municipal requirements"[165]. Yet after its June 13, 1994 proposal was rejected by the *Ayuntamiento*, it instructed local counsel not to apply for the permit and simply proceeded with construction.

186. After the second shut down order was issued, the company applied for the permit and then expedited completion of construction during the transition in Municipal administrations.

187. Metalclad made a very poor choice in employing Mr. Humberto Rodarte as its consultant and liaison with the State and local officials. As Metalclad's own witness Anthony Talamántez testified, at the March 10, 1995 demonstration, the protesters called for Mr. Rodarte, accusing him of accepting kickbacks[166]. (The demonstrators were right.) As former Municipal President Salomón Ávila testified, Mr. Rodarte was seen as one of the individuals who was associated with the contamination in the first place[167]. His representation of the company was hardly calculated to build trust with the local community.

188. Mr. Rodarte also verbally attacked Dr. Medellín after the January 28, 1994 meeting with the Governor[168]. This act could not have contributed to building a good relationship with the State.

189. Mr. Rodarte's attack of Dr. Medellín —an act which Mr. Neveau agreed took place[169]— is particularly cogent circumstantial evidence that supports the testimony of former Governor Sánchez Unzueta, Dr. Medellín, Mr. Abella, Lic. de la Garza and Lic. García Leos that the main points made by the Governor at the meeting was that Metalclad should move to another site with the State's assistance because of the social opposition to La Pedrera.

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164. Metalclad refused to disclose this evidence until so ordered by the Tribunal on April 27, 1999. See the transcript of the videotape included in the cross-examination exhibits of Grant Kesler.

165. Exhibit 2 to the Counter-memorial.

166. Reply witness statement of Anthony Talamentez at paragraph 6.

167. Counter-memorial Witness statement of Salomon Ávila Pérez at paragraph 6.

168. See the statements of Messrs. De la Garza, García Leos, and Abella all filed with the Rejoinder..

169. See Transcript, Vol. VII, at pp. 96-97.

190. If the meeting had gone as well as Metalclad's witnesses have claimed. why did Mr. Rodarte attack Dr. Medellín that night? His act does not comport with the claims that strong expressions of support for La Pedrera were given by the Governor at that meeting[170].

191. In March 1995, the company published notices announcing commencement of commercial operations even though the audit was not complete, the Site was still shut down by federal order, and the municipal permit remained unresolved[171].

192. The narrow legal issues cannot be decided in isolation of the facts peculiar to this type of industry, to this Site, and to this Claimant (which at the end of the day was run by Messrs. Kesler and Neveau, two individuals with no prior experience in this business and whose background was in the areas of stock financing and commercial real estate development in California).

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170. This was addressed in Mr. Neveau's cross-examination. Transcript, Vol. VII, at p. 98. The cross-examination took Mr. Neveau to the letter from Metalclad's local counsel sent shortly after the meeting urging the company not to use Mr. Rodarte in dealings with the State.

171. Transcript, Vol. V, at p. 31.

PART IV: THE RELEVANCE OF MEXICAN DOMESTIC LAW

193. Questions of Mexican law have arisen in this proceeding. The Claimant spent considerable time cross-examining lay witnesses on their views of the interpretation of fine points of law, even when the witnesses stated that they were not professionally qualified to testify on those issues[172]. It did not call any of the experts on Mexican law who filed reports[173] or Lic. García Leos or Lic. de la Garza, who testified as to the advice given to Metalclad. (The latter was excused after he attended to Washington.)

194. As discussed further below, the Respondent did not call the Claimant's "expert" for cross-examination because the factual premises of the Centro Jurici reports were not made out (see paragraphs 208-216 below). Moreover, the individual tendered as an expert lacks the necessary credentials[174]. He does not have a license (*cédula profesional*) that authorizes him to opine on or practice Mexican law. The Tribunal will recall that he assumed the role of acting as a an unofficial interpretation checker in the Hearing.

195. While at international law issues of domestic law are issues of fact, they do not fall within the same category as other issues of fact. International tribunals exercise caution and restraint on matters of interpreting domestic law[175].

196. Although made in the context of discussing the international review of a municipal court decision, the observation of Eduardo Jiménez de Arechaga is apposite to this Tribunal's examination of the domestic law:

> "It is not for an international tribunal to act as a court of appeal or of cassation and to verify in minute detail the correct application of municipal law. The essential business of an international tribunal in these cases is to see whether gross injustices have been committed against an alien and, if so, whether the three indicated requirements are present. The angle of examination is different from that of an appeal judge: it is not the grounds invoked by the domestic tribunal which must be scrutinized, but rather the result of the decision which must be evaluated, taking into account the elements of justice and equitable consideration[176]."

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172. For example, Secretary Carabias noted this on 6 occasions. See Transcript, Vol. I, at p. 70, p. 71, p. 100, p. 102, pp. 161-162.

173. Lic. Ulises Schimill Ordóñez, Lic. Carlos de Silva and Dr. José Ramón Cossío Díaz; and Dr. Sergio López Ayllón.

174. Mr. Eaton's resume was included as Memorial Volume 1, Exhibit 34.

175. See the Rejoinder at paragraphs 535 – 538.

176. *Supra* note 7 at p. 282.

1. Questions of Mexican Domestic Law are Questions of Fact for This Tribunal

197. Although the legal correctness of a measure under domestic law is only a factor in determining whether the Respondent has complied with its NAFTA obligations[177], this Tribunal has inquired into domestic legal issues.

198. This Tribunal has been directed to the following sources of Mexican domestic law:

1) direct reference to constitutional principles and legislative provisions;

2) expert opinions;

3) the specific legal advice given to the Claimant, noted above; and

4) the findings of the local courts, noted above.

199. The latter two sources will not be repeated here.

2. Constitutional Principles

200. The Mexican Constitution is the supreme law of Mexico. It sets out the basic structure of the Government, and it principal powers and duties. It is a fundamental principle of legal order that the rest of the legislation must conform to the constitutional provisions. No federal or state law can modify constitutional provisions; rather, federal or state law shall be construed in accordance with the Constitution (Article 133 of the Mexican Constitution).

201. Thus the provisions of the Ecological Balance and Environmental Protection General Act stipulating the role of the federal government in the siting of a hazardous waste landfill cannot, constitutionally, restrict or annul constitutional powers granted to the Municipality to issue or deny construction permits and to control and supervise the use of land within municipal territories[178].

202. The Constitution requires States to organize themselves into municipalities. Municipalities constitute the basic territorial, political and administrative organization of States. Municipalities are governed by representative, democratic, elected bodies of government: the *Ayuntamientos*. The three levels of government, federal, State and municipal, exercise their powers autonomously (Art. 115, first paragraph, of the Mexican Constitution)[179].

203. The Constitution directly confers a number of powers on municipalities in furtherance of their representative and autonomous nature as the political organ closest to the local community situated within their territorial bounds. One such power is the power to issue construction permits. Another power is the power to control and supervise the use of land within their own

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177. *ELSI*, paragraph 73.

178. Thus, the transitional provisions of the General Law of Ecological Balance and Environmental Protection cannot alter the constitutional powers of the municipalities; federal law cannot amend the Constitution.

179. These provisions are also contained in article 114, V, of the San Luis Potosí Constitution.

territories (Article 115, V, of the Mexican Constitution). (Mr. Carvajal testified that the municipalities structured themselves under the Constitution and "in the majority of them, the municipalities have it committed for environment)"[180].

204. The Tribunal should note that the Mexican Constitution does not confer exclusive jurisdiction on the federation in matters concerning hazardous waste. Article 73, section XXIX-G of the Constitution, empowers the Federation to enact laws for the protection of the environment and preservation and the restoration of the ecological balance, that provide for the concurrence of the federal, state and municipal governments, within their respective jurisdictions. There is no exclusive jurisdiction vested in the federation as a matter of constitutional law, but rather a delegated authority on the General Congress.

205. It is the Ecological Balance and Environmental Protection General Act, a secondary law, that grants the federation jurisdiction over hazardous waste matters. This authority is limited to the approval of the environmental impact statement and risk assessment studies, and is by no means absolute. It is subject to the powers that are expressly vested in the federation, states or municipalities by Mexican Constitution. Indeed, Article 4 of the Ecological Balance and Environmental Protection General Act provides that "The Federation, the States, the Federal District and the Municipalities shall exercise their powers regarding the protection of the environment in accordance with the distribution of powers provided for in this Act, and other legal instruments".

206. The Federal Congress, although authorized to legislate from a national perspective on hazardous waste, as it did by enacting the Ecological Balance and Environmental Protection General Act, cannot affect the constitutional authority of municipal governments. Federal law must be construed in accordance with the Constitution. The role of federal environmental authorities in approving a hazardous waste landfill proposal from the national perspective cannot be construed to supersede the municipal constitutional authority to issue and deny construction permits. The federal and municipal requirements are parallel, not primary and secondary. Each requirement is necessary, none is sufficient.

207. Municipalities do not have direct legislative powers and, therefore, States (the repository of all powers not otherwise expressly granted by the Constitution) are generally empowered to enact laws applicable at the municipal level, in furtherance of their obligation to organize themselves into municipalities (the federation may, within its sphere of competence, also enact laws applicable at the municipal level). Thus, the details of municipal construction permitting requirements (when required, how obtained and sanctions for failure to obtain) are found in State legislation: The Ecological and Urban Code of the State of San Luis Potosí chiefly, but also the Municipal Organic Act of the State of San Luis Potosí, the Environmental Protection Act of the State of San Luis Potosí and the Treasury Act for the Municipalities of the State of San Luis Potosí. The relevant provisions of the Ecological and Urban Code are set out below.

208. When Secretary Carabias, who noted six times that she was not a lawyer, but was cross-examined on a number of legal issues[181], testified that a Municipality would not be empowered to

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180. Transcript, Vol. VI, at p. 33. He admitted that during the administration of Juan Carrera, an Ecology Committee was formed; he was also directed to the testimony of Hermilio Méndez, who served as the Ecology *Regidor* in the prior administration. [At pp. 33-37.]

revisit federal environmental decisions that had already approved a hazardous waste facility, she was testifying about federal environmental assessment and correctly pointed out that the Municipality has no power to overturn the federal approval of an environmental impact study. But at the same time, her testimony as a whole and the specific provisions of law made clear that even federally approved projects required and obtained local approval and that the Municipality had the power to consider the impact of such projects from its perspective, including the impact on the life conditions of the inhabitants, the ecological context, and the other factors specified in the State Ecological and Urban Code.

3. Mexican Legislative Provisions: Specific Legislation Regulating the Granting of Municipal Construction Permits

209. As noted below, the relevant provisions of the law requiring municipal construction permits are "public order" provisions. An elected council making a decision on the public interest will identify and weigh a variety of considerations: the demands of the various interested parties, the advice of any experts it may have, data from research resources, etc. It will also undoubtedly be influenced by the preferences expressed by the electorate. What an elected council decides is necessarily its collective perception of the public interest.

210. The Ecological and Urban Code of San Luis Potosí provides when municipal construction permits are required, how they are applied for and the sanction for non-compliance, as follows:

5) Art. 1 - The provisions of this Code are of public order and of social interest and their objective is to regulate:

IV. the use of ... municipal constructions...

6) Art. 5 - The Executive of the State and the *Ayuntamientos* are empowered to establish restrictions to the use of land and to any kind of construction as required by urban development and ecological balance within the state territory.

7) Art 13. - The *Ayuntamientos* in the State shall have, within the scope of their respective jurisdictions, the following powers:

XII. to grant construction municipal licenses and to supervise the conduct of all works or construction performed within its jurisdictional territory.

8) Art. 31 - The following definitions are provided for the purpose of this title and Code:

XIV. Uses that Produce Significant Impact.

Footnote continued from previous page

181. *Supra*, note 171. The Respondent observes that during his closing speech, Mr. Pearce was quick to qualify Mr. Deets' interpretation of the State Land Use Permit: "he may have already said once or twice that he wasn't a lawyer" (Transcript, Vol. VIII, at p. 36). However, this did not stop Mr. Pearce from selectively quoting Secretary Carabias' testimony notwithstanding her repeated disclaimers that she was not qualified to testify as to legal matters.

The uses that produce significant impact are constructions and facilities destined for industrial, commercial or residential uses that because of their dimensions, infrastructure, transportation needs or potential contamination, may severely harm the life conditions of the inhabitants, the urban, ecological and landscape context, as well as the regular operation of the services.

9) Municipal Construction License

Art. 63 - Cases in which the construction license is required.

The municipal construction license shall be required to:

I. Perform a new construction ...[Emphasis added]

211. The Treasury Law for the Municipalities of the State of San Luis Potosí provides:

Art. 17 - The licenses, permits, certificates [MR1]or titles [MR2]issued by the municipal authorities shall be valid for the corresponding fiscal year and for the exclusive use of the persons, places, activities or business to whom they were granted. The municipal authorities are empowered to revoke them for [MR3]on for public utility, social interest reasons or on the basis of serious and justified causes.[MR4][Emphasis added]

4. Expert Opinions

A. The Centro Jurici ("CJ") Reports Filed by the Claimant

212. It is a rare occurrence when a person tendered as a expert denies having signed the report. Yet that is what Mr. Eaton did during the course of the Respondent's closing[182]. Mr. Eaton co-authored two reports; both are signed by him and the Executive Summary to the first is authored by him[183]. As a 1994 graduate of the University of Arizona, it is questionable whether Mr. Eaton would qualify as an expert on U.S. law. Mr. Eaton is not authorized to opine on Mexican law and, the Respondent submits, the other signatories to the report should also be considered to be unqualified for the reasons stated below[184].

213. Both CJ Reports read not as opinion but rather as argument and their premises either have not been established in the evidence or have been proven false.

214. The first premise which has not been established is the assumption on CJ's part is that the federal government "acting through various functionaries", assured Metalclad on several occasions that COTERIN could lawfully operate the landfill simply by complying with the

182. Transcript, Vol. IX at p.147. Mr. Eaton is one of three signatories to the reports.

183. See Memorial Volume I, Exhibit 34.

184. Mr. Eaton's resume is an Exhibit to the Memorial. It states that he graduated with a J.D. from University of Arizona in 1994 and was doing his Masters at the ITESM at the time of the reports' writing. Yet he informed the Tribunal during the Respondent's closing that he did not sign them. See Transcript, Vol. IX, at p. 147.

federal requirements[185]. Reference to the 'without prejudice' clauses in the federal permits issued by Mr. Altamirano should have raised questions in the authors' minds about that assumption.

215. Second, the first CJ Report describes the State Land use permit as "of special significance because it demonstrates the State's clear intention to allow COTERIN to operate the landfill"[186]. It is obvious that CJ did not read the State land use permit because the permit states on its face that it does not authorize construction or operation of the facility[187]. Also, while arguing federal primacy, the CJ fails to explain why a state land use permit would be required, and why the Claimant acquiesced and, in fact, submitted to the jurisdiction of the state insofar as the land use license is concerned.

216. Third, the first CJ Report incorrectly states that "it was only when Metalclad (through its subsidiaries) acquired a controlling interest in COTERIN that the State Government sought to impose additional permitting requirements"[188]. As noted above, in 1991, when COTERIN was controlled by Mexican investors, the same permitting requirement was imposed by the Municipality, a fact admitted by Metalclad in the Reply but apparently withheld from CJ when it was instructed as to the facts.

217. Fourth, another false premise of the second CJ Report is reflected in CJ's argument that prior to 1996, "[t]he labyrinth of environmental impact red tape prior to 1996 made it reasonable to believe that an entity acting in good faith, making every possible effort, might not have known that certain permits were required"[189]. [Emphasis added]

218. It is now known that contrary to its legal advice, Metalclad deliberately decided not to apply for the municipal construction permit, preferring to ignore the issue rather than raise it to a level of awareness in September 1994. This fact too was apparently withheld from the CJ.

219. The September 9, 1993 amended option agreement also shows that the CJ was falsely instructed that Metalclad did not know of the municipal permit issue when it did due diligence[190].

185. First Report at p. 10.

186. Ibid. at p. 11.

187. Memorial, Exhibit 7, State land use license (General statements, item 1).

188. Ibid.

189. "Lack of Clarity in Mexican Environmental Legislation in the Period of Transition: 1988 to 1996" at p. 8. This Report is also signed by Mr. Eaton.

190. Ibid. at p. 8.

220. Finally, the first CJ Report argues in favor of federal primacy on the basis of an alleged principle of Mexican law that a special or specific rule prevails over a conflicting general provision. However, it does not address the supremacy of the Constitution over legislative enactments. Nor does it address the concept of parallel jurisdictions that is fundamental to Mexican constitutional law[191].

B. The Opinions Filed by the Respondent

221. Two legal opinions were filed by the Respondent. The first, prepared by the Institute of Legal Research of the Autonomous University of Mexico (UNAM), opines that in order to establish a hazardous waste facility it is necessary to obtain:

1) two federal authorizations (an environmental impact authorization and an authorization to establish and operate);

2) a land use license issued by the State executive;

3) a construction permit issued by the competent municipal authorities, which is the *Ayuntamiento*, elected by the residents of the Municipality[192].

222. The second legal opinion by three former Justices of the Mexican Supreme Court, Dr. Ulises Schmill Ordóñez (a former Chief Justice), Lic. Carlos de Silva Nava and Dr. José Ramón Cossío Díaz, confirms the first and also examines the scope of the power of municipalities to grant, deny or revoke construction permits[193].

223. This opinion notes that the applicable provisions of the Ecological and Urban Code of the State of San Luis Potosí are provisions of "public order and of social interest". In addition, it states that municipal authorities are expressly empowered to revoke construction permits for reasons of "public utility, social interest or serious and justified causes".

224. The weight of the qualified expert evidence supports the Municipality's view that it had the authority to review the project's impact on the local environment, health and safety concerns, previous unauthorized conduct of the applicant, and the social interests of the Municipality as evidenced by residents' opposition.

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191. The Respondent notes that in closing argument, Mr. Pearce asserted that Article 5 of the General Law "specifically establishes hazardous waste as the exclusive jurisdiction of the federal government", Transcript, Vol. VIII, at p. 7. The Respondent wishes to point out that the word "exclusive" is not used in Article 5.

192. Legal Opinion of the Insituto de Investigaciones Jurídicas de la UNAM Regarding the Federal, State and Municipal Legal Requirements Applicable to the Establishment of a Hazardous Waste Disposal Facility in the State of San Luis Potosí; Counter-memorial, Annex Eight, p. 15.

193. Opinion Submitted by the Attorneys at Law, Ulises Schmill Ordóñez, Carlos de Silva Nava, and José Ramón Cosío Díaz with regard to a consultation requested by SECOFI; Counter-memorial, Annex Seven, pp. 11-16.

225. The Municipality's practice with respect to hazardous waste facilities shows that it asserted and exercised this jurisdiction when presented with the original project in 1991[194].

226. Whether the elected councilors were right or wrong in 1991 or 1995 in their conclusion as to the impact of this project on the municipal environment is not the issue. As the *ELSI* case shows, even if the Council's view of its jurisdiction was incorrect under domestic law, that is not necessarily evidence of arbitrariness.

227. *ELSI* also recognized the relevance of social pressures on local elected officials. The evidence shows that there was local opposition and the Council, an elected body which Mr. Kesler agreed, was elected to represent the interests of its constituents[195], was in the best position to evaluate the strength of such pressure.

228. However, the Municipal Council went further than simply relying upon its own sense of the sentiments of the populace: In the *Acuerdo*, at clause 1.5, the Council and Metalclad agreed that for the landfill to operate, it was necessary to have the support of most of the population. Therefore, the *Acuerdo* set forth a three step process for consulting the community. Mr. Carvajal agreed that the "community" meant, in this context, the totality of the community[196], and not just the "micro-communities" that surrounded the Site. Metalclad abandoned this three-step process in favor of this arbitration.

229. Metalclad's response throughout this proceeding has been to assert that the micro-communities surrounding the Site supported the project. The Respondent has not disagreed that some local residents wanted the landfill for the employment it would provide. It notes, however, that Metalclad's internal documents show that the landfill would employ far fewer people than the number of people used to construct it (one Metalclad document, apparently prepared for investors, listed the number of workers at only 33)[197].

230. Moreover, Metalclad's claim of widespread support in the micro-communities is contradicted by the witness statements of Praxedis Palomo of the *ejido* of Los Amoles[198], Juan Romo of the *ejido* of El Entronque[199], Rogelio Orta of Los Amoles[200], Leonel Ramos (who testified that he consulted with leaders of the *ejidos*[201]), and Father Aurelio Romo, the Priest of Guadalcázar[202].

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194. Its practice with respect to minor construction is irrelevant because such construction can not have a major impact on the Municipality.

195. Transcript, Vol. V, at pp. 182-183.

196. Transcript, Vol. VI, at pp. 50-51.

197. Counter-memorial at paragraph 416.

198. Rejoinder witness statement at paragraphs 2-6.

199. Rejoinder witness statement at paragraphs 2 and 7.

200. See the whole of his Rejoinder witness.

201. Transcript, Vol. III, at p.48.

202. Rejoinder witness statement at paragraphs 3, 7, 11, 14 and 17.

PART V: LEGAL SUBMISSIONS

1. The Governing Law

231. The Tribunal's jurisdiction is to decide any claims properly before it in accordance with the governing law as set out in Article 1131:

> "A Tribunal established under this Section shall decide the issues in accordance with this Agreement and applicable rules of international law.

2. The Scope and Coverage of NAFTA

232. The Tribunal asked whether the Government of Mexico could be internationally responsible under the NAFTA for the acts of its States and local governments.

233. The Respondent did not plead that the acts of the Municipality were not covered by the NAFTA. It was, and remains, prepared to proceed on the assumption that the normal rule of state responsibility applies; that is, that the Respondent can be internationally responsible for the acts of state organs at all three levels of government.

234. It was only because of the Tribunal's question that the Respondent revisited this point.

235. By its express terms, Article 105, entitled "Extent of Obligations", makes the NAFTA expressly apply to the first level of sub-national government and does not go further. Rather than expressly stating that the Parties "shall ensure that all necessary measures shall be taken to give effect to the provisions of this Agreement... by state, provincial and local governments"[203], as stated in the Canada-US Free Trade Agreement, and thereby confirming that the normal rule of state responsibility applied fully, Article 105 specified federal and first sub-national levels of government only.

236. Reference must also be made to Article 201.2, which states:

> "For purposes of this Agreement, unless otherwise specified, a reference to a state or province includes local governments of that state or province."

237. According to this provision, where the NAFTA expressly refers to a state or province, then the reference is said to include local governments within the state or province, unless otherwise specified. Article 105 itself does not refer to a "state or province" but rather to "state and provincial governments". However, other provisions of the NAFTA, such as Article 1102, do use the words "state or province".

238. Taken together, the two provisions could be read to mean where the NAFTA uses the term "Party", that term is to be taken to include a Party's federal government and also its state or provincial governments, as the case may be. However, if the relevant provision of the

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203. Canada-U.S. Free Trade Agreement Article 103.

Agreement does not refer expressly to a state or province, the provision could be taken to extend only to the first level of sub-national government.

239. After the Hearing, the Respondent found that the US Executive Branch has stated that its view was that, in general, NAFTA did apply to local governments "with significant exceptions"[204]. The Statement of Administrative Action (SAA) is not particularly clear on why the Executive thought so:

> "NAFTA Article 105 is virtually identical to Article 103 of the United States-Canada Free Trade Agreement ("CFTA") and builds on language in GATT Article XXIV:12. It makes clear that state, provincial and local governments must, as a general rule, conform to the same obligations as those applicable to the three countries' federal governments, subject to the same exceptions[205]."

240. As the excerpts from the relevant agreements cited above show, the assertion that FTA Article 103 and NAFTA Article 105 are "virtually identical" is wrong. The former expressly extended the FTA's coverage to local governments; the latter expressly reaches only the state and provincial government level.

241. The Respondent found another statement by the U.S. Executive in response to a question from a Member of Congress. The letter, from US Trade Representative Michael Kantor, discusses federal and state measures. He states:

> "Article 105 is intended to ensure that the federal government in each of the three NAFTA countries is fully accountable for any state or provincial measures covered by the agreement[206]."

(As it is lengthy, the relevant excerpt is reproduced in Annex 3.)

242. Pursuant to Article 201, the Respondent reviewed the NAFTA for express references to "a state or province". It found that the Agreement makes such references in each of the national treatment obligations: Articles 301 (for goods), 1102 (for investment), 1202 (for services), and 1405 (financial services).

243. Article 1108.1 is a "grandfathering" article that excludes governmental measure at all three levels from certain Chapter Eleven obligations. It can be read as suggesting that since local governments are listed in the hierarchy of non-conforming measures to Articles 1102, 1103, 1106, and 1107, therefore those obligations apply. However, the structure of Article 1108 seems to be a drafting convention used by the negotiators; it is used in each of Chapters Three, Eleven, Twelve and Fourteen. In light of the text of Article 105, it would seem a rather oblique way to submit local governments to all obligations set forth in Chapters Three, Eleven, Twelve and Fourteen.

244. It may not be necessary for the Tribunal to decide this issue, given that the facts of this case do not give rise to international responsibility even if municipalities are fully covered.

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204. Legislative History, House Report No. 103-361(1) at page 18.

205. NAFTA Statement of Administrative Action at pp. 132-133.

206. NAFTA Implementation Act, Legislative History, House Report No. 103-361(I), p. 132.

3. Expropriation

245. The Claimant has alleged that the acts complained of constitute a breach of Article 1110.

246. Article 1110 covers three forms of governmental action:

1) "direct nationalization or expropriation";

2) "indirect nationalization or expropriation"; and

3) "a measure" (singular) "tantamount to nationalization or expropriation".

247. Unlike its regional predecessor, the Canada-U.S. Free Trade Agreement, the NAFTA uses the word "measure" in the singular. The FTA used the phrase "any measure or series of measures tantamount to an expropriation"[207]. Although the Respondent addresses the "totality of the circumstances" argument, the deletion of the words "or series of measures" indicates the drafters' intention to exclude the possibility of cumulating a set of actions in order to find an act tantamount to expropriation[208]. Article 1110 focuses on a single measure that is, according to the plain meaning of the word tantamount, equivalent to nationalization or expropriation.

248. Article 1110 is informed by the rest of the NAFTA, including Article 1114, which permits a Party to adopt, maintain, or enforce any measure otherwise consistent with Chapter Eleven that it considers appropriate to ensure that any investment activity in its territory is undertaken "in a manner sensitive to environmental concerns". The term "environmental concerns" is undefined and is subjective (note the self-determining nature of the power recognized by the words "that it considers appropriate").

249. If the Tribunal finds that the NAFTA extends fully to the municipal level, it will find the following statement of the US Executive to be of particular applicability to the facts of this case. The US Statement of Administrative Action states:

> "It is important to note that neither Article 105 nor any other provision of the NAFTA imposes any obligation on states, provinces or municipalities to adopt or conform with federal government standards or to refrain from setting higher levels of protection for human, animal or plant health or the environment than those imposed under federal law or to refrain from modifying their health or labor standards[209]."

250. The words "nor any other provision of the NAFTA" must, in the U.S. authorities' view, extend to the whole of Chapter Eleven.

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207. Article 1605 of the FTA (a copy of which was provided to the Tribunal members during the Closing).

208. The President asked whether the French version of the FTA used the same phrasing. Counsel undertook to inform the Tribunal what the French version stated. It can advise that that text uses the same phrasing: "...ni adopter une m sure ou une s rie de m sures equivalent a l'expropriation du dit investissement..."

209. Statement of Administrative Action, contained in message from the President of the United States Transmitting the North American Free Trade Agreement, at p. 5.

A. The Meaning of "Tantamount to" Expropriation

251. The dictionary meaning of the word "tantamount" is "equivalent". The equally authentic Spanish and French versions of the NAFTA use the word "equivalent" (see Article 2206).

252. The Respondent submits that for a NAFTA tribunal to find that a measure is tantamount to expropriation, that measure must be equivalent to expropriation in all material respects.

253. Although the word 'tantamount' has not received much discussion, the concept appears to dated back to a recommendation from the New York City Bar Association to the U.S. Senate Committee on Foreign Relations where it was suggested that there should be a definition of a taking that would include "...measures which, though falling just short of the seizure of the full title to the property, effectively deprive its owner of the use and enjoyment thereof, for example, the appointment of a custodian"[210]. [Emphasis added]

254. The Respondent notes that vested property rights are contemplated and that the deprivation effected by such a measure is total —all economic use and enjoyment of the property is taken, not just an optimal economic use.

B. The Applicability of the Jurisprudence of the Iran-U.S. Claims Tribunal

255. The Claimant relies heavily on awards rendered by the Iran-U.S. Claims Tribunal. During closing, it was noted that the Iran-U.S. Claims Tribunal had a broad jurisdiction to consider "expropriation or other measures affecting property rights"[211].

256. Some of that tribunal's awards have found that deprivation of property rights constituted "a lesser form of interference" than expropriation. The cases of *Eastman Kodak Company*[212] and *Foremost Tehran*[213], for example, found a deprivation based on "measures affecting property, although the level of interference established did not rise to the level of a taking"[214]. Although the claims advanced were expropriation claims, two Chambers decided they could consider a claim of deprivation because "a claim for expropriation must be taken to include a claim for a lesser degree of interference with its rights"[215]. Similarly, in *Seismograph Service Corporation*,

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210. Hearings Before the Senate Committee on Foreign Relations on Executives E, G, and H, 84th Cong., 2nd Sess., 15 (1956).

211. Article II, paragraph 1 of the Claims Settlement Declaration.

212. *Eastman Kodak Company, et al. v. The Government of Iran, et al.*, 17 Iran-U.S. C.T.R. 153 and 27 Iran-U.S. C.T.R. 3.

213. *Foremost Tehran Inc. et al, v. The Government of the Islamic Republic of Iran,* 10 Iran-U.S. C.T.R. 229, 240.

214. In *Foremost*, the Tribunal found that to was open to find that the acts of governmental shareholders against Foremost's right to receive dividends constituted interference "attributable to the Iranian Government or other State organs of Iran, while not amounting to an expropriation, gives rise to a right to compensation for the loss of enjoyment of the property in question". [At page 251.]

215. *Foremost Tehran Inc. et al. v. The Government of the Islamic Republic of Iran*, 10 Iran-U.S. C.T.R. 229, 240.

the tribunal found that a deprivation of use, benefit and control of property was compensable under the Claims Settlement Declaration, not as an expropriation, but rather as a deprivation[216].

257. A tendency by some tribunal judges to equate the two concepts has been the subject of comment by international legal scholars. For example, Sonarajah cautioned:

> "The awards of the Iran-U.S. Claims Tribunal have been a fruitful recent source for the identification of such takings ["indirect takings", or "disguised" or "creeping" expropriation]. But the Iran-U.S. Claims Tribunal dealt with takings that took place in the context of a revolutionary upheaval and the propositions the tribunal formulated may not have relevance outside the context of the events that attended the Iranian upheaval following the overthrow of the Shah of Iran. Also, one has to be cautious in the making of any generalization on the basis of dicta in the awards of this tribunal as its constituent documents gave the tribunal power to deal not only with direct takings of physical assets but 'all measures affecting property rights'. It is clear that such a wide definition of taking will not be acceptable in international law for the simple reason that many normal activities of states, such as taxation, affect property rights and cannot be expected to give rise to international concern[217]."

258. The Government of Canada has intervened on this point[218]. The Respondent agrees with Canada's view that this Tribunal's jurisdiction is narrower than that of the Iran-U.S. Claims Tribunal and caution should be exercised in applying that tribunal's reasoning to the facts of the instant case.

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216. *Seismograph Service Corporation v. The Government of the Islamic Republic of Iran*, 22 Iran-U.S. C.T.R.3.

217. M. Sonarajah, *The International Law on Foreign Investment*, (1994), at pp. 282-283.

218. Letter from Mr. Joseph de Pencier to the Tribunal, dated July 28, 1999, p. 2.

C. The Other Distinguishing Features of the Authorities Cited by the Claimant

(1) Preliminary Comments

259. When referring to the cases, the Claimant cited *dicta* without relating their facts and reasoning to the facts of this case. For example, Professor Coe stated that an informal act could constitute a taking without identifying the act to which he was referring[219].

260. Upon examination, it can be seen that the cases cited involve outright nationalizations, or in the *de facto* expropriation cases, seizure in the form of interference in the management of the claimant's affairs (such as the appointment of a manager or custodian), armed force by military personnel or revolutionary guards associated with the respondent state, threats of violence, expulsion of key personnel, and the like.

261. The facts of this case involve, on the other hand, regulation by the Municipality and a temporary injunction by the domestic courts.

262. That mere resort to litigation against the act of another level of government in a federal state is pleaded as a NAFTA breach shows how much this Claim differs from the facts of the cases relied upon.

(2) The Facts of the Cases Are Very Different

263. *Philips Petroleum*[220], cited for the proposition that "informal acts can constitute a taking"[221], was a decision of the Iran–U.S. Claims Tribunal that concerned a set of acts and decisions that were found to be consistent with a policy to nationalize a whole industry[222]. The informal acts were the culmination of a series of acts that included abrogation of a "Joint Structure Agreement" with the National Iranian Oil Company, the dismissal of management and the appointment of a new management committee without Phillips' consent, and a declaration by the Revolutionary Council that all such contracts were null and void.

264. Professor Coe placed particular reliance upon the *Southern Pacific Properties Case*[223]. That case was discussed in the Counter-memorial and the Rejoinder[224].

265. The facts of that case are completely different: First, the claimant had fully vested rights established in a detailed joint venture agreement with the respondent. The joint venture was to develop tourist complexes according to master plans developed by the claimant and subsequently approved by the respondent. Under the joint venture contract (signed by the Minister of Tourism), the ministry agreed to secure title to the lands and transfer the right of usufruct

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219. Transcript, Vol. VIII, at p.71.

220. *Phillips Petroleum Company Iran v. The Islamic Republic of Iran and another*, 21 Iran-U.S. C.T.R. 79.

221. Ibid.

222. *Phillips Petroleum v the Islamic Republic of Iran*, 21 Iran-U.S. C.T.R. 79 at 115.

223. *Southern Pacific Properties v. Republic of Egypt*, 3 ICSID Reports 45.

224. See the Counter-memorial at paragraph 921 and Rejoinder at paragraphs 629-645.

"irrevocably" and without restrictions to the company for the life of the joint venture. This was done by Presidential Decree. The contract also obliged the respondent to obtain all necessary final approvals. This was done. The claimant proceeded lawfully and roads were laid, excavations for sewage, artificial lakes, and a reservoir were undertaken and lots were sold. This was all done lawfully pursuant to a plan approved by the Minister of Tourism[225]. The project was then halted under the respondent's antiquities law.

266. The joint venture contractual relationship, the extensive involvement of the respondent's officials and organs in securing permits for the joint venture company and resolving other land use issues pursuant to the respondent's contractual commitment, and the complete approvals that were issued, etc., differ from the instant case. Here the Claimant had no vested right to construct and operate a hazardous waste landfill. The Claimant proceeded to construct without prior authorization. The *Convenio* was not a joint venture agreement; it was an agreement by one level of government to resolve the contamination problem and lift its closure seals. The federal government's public statement made contemporaneously with the agreement shows that it was necessary but not sufficient.

267. A review of *Southern Pacific Properties* shows that it was the "rights that SPP (ME), as a shareholder of ETDC, derived from EGOTH's right of usufruct, which had been 'irrevocably' transferred to ETDC by the State" that was found to have been expropriated[226]. No such right was transferred at any time in this case.

268. In the instant case, there was no joint venture, no transfer of land by the Respondent to the Claimant, and no contractual commitment to secure other approvals and to transfer "irrevocably" rights such as a right of usufruct.

269. Professor Coe also relied upon a case which he called *Ghana Investment Centre*. The name of the proceeding is *Marine Drive Complex v. Ghana*[227]. It was an *ad hoc* UNCITRAL arbitration. In that case, the claimant worked on the project approved by a contract with the Ghanaian authorities for approximately a year. After previous assurances of approval directly from the municipal authorities, a municipal building permit issue arose retroactively.

270. The sequence of events which followed the sudden appearance of the building permit issue were as follows: six days later, apparently without any opportunity to challenge the order, the construction was ordered to be demolished (and partly was). On the same day, the claimant's principal shareholder and other persons connected with the company were ordered to report to the "National Investigations Commission" to disclose their assets. The claimant's principal was subsequently arrested and held in custody without charge for 13 days, during which a deportation order was issued, stating that his presence in Ghana was "not conducive to the public good". He

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225. Ibid. at paragraphs 202-204.

226. *Southern Pacific Properties v. Republic of Egypt* at page paragraph 164.

227. It was an *ad hoc* UNCITRAL arbitration established pursuant to an arbitration clause contained in an agreement between the claimant and the Ghana Investment Centre whereby the latter approved a joint venture arrangement between foreign and Ghanaian partners. (Due to the respondent's initial refusal to appear in the arbitration, the appointing authority appointed Judge Stephen Schwebel, Mr. Monroe Leigh and Professor Don Wallace, Jr. to the tribunal.) Ad Hoc UNCITRAL Award, Yearbook of Commercial Arbitration, Vol. XIX –1994 at 11.

was deported forthwith[228]. The facts of the *Marine Drive Complex* case are so at variance with the facts of this case as to make it irrelevant.

271. The *Oil Fields of Texas* Award, the *Schufeldt Claim* and *Petrolane Award* also bear no resemblance to the facts of this arbitration[229].

272. Professor Coe also addressed the doctrine of "administrative contracts", a doctrine that has been invoked by certain states in connection with their attempts to undo the effects of stabilization clauses in long-term concessions. The Respondent has reviewed the *BP* and *Aminoil* cases and does not see that they bear any relevance to the facts of this case.

D. International Law Recognizes the State's Right to Regulate

273. The Claimant urges an overly expansive interpretation of Article 1110 that would undermine the Party's rights to regulate. International law has always recognized a state's right to regulate.

274. In a federal state, the right to regulate exists not only at the federal level but at the State and municipal levels as well[230]. Federalism has two other important features: First, at the non-federal levels, the regulatory perspective will be different from that of the federal government and second, the lower the level of the government action, the more there will be judicial remedies available.

275. The Respondent submits that this issue is illustrated by the facts of this case. For the purposes of argument, the Respondent accepts that a formal act of expropriation by a sub-national government could be taken to Chapter Eleven without the need to resort to domestic remedies. However, where the act complained of is not an expropriation on its face and could be accepted by the domestic courts as regulatory, a claimant ought not to be able to immediately elevate the act to the international plane. As *ELSI* shows, the views of the domestic courts in reviewing the act of a local official will be valuable juridical facts in the characterization of the act at international law[231].

276. The point was made in an exchange between Mr. Civiletti and Mr. Foy:

> ARBITRATOR CIVILETTI: Are you suggesting that in order to have an action which is tantamount to expropriation that you have to exhaust either administrative remedies or judicial remedies?

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228. Ibid.

229. With respect to the assertion that the principle set out in *Petrolane*, for example, should be of general application even though the breach of the obligation complained of was contractual, the Respondent strongly disagrees. See Professor Coe's argument at Transcript, Vol. VIII, at p. 54.

230. See the excerpt from the US Statement of Administrative Action at p. 133.

231. At paragraphs 128-129. The Court observed at the latter paragraph: "Nothing in the decision of the Prefect [the first court of review], or in the judgment of the Court of Appeal of Palermo, conveys any indication that the requisition order of the Mayor was to be regarded in that light" [as arbitrary].

> MR FOY: ...In some cases, it may be crystal clear that what has occurred is an expropriation, and it may be that under Chapter 11, a claimant is not required to exhaust remedies when that is the case.
>
> In the case of denial of a municipal permit, by the first body entitled to deal with that issue, which is subject to review in the courts, in administrative tribunals, and then in the federal courts, you do not have anything close to an act of expropriation at that stage. If you did, you would have before this Tribunal —every time a municipal permit is denied, you would have potentially a Chapter 11 expropriation case. That is not, in my submission, what Chapter 11 intended[232].

277. This exchange echoes the underlying philosophy of the local remedies rule, which the Respondent recognizes has been modified somewhat by the NAFTA: it reflects international law's recognition of the state's opportunity to redress acts complained of by its own means within the framework of its own laws. "Otherwise the alien would become a privileged individual for whom the local law and municipal tribunals would not exist and who could immediately introduce the political influence of the State of his nationality when the slightest difficulty arises with another government"[233].

278. B.H. Weston, "'Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation'"[234] states that it:

> "...is serious business to dispute a state's claim to "regulation". International law traditionally has granted states broad competence in the definition and management of their economies."

279. In an article in the British Yearbook of International Law, entitled, "What Constitutes a Taking of Property Under International Law"[235], G.C. Christie stated:

> "A state's declaration that a particular interference with an alien's enjoyment of his property is justified by the so-called "police power" does not preclude an international tribunal from making an independent determination of this issue. But, if the reasons given are valid and bear some plausible relationship to the action taken, no attempt may be made to search deeper to see whether the state was activated by some illicit motive." [Emphasis added]

280. Rosalyn Higgins in her article, "The Taking of Property by the State: Recent Developments in International Law"[236], states that as a general proposition no compensation will be payable for general regulatory measures, even measures that decrease the value of property provided the right to use, enjoy, manage and control property are left substantially intact.

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232. Transcript, Vol. IX, at pp. 93-94.

233. See Jiménez de Arechaga, *supra* note 8 at p. 292.

234. (1975), 16 Va. J. Int'l. L. 103, at page 121.

235. (1988), 33 B.Y.I.L. 307, at page 338.

236. Rosalyn Higgins, (1982) 176 Receuil des Cours 259 at p. 271.

281. Investors can expect and assume the risk of regulatory measures on the part of a government, even where economic interests are affected negatively. Generally a state will not be held to have made a compensable expropriation when it takes a measure which is an exercise of its regulatory powers, especially when those measures are not arbitrary or discriminatory. Under international law "jurists supporting the compensation rule recognize the existence of exceptions, the most widely accepted of which include: a legitimate exercise of police power [which includes] loss caused indirectly by health and planning legislation and the concomitant restrictions on the use of property"[237].

282. R. Dolzer, "Indirect Expropriation of Alien Property"[238], surveys the applicable domestic law concepts of expropriation in the United State, the United Kingdom, France and Germany. He found that even those systems distinguished between regulations which prohibit:

1) economically optimal use;

2) economically reasonable use; and

3) existing use.

283. Dolzer concludes that these legal systems will not find the prohibition of the economically optimal use of property to be a taking[239]. Restrictions on the economically optimal use exist for valid reasons across a range of property regulation. A measure will only be found to be a taking at the point where the property in question can no longer be put to any reasonable economic use.

284. In determining whether an act complained of is a measure tantamount to expropriation, therefore, a tribunal must examine the act within the larger context of the domestic legal system; a measure tantamount to expropriation requires more than simply alleging that, because of the act, the investor was unable to operate the investment in the manner in which it wished.

285. In the *Acuerdo*, the Municipality expressly agreed to the use of the Site as an industrial waste landfill and possibly, after remediation, and local approval, use as a hazardous waste landfill.

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237. See B.A. Wortley, *Expropriation in International Law* (1959) at 40-57; L.B. Sohn and R.R. Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens" (1961), 55 A.J.I.L. 545 at 561-562.

238. (1988), 1 ICSID Rev. 41.

239. The Respondent observes that although general principles of law of civilized nations can be examined as a source of international law, it does not consider that the international law of expropriation comports with the domestic law of any of the States reviewed by Dolzer.

E. Applying the 'Tantamount to' Test to The Facts of This Case

286. In the Respondent's submission, neither the criteria for an expropriation, nor the criteria of an arbitrary regulation tantamount to expropriation have been made out on the facts of this case.

287. The Respondent repeats the arguments made regarding expropriation contained in the Rejoinder at paragraphs 618 to 650.

288. The Claimant alleged the *Convenio* granted a vested right to operate a fully permitted hazardous waste landfill[240]. The federal authorities' statement on the day they published the *Convenio* is incontrovertible context showing that that was not the case. There was no intention on the federal authorities to vest or to purport to vest in the Claimant a perfected "concession-like" interest or right to operate the landfill.

289. In another false pleading, Metalclad alleged that the federal government subsequently argued in court that there were rights vested in COTERIN by the *Convenio*[241]. At paragraphs 623-625 of the Rejoinder, it was pointed out that Metalclad's translation simply added the word "vested" to the translated excerpt. The word does not appear in the Spanish original.

290. The municipal permitting requirements contained in the State's Ecology and Urban Code pre-dated the investment. The investor's due diligence revealed the salient legal facts, the previous permit's denial, the applicable statutory provisions and the Municipality's view as to its jurisdiction. The Claimant's contract of purchase set out a means for resolving the permits issue so that, in the contract's words, COTERIN could "legally proceed" with construction.

291. The record evidence shows that counsel was able to establish the law and advise on its compliance. In fact, counsel advised applying for the permit before commencing construction. Its advice was ignored[242].

292. Regardless of whether the Municipality was correct in construing its jurisdiction as extending to "environmental concerns" (Metalclad's own application, the applicable law, and the Respondent's experts say that it was), it clearly had jurisdiction to deny a permit on the basis of unauthorized construction before the permit was sought.

293. There was no total or even substantial deprivation of COTERIN or its assets. The Municipality was prepared to accept the Site's operation as an industrial waste landfill.

294. It would be speculation for this Tribunal to make any finding as to how the Municipality would have treated a fresh application for a municipal construction permit, made after:

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240. Memorial, paragraphs 169-170.

241. Memorial, paragraph 169.

242. The contemporaneous documents and testimony of Metalclad's former counsel therefore disprove the underlying basis of the Claimant's argument that its analysis of Mexican law "is designed to show that its content and methods were confused and confusing, perhaps even to organs of the state, and that said disarray led to both detrimental reliance by claimant and to jurisdictional gridlock, substantially depriving claimant of its investment". Transcript, Vol. VIII, at p. 62.

1) An agreement had been reached with the Municipality;

2) Metalclad had remediated; or

3) Metalclad had regularized the prior unauthorized construction.

295. Mr. Ramos Torres testified that if an agreement had been reached, it would have been a decision for the *Cabildo* as to what to do next[243].

296. Although there was evidence indicating continuing local opposition to the introduction of new hazardous waste, the fact remains that, as Marcia Williams said, Metalclad "pulled out of the process well in advance of a final determination of the denial of the permit"[244].

4. Conclusion: There Has Been No Measure Tantamount to Expropriation

297. Just as there has been no formal nationalization or expropriation decree, none of the types of state action that are typical of indirect expropriation are present nor is there a measure tantamount to nationalization or expropriation.

298. There was no intervention by armed troops or revolutionary guards, no threats against the person of any of the Claimant's employees, no expulsion of any manager or employees, no appointment by the state of a manager or custodian, and no other interference in the Claimant's managerial and financial affairs.

299. There has been no taking of a vested right and no arbitrary regulation. Some of the risks attendant in this project were common to all hazardous waste landfill projects. Others were created by the Claimant's own actions.

300. In the end, there was action taken under a clear color of right under domestic law and resort to the courts. The Claimant cannot point to any other measure by the Municipality. The Respondent submits that there is no basis in law to support a finding that these two measures taken separately or when 'cumulated' —wrongfully, according to the plain text of Article 1110— amounted to a measure tantamount to expropriation.

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243. Transcript, Vol. III, at p. 38.

244. First Williams' report at paragraph 51.

5. There Was No Denial of Fair and Equitable Treatment

A. The Claimant Has Not Specified the Alleged Breach of Article 1105

301. Prior to the closing speeches, the Tribunal posed the following question: If Claimant asserts a violation of NAFTA 1105, what exactly was the violation?

302. This question could only be answered by the Claimant. It declined to do so. The Claimant referred instead to the "cumulative effect principle" and spoke of "overlapping guarantees" with Article 1110, relying upon the "totality of circumstances" rather than identifying what the alleged violation of Article 1105 was. In the course of closing, the Claimant referred to general concepts such as abuse of rights, abuse of discretion, denial of justice, lack of transparency, and comparative disadvantages again without relating any of those concepts to the specific facts of this case.

B. There is No Evidence of Arbitrary Action Under International Law

303. The Respondent directed the Tribunal to the decision of the Chamber of the International Court of Justice in the *Case Concerning Elettronica Sicula S.P.A. (ELSI)*[245]. That case recognized the legal relevance of social pressures upon a local official (and accepted it as "understandable that the Mayor, as a public official, should have made his order, in some measure, as a response to local public pressures"[246]) and analyzed an allegation of arbitrariness and the role of a domestic court decision which struck down the local official's act.

304. With respect to arbitrariness, the Court propounded a stiff test:

> "Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the court in the *Asylum* case, when it spoke of 'arbitrary action' being 'substituted for the rule of law' ... It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety. Nothing in the decision of the Prefect, or in the judgment of the Court of Appeal of Palermo, conveys any indication that the requisition order of the Mayor was to be regarded in that light[247]." [Emphasis added]

305. In this proceeding, the Claimant attempted to establish arbitrariness by the Municipality by:

1) deliberately concealing its own legal advice on the municipal permit issue and implying that it was taken by surprise by that issue;

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245. 1989 I.C.J. 15.

246. Ibid. at page 74.

247. Ibid. at page 76.

2) concealing its knowledge of the options open to it to challenge the municipal closure order; and

3) filing expert's reports based on factual premises known to be false.

306. It is Metalclad's conduct in this proceeding which shocks a sense of judicial propriety.

307. The same cannot be said of the denial of the permit and the court's response thereto. The denial does not shock or even surprise given the Site's history and the fact that construction started well before the permit's application was filed. The Municipality provided written reasons for its actions. It willingly defended the denial in court. Nothing that the Municipality did meets the stiff test for arbitrariness propounded by the International Court of Justice.

308. As noted above, *ELSI* also held that an unlawful act under domestic law does not necessarily amount to an unlawful act under international law:

> "Yet it must be borne in mind that the fact that an act of a public authority may have been unlawful in municipal law does not necessarily mean that that act was unlawful in international law, as a breach of treaty or otherwise. A finding of the local courts that an act was unlawful may well be relevant to an argument that it was also arbitrary; but by itself, and without more, unlawfulness cannot be said to amount to arbitrariness. It would be absurd if measures later quashed by higher authority or a superior court could, for that reason, be said to have been arbitrary in the sense of international law. To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. Nor does it follow from a finding by a municipal court that an act was unjustified, or unreasonable, or arbitrary, that that act is necessarily to be classed as arbitrary in international law, though the qualification given to the impugned act by a municipal authority may be a valuable indication"[248]. [Emphasis added]

309. The *ELSI* decision, rendered by a Chamber which included Sir Robert Jennings and Judge Ago, both notable experts on state responsibility, is particularly persuasive and should be given considerable weight by this Tribunal.

310. A prudent investor would recognize that the issue of remediation of the prior contamination had to be addressed. The views of the local community, as expressed in the denial of the 1991 municipal construction permit application, and in the separate 1992 resolution of the *Cabildo* confirming the opposition of the residents to the introduction of hazardous waste at La Pedrera, were important for three reasons:

1) these facts predated Metalclad's acquisition of COTERIN and were well known to it prior to that acquisition[249];

2) Metalclad could reasonably expect that the Municipality would be concerned to ensure that investment activity was undertaken in a manner sensitive to

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248. Ibid. at page 73.

249. See the Rejoinder witness statement of Ronald E. Robertson at paragraph 76.

environmental concerns, in the broad sense of impact on the Municipality, and in the sense of risks to health and safety; and

3) Metalclad could reasonably have anticipated the fear occasioned by the contamination and the impact that missteps such as premature announcements of the Site's opening would have on the community.

311. Notwithstanding its public assurances of regard for a healthy municipal environment, and its agreement that the consensus of the population of Guadalcázar was required in order to be able to construct and operate a facility, and its recognition of the need to meet municipal requirements and to respect the autonomy of the Municipality, Metalclad simply pushed ahead. It is Metalclad who must be taken to have assumed the risks inherent in that decision.

312. Unauthorized construction in 1994 was misrepresented as related to remediation or maintenance, speeded up and completed without interruption, notwithstanding the issuance of two municipal stop work orders. Metalclad took advantage of a change in municipal administration to expedite completion of the construction.

313. Although in January 1994 Metalclad had advised the Municipality that it was ready to invest 5 million dollars to treat and confine the contamination, instead it commenced construction prior to seeking authorization, overruling counsel's advice, preferring to "ignore the issue" rather than to meet it head-on. When the landfill was constructed, it took the position that it had to operate the landfill as a hazardous waste landfill, not as an industrial waste landfill, in order for it to remediate. This was an economic, not a technical imperative.

314. The Municipality's response was reasonable and predictable. It showed no intent to expropriate. It was willing to have the Site operated as an industrial waste landfill.

C. There Was No Denial of Justice by the Courts

315. In considering the "totality of the circumstances", this Tribunal must go beyond the Municipality's response because Metalclad challenged its actions in the domestic courts.

316. Actions which fit within the category of public acts from which appeals on juridical grounds is provided in law, cannot be treated in isolation; the entire juridical structure must be considered in order to determine whether fair and equitable treatment has been accorded[250].

317. Metalclad has not identified any denial of justice, abuse of discretion or abuse of rights in the domestic proceedings it initiated challenging the denial by the Municipality of the construction permit.

318. Metalclad abandoned that domestic legal challenge prior to its final determination in favor of direct negotiations with the Municipality. As a result, this Tribunal does not have before it a final determination of the Mexican courts on the domestic validity of the denial of the construction permit application.

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250. *ELSI*, paragraph 129.

D. The Municipality's Challenge of the *Convenio* Was Not Unlawful in International Law

319. The Municipality's challenge of the legality of the *Convenio* was reasonable, not arbitrary, and did not subject Metalclad to any denial of justice.

320. Given the frequent resort to the courts in all three NAFTA Parties to resolve federalism disputes, it would be a novel proposition that the Municipality's mere resort to litigation to challenge the *Convenio* could attract international responsibility to the Mexican State. If that is the case, the scope of judicial measures attracting international responsibility under Chapter Eleven is far broader than the existing international jurisprudence has supported and any of the NAFTA Parties have hitherto contemplated.

321. The Municipality had every right to request from the courts a ruling as to whether the *Convenio*, which contemplated simultaneous remediation and operation, was lawful in light of the August 30, 1994 PROFEPA Resolution. Why should its rights be any lesser than Metalclad's right to commence a legal challenge against the permit denial?

322. On May 18, 1999, the *amparo* was resolved on its merits and dismissed. With that dismissal, the interlocutory injunction granted in February 1996 is no longer in effect, notwithstanding the current Municipality's appeal against the court's dismissal of the *amparo*.

323. It is reasonable for hazardous waste project proponents to expect delays attendant upon litigation, including litigation among different levels of government in a federal State, as a normal risk in siting such facilities[251].

324. The existence of multiple permitting levels, each with some environmental jurisdiction, exercised from a different perspective, is common in federal states. It is hardly unfair treatment.

325. Metalclad was given standing in the Municipality's action against the *Convenio* and has not identified any denial of access, denial of justice or any arbitrary or discriminatory treatment by the Mexican courts of Metalclad in these proceedings.

E. The 1996 Injunction Granted By the Court, Since Vacated, is Not Contrary to Article 1105

326. The Respondent finds it surprising that the Claimant could, on the one hand, omit to tell would-be investors of the litigation against SEMARNAP and the injunction issued therein, yet argue to this Tribunal that the injunction is an expropriatory act and a denial of fair and equitable treatment giving rise to international responsibility.

327. Regardless of whether the Tribunal considers this to be an act of good faith on Metalclad's part, the fact is that the Claimant could point to no authority holding that the grant of a provisional injunction, subsequently dissolved, amounts to a denial of fair and equitable treatment.

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251. Marcia Williams' first Report at paragraph 41.

328. Professor Coe directed the Tribunal to the *Barcelona Traction* case, which was cited for the proposition that the actions of a court can give rise to an expropriation (citing the judgments of Judges Fitzmaurice and Gros).

329. The Respondent does not disagree that in appropriate circumstances the acts of a judiciary can found an expropriation[252]. However, leaving aside the fact that *Barcelona Traction* was decided on other grounds, the extensive involvement of the Spanish judiciary as reflected in the length of the Spanish proceedings and the number of court decisions makes the facts of that case categorically different from the instant case. President Lauterpacht will recall that, according to the Spanish Government in *Barcelona Traction*, 2,736 judicial orders were made in the Spanish litigation with 494 judgments given by lower and 37 by higher courts before it was submitted to the International Court[253].

330. It is not enough to simply allege a denial of justice. It is a serious allegation and the Claimant has not begun to identify the elements necessary to meet the test propounded in the decided cases.

6. The Municipal Permitting Requirement Was Not a Denial of National Treatment

331. The absence of permitting requirements for residential and other renovation construction, which did not have any significant impact in the Municipality, was not a like circumstance. The evidence shows that Guadalcázar is a very poor and undeveloped municipality[254]. It did not have any other works of any significance. Therefore, the evidence of Lic. Carvajal is if no legal relevance because the test of NAFTA Article 1102 requires the Tribunal to focus on the treatment of investors and investments "in like circumstances".

332. The permit requirement was enforced with respect to COTERIN when owned by Mexican investors. This was a situation of "identical" treatment, not merely "like" treatment of investors.

333. The national treatment obligation applies at two levels: federal and state. No case has been made out that the federal government treated Metalclad less favorably than a domestic investor in like circumstances. Metalclad is estopped from asserting a denial of national treatment, given its earlier pleading that the federal authorities were at all times supportive[255].

334. With respect to State and municipal permitting requirements within the State of San Luis Potosí, the only relevant legal standard is how San Luis Potosí treated investors in like circumstances. The actions of any other State in relation to any other investor are legally irrelevant to NAFTA Article 1102.3. The plain meaning of Article 1102 shows that RIMSA's

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252. Professor Coe's assertion at Vol. VIII, p. 63 that the "Respondent develops the related theme that acts of a national judiciary are not examined –may not be examined by this Tribunal" is an erroneous description of the Respondent's argument. What it asserted, and continues to assert, is that international arbitral tribunals defer to the decisions of domestic courts given their greater expertise in the interpreting national law.

253. See paragraphs 8-24 of the Court's Final Judgment of 5 February 1970.

254. Mr. Ramos Torres testified as to the Municipality's very basic administration.

255. Memorial, paragraphs 117-125.

treatment under the law of the State of Nuevo León is not germane to a national treatment analysis for the State of San Luis Potosí.

335. During the Hearing, the Claimant accused the Respondent of improperly withholding evidence relating to RIMSA's permit situation[256]. The Respondent objects to this and refers to the Tribunal's directions concerning requests for documents. At the First Session, the Tribunal informed the parties that each could request the other to disclose a specific document, and if either encountered a problem, the requesting party could ask the Tribunal to request disclosure of the document. The Tribunal noted that "if the requested party did not comply with the Tribunal's request, then the Tribunal might draw inferences therefrom".

336. Annex 1 sets out the history of Metalclad's request for documents relating to RIMSA. The Tribunal can see that the Respondent dealt with the request in an appropriate fashion. The Claimant did not make a request for production of RIMSA's municipal permits in connection with national treatment issues, nor did it reiterate a request for any RIMSA document, except a request after the Reply and Rejoinder were filed for "the most recent INE permit for the RIMSA facility", a document that had been provided to the Claimant 10 months earlier.

337. More importantly, however, the Claimant never asked the Tribunal to request disclosure of the RIMSA municipal permits that it now complains were not produced. Rather, in its Memorandum on Marshalling of Evidence it asked the Tribunal to direct the Respondent to produce 15 classes of documents, none of which related to RIMSA. The President advised on July 6, 1999 that no further documents should be filed by either party.

7. The Decree is Not Expropriatory Nor a Denial of Fair and Equitable Treatment

338. Almost one year after the Notice of Intent and months after this Tribunal was constituted to examine the acts that were alleged to have constituted a "direct and indirect expropriation", a denial of fair and equitable treatment, and numerous other NAFTA provisions, a decree to protect cacti was promulgated.

339. At the time the Notice of Claim was filed, the Claimant considered that its claim was ripe, i.e., the Respondent had allegedly engaged in acts which constituted a "direct and indirect expropriation of Complainant's investment and enterprise"[257].

340. Section B of Chapter Eleven does not contemplate the amendment of ripened claims to include post-claim events. It modifies the Additional Facility's Rules regarding the amendment of claims and the filing of ancillary claims, making the latter rules inapplicable.

341. In the alternative, if Metalclad's claim with respect to the Ecological Decree is considered an ancillary claim which, by reason of the Additional Facility Rules, is found to be within this Tribunal's jurisdiction or that an amendment is allowed, that claim should be dismissed for want of proof of any adverse legal effect of the Decree.

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256. Transcript, Vol. VIII, at p. 150.

257. Notice of Intent to Submit a Claim to Arbitration, dated September 28, 1996, at page 3.

342. Only the Respondent has adduced any evidence of the potential effect of the Decree on the Site. The news reports of the Governor's alleged statements on the effect of the Decree, which were denied, would not, even if proven, amount to a measure[258]. As noted above, that evidence demonstrates that the Decree has no expropriatory effect.

343. The Decree's terms preserve permits and authorizations granted prior to its enactment, or regularized within 90 days of the enactment date, and empower the General Coordinator of Ecology and Environmental Proceedings to authorize public or private works within the Ecological Reserve, provided that projects comply with certain requirements to ensure sustainability of natural resources.

344. The Decree was the result of a process spanning several years that began with detailed studies that concluded that the region is the place with the highest concentration of cacti species in the world, including several threatened species[259].

345. The Decree's purpose was to protect the region, not by precluding the development of activities but rather by exercising a more stringent control, to ensure sustainability of natural resources. The effect of the Decree is described in the Rejoinder at paragraphs 399 to 404. In addition, given the provisions of the *Convenio* concerning cacti, the project would have no effect on cacti and therefore the Decree would have no practical effect.

346. The only direct evidence of legal effect has been adduced by the Respondent. That evidence is that the decree has no adverse effect. Given the Claimant's abandonment of the investment in favor of arbitration, it never attempted to operate under the decree.

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258. The Respondent notes that Ambassador Sánchez Unzueta and Dr. Medellín were not the only witnesses to deny quotations attributed to them by a newspaper report. Mr. Kesler himself did so in his cross-examination.

259. Rejoinder, paragraphs 395-397; see also footnote 320.

PART VI: SUBMISSION ON DAMAGES

1. Introduction

347. Article 1110 specifies methods of determining compensation in the event that a tribunal finds that an expropriation has occurred. There are no methods specified by NAFTA for a finding of a breach of Article 1105.

348. Were any breach of Article 1105 found on the facts of this case, the measure of damages would have to be tailored to the precise violation identified, and the economic effects caused by that measure. The Claimant has refused to identify precisely any specific violations and correspondingly has failed to adduce evidence of any specific damages flowing from such alleged violations.

2. The Methods of Valuation Specified in Article 1110

349. Paragraph 2 of Article 1110 states that compensation shall be equivalent to the 'fair market value' of the expropriated investment. The latter part of the paragraph states that:

> "Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value."

350. Question 9 of the Tribunal's written questions set out four possible means of valuing the investment and asked which was supported by evidence:

1) Comparable sales,

2) Asset value (cost less depreciation),

3) Capitalization of net income to present value (the Discounted Cash Flow method), and

4) Reduction in market capitalization value.

351. The parties agreed that the comparable sales method was not supported by the evidence and could be dismissed.

352. Not surprisingly, the Claimant has presented a shifting position on damages ranging up to a 115 million dollar (before interest) discounted cash flow and market capitalization claim. The sheer magnitude of this claim, along with its changing definition[260], obliged the Respondent to expend significant time and money addressing what turned out to be a false and deceptive claim.

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260. Metalclad acknowledged for the first time in Mr. Kesler's cross-examination that even the investment cost summary proffered as its investment in COTERIN in reality consisted of money spent on every other failed or abandoned project prior to and after COTERIN.

353. The Tribunal is obliged to identify precisely what "investment" was taken and when in order to appropriately define damages under Article 1110. The Claimant has pleaded that the project died when the municipal permit was denied on December 5, 1995. It pleaded that no amount of federal assistance after the denial would help to resuscitate the project[261]. This pleading should have estoppel effect; it is the Claimant's own evidence as to when it considered the project to be dead. If the denial of the permit was an expropriation, the investment was taken, and according to Article 1110.2 must be valued, as of that date.

354. The resulting damages calculation must be applied consistently with the express language of Article 1110.2:

> "Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier."

355. As of December 5, 1995, the Claimant was authorized by the federal and State authorities to operate a landfill with an annual total capacity of 36,500 tonnes. If it was taken by the denial of the municipal permit, Mr. Butler concludes that the landfill, being permitted for a period of 5 years, was worth one cent[262]. If it was considered to have a life-span of 20 years (at 36,500 tonnes annually), Mr. Butler concluded that it would be worth 1.4 million dollars on a DCF basis[263]. Both figures include the cost of remediation estimated at 3 million dollars.

356. The Claimant did not adduce any evidence of value based on an annual operating capacity of 36,500 tonnes.

3. Preliminary Observation

357. The Respondent submits that in valuing whatever rights it is that Metalclad possessed, and have been expropriated, only those directly attributable to La Pedrera are appropriate as considerations of potential damages. None of the alleged measures —the permit denial, the injunction, the decree— relate to or affect any other investment made by Metalclad in Mexico. This point applies to costs and expenses, as well as projected revenues.

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261. Reply, paragraph 396.

262. Although the federal authorities later granted an increase in capacity, Metalclad never sought or obtained a modification or re-issuance of COTERIN's State land use license which, under the heading "Environmental Impact" expressly incorporated the terms of COTERIN's 1993 Environmental Impact Study (EIS) approval. Under the EIS approval - which was based on the environmental impact of a landfill that would receive 500 to 700 tonnes of waste per week, COTERIN was authorized to develop a facility having a capacity of 100 tonnes per day, or 36,500 tonnes per year. The question of whether COTERIN may now lawfully operate at 10 times that capacity without submitting a new environmental impact study and/or without seeking modification of its State Land Use License is an issue that has not yet arisen because the landfill has not yet operated. See the testimony of Lee Deets, Transcript, Vol. VI, at pp. 8-10, 16-20, 27-34 and Memorial Exhibit 6 (Federal Environmental Impact Approval dated January 27, 1993) and Memorial Exhibit 7 (State Land Use License dated May 11, 1993).

263. Counter-memorial Butler Report, at p. 33.

A. Asset Value

358. With respect to asset value, the Tribunal is aware of the Claimant's initial false claim that it expended 20.5 million dollar on acquiring the site and constructing the landfill. At the Hearing, the Respondent challenged Mr. Dabbene's evidence and AAA's reliance upon a single page prepared by him that purported to show that 20.5 million dollar had been spent.

359. The Tribunal will recall the specificity of the AAA Report's false description of the alleged 20.5 million expenditure:

> "The $1,151,500 was the purchase price for COTERIN. The balance of $19,323,028 represents Metalclad's expenditures for the analysis of the site and construction of the La Pedrera facility as it exists today. Total cost to Metalclad was almost $20,500,000[264]."

360. Under cross-examination, Mr. Dabbene admitted that although he sought to justify the 20.5 million dollar figure, nowhere in his sworn statement did he testify that Metalclad actually spent 20.5 million on the landfill[265]. His evidence was, in the Respondent's submission, an evasive and misleading attempt to re-cast the claimed expenditures.

361. The Tribunal is also aware of the Respondent's repeated requests that the Claimant provide a detail listing of expenditures so that Mr. Dages would be able to vouch them[266].

362. The Claimant's lack of good faith is illustrated vividly by this issue. In obscuring its previous ventures in Mexico and proffering an expert's report that did no independent analysis of the claimed expenditures but still asserted that the costs were the direct costs of acquiring the land and constructing the landfill, the Claimant seriously misled the Respondent and the Tribunal as to what went into the claimed 20.5 million dollar figure. It was only under cross-examination that Mr. Kesler admitted that the figure included costs that were allegedly incurred in connection with its other ventures such as Eco-Administración, Descontaminadora, and Eliminación[267]. Even after that admission, the costs included in this amended description were not established on the evidence due to the lack of detail offered.

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264. AAA Report at p. 74. This was reviewed with Mr. Dabbene; see Transcript, Vol. VI, at p. 77.

265. Transcript, Vol. VI, at pp. 90-91.

266. Transcript, Vol. VI, at pp.78-84.

267. Transcript, Vol. V, at pp. 166-188.

(1) Bundling

363. Faced with the clear evidence that its proffered COTERIN investment figures contained inappropriate items, Metalclad's witnesses, Mr. Kesler and Mr. Dabbene[268], testified that the inclusion of these undefined (other than they are now clearly not COTERIN-related) costs is somehow permissible under US accounting pronouncements. This rationale was dispelled in Mr. Dabbene's cross-examination when he acknowledged that:

> "The practice of combining costs from multiple failed projects was called 'bundling', and
>
> He was aware of bundling from the highly publicized Waste Management Inc. 1998 restatement and securities claim debacle[269]."

364. As Mr. Dages noted in his reports, the only costs which could be included in the Claimant's COTERIN investment are those costs which can be directly traced to the COTERIN project itself. The Tribunal should reject the "bundling" rationale on a common sense basis, let alone an accounting basis.

(2) The Claimant Did Not Vouch its Expenditures and Blocked Any Attempt By the Respondent to Do So

365. Mr. Dabbene was confronted with the various descriptions of the alleged 20.5 million dollar expenditure. He was forced to admit that if the kind of one page summary that has been presented to this Tribunal as proof of expenditure on the landfill was presented to him as a travel expense, he would not accept it[270]. He also admitted that no proof of invoices or proof of payment was on the record of this proceeding.

366. When questioned on the lack of vouching, Mr. Dabbene stated that Metalclad was obliged to keep its business records for two years only, that the company's auditors had had access to all of the records, and seemed to imply that it was unable to prepare the detail listing[271]. (Nowhere did Mr. Dabbene actually say that the relevant records had been destroyed or that Metalclad could not have met the Respondent's requests[272].)

367. Under U.S. law, there is no statutory limitation for tax fraud[273] and the ordinary three year mandatory period for record keeping[274] is extended to six years where the taxpayer has omitted

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268. Both of whom admitted to having personal financial interests in the outcome of this proceeding.

269. Mr. Dages, who is an expert on the issue of "bundling" of costs as he has been assisting Waste Management in "unbundling" its improperly stated project costs testified on this issue in both of his reports.

270. Ibid. at pp. 98-109.

271. Transcript, at pp. 157-158.

272. Since Metalclad was carrying forward tax losses, it would have been foolhardy to destroy records that could be called for by the IRS when such losses were eventually used in the company's tax returns.

273. 26 USC §6501(c).

274. The normal period is three years from the date of filing 26 USC §6501(c).

from gross income an amount exceeding 25% of the gross income reported by the taxpayer[275]. Moreover, a company that incurs tax losses generally can carry those losses forward for up to 20 years[276]. In order to support the deduction of those losses in such succeeding years, the taxpayer would have to keep records of those losses until the expiration of the statute of limitations for the years to which the losses were carried forward.

368. Prudent practice would be to keep the bills, bank records, cancelled checks, etc. for at least six years[277]. By at least September of 1995, Metalclad was contemplating a NAFTA arbitration. Prudence would have dictated retention of the records necessary to vouch the expenditures.

369. Metalclad's refusal to offer expenditure records suggests either (1) it imprudently discarded its accounting records in a manner inconsistent with the behavior of a normal corporation, or (2) given its conduct in withholding other evidence, it possesses the records but has withheld them from the Respondent and this Tribunal[278].

370. In either event, the Claimant has the burden of proof. The Respondent submits that the 20.5 million dollar figure of claimed expenditure on La Pedrera fails for a lack of proof.

(3) The 1996 Tax Returns

371. There is other evidence of the actual value of the landfill asset, namely, COTERIN's Mexican tax returns for December 1996 (found in Exhibit 7 to the Closing submission exhibits). The Tribunal will recall that by this time, Metalclad had organized its affairs so that COTERIN owned the landfill site (and the remediation liability), and Ecosistemas del Potosí (ECOPSA), formerly known as Eco-Administración, was intended to operate the landfill.

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275. 26 USC §6501(e).

276. 26 USC §172(b)(1)(A).

277. Albert Ellentuck, When to Throw Out Those Old Records, Nation's Business, August 1995, Vol. 83, No. 8 at 60 comments:

> "...[B]usinesses today need to know when their old tax records can safely be discarded. Some businesses hold their tax records for only three years because they have heard about the three-year statute of limitations for an Internal Revenue Service audit... While there is indeed a three-year statute of limitations, it is extended to six years if more than 25 percent of gross income is omitted from a return —even if the omission is unintentional. If a return is fraudulent, there is no statute of limitations. Thus, the general rule of thumb is six years for bills and other written records such a bank statement and cancelled checks, sales records and journals, employee payroll records, and inventory records... Tax returns themselves, as distinguished from the supporting information, should never be discarded. They constitute evidence, and sometimes the only evidence, that a return was in fact filed for the business.

278. The Tribunal will recall the extensive and repeated attempts by the Respondent to have Metalclad disclose the audited financial statements (including footnotes) of its various Mexican subsidiaries. This was done to try to work back from the ground up, as it were, to see what exactly went into the Claimant's consolidated U.S. tax returns. The Claimant was finally ordered to disclose the statements. Virtually nothing was disclosed. A balance sheet for Eco-Administración that was disclosed, did not comport with the one audited financial statement that was previously provided for that company.

372. The Tribunal will recall from Mr. Kesler's cross-examination that Eco-Administración[279] was the first venture in which Mr. Kesler and the other ETI shareholders held an interest together with Mr. Hermosillo, his colleagues, and Lucía Rátner. That was the company that Mr. Kesler then arranged for Metalclad to buy; the company was acquired in stages by Metalclad from 1991-1993.

373. Tab 8 of the Respondent's Closing exhibits was a table prepared by Mr. Dages based upon the 1996 tax returns. He converted the amounts using a peso to U.S. dollars exchange rate of 7.89, the prevailing exchange rate in December of 1996. The resulting asset values are strikingly different from the claimed 20.5 million dollar expenditure.

374. The combined total of asset value for COTERIN reported in its 1996 Mexican tax return prepared by Metalclad amounted to a total of only 136,339 dollars.

375. The combined total of asset value for ECOPSA reported in its 1996 Mexican tax return was roughly 3.4 million dollars. However, as noted at the Hearing, the ECOPSA tax return contains a line item of almost 2 million dollars described as other fixed assets and deferred charges. Given that ECOPSA dates back to August 11, 1991, and that it is the Respondent's understanding that ECOPSA owned a parcel of land at Santa María del Río, SLP, Mr. Dages was not prepared to assume that this 2 million dollar line item was in any way related to the La Pedrera landfill[280].

376. This is before any consideration of the estimated 3 million dollar remediation cost of the contamination of the Site (the remediation liability referred to in the first AAA report at page 81).

377. When the remediation liability is considered, COTERIN has a negative asset value.

B. Discounted Cash Flow (DCF)

(1) The Relevance of the Company's Inexperience

378. There is a serious question as to the appropriateness of utilizing DCF analysis for a facility that was not a "going concern". The Tribunal will recall Mr. Kesler's cross-examination with respect to Metalclad's experience in the hazardous waste disposal business. Mr. Kesler made much of the asbestos abatement the company had engaged in[281].

379. The Tribunal is directed to the witness statement of Ronald E. Robertson, the former Chairman of the Board of Metalclad Corporation, wherein he describes the company's experience:

> "19. I have been directed by counsel for the United Mexican States to Mr. Kesler's claim in his first witness statement that Metalclad had done over "One Billion Dollars worth of environmental contracting." However, Metalclad was

279. See cross-examination of Grant Kesler, Transcript, Vol. X, at pp. 160-161.

280. Transcript, Vol. IX, at pp. 168-173.

281. Transcript, Vol. V, at pp. 143-149.

not a waste management company or a developer of environmental projects as such. Its only connection with environmental contracting experience was its asbestos abatement work which had little to do with waste management or developing and operating hazardous waste facilities."

380. Mr. Deets admitted under cross-examination that he was the only officer or director of Metalclad that had any hazardous waste experience in 1993-94[282]. He left the company in March of 1994, before construction began at the Site. He was succeeded by Mr. Neveau, whose prior experience was as a commercial real estate developer in Southern California with no hazardous waste industry experience whatsoever[283].

381. At the Hearing, Mr. Kesler admitted that the hazardous waste landfilling business was a "completely new line of business for Metalclad" and that there were no assurances that it would be successful in this business. He refused to be held to the company's statement in its SEC filings that the business was "speculative"[284].

382. The Tribunal is further directed to the witness statement of Ronald Robertson where he testified as to Metalclad's financial problems[285]. Mr. Dages' report examined the company's poor financial condition in detail[286].

383. The Respondent also directs the Tribunal to paragraphs 919-926 of its Counter-memorial where the point is made that international tribunals have declined to use the DCF method of valuation where the asset being valued was not a "going concern".

384. As noted at paragraph 921 of the Counter-memorial, in the ICSID Tribunal Award of *Asian Agricultural Products Ltd. (AAPL)* v. *Republic of Sri Lanka*, the Tribunal refused to award the claimant compensation for either goodwill or loss of future profits, as "neither could be established with a sufficient degree of certainty"[287]. See also the rejection of the DCF method in the *Southern Pacific Properties Award*[288].

385. The Respondent submits, therefore, that there is insufficient certainty to employ a damages calculation method that would include loss of future profits, especially in a business in which the Claimant had no operating experience.

386. There is persuasive record evidence of the perils of operating a hazardous waste landfill. The Tribunal will recall Mr. Deets' written testimony that his landfill, Kansas Industrial Environmental Services, at Furley, Kansas, was ranked number one by the Chemical

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282. By 1993, Alan Borner, the other director with experience resigned.

283. Transcript, Vol. VII, at pp. 85-86.

284. Transcript, Vol. V, at pp. 223-228.

285. Rejoinder witness statement of Ronald Robertson at paragraphs 59-60.

286. First Report of Kevin Dages.

287. *Asion Agricultural Products Ltd. (AAPL)* v. *Republic of Sri Lanka*, 6:2 ICSID Review – Foreign Investment Law Journal 526 (1990) at paragraph 106, and generally, paragraph 87-108.

288. 3 ICSID Reports 45 at paragraph 65 (pp. 76-77).

Manufacturers Association in 1978[289]. Mr. Deets testified that he did the site selection and designed the facility.

387. What Mr. Deets did not tell the Tribunal was that in 1982 the site was shut down due to carcinogenic chemicals seeping into the soil, in 1984 the site was the designated as a "National Superfund Priorities" site (which required remediation[290]), and in 1985, the site's purchaser obtained a judgment against the vendors[291] based on a breach of the implied warranty that the site met all State and federal regulations[292].

388. Mr. Deets' landfill's experience makes Mr. Kesler's statement that "with today's technology you could build a hazardous waste landfill facility on a lake" all the more appalling.[293]

(2) The 20 Million Dollar "State-of-the-Art" Facility

389. There is also evidence that the facility that Metalclad claimed to have spent 20.5 million dollars constructing was not the one that it had originally planned. Perhaps inadvertently, Mr. Deets testified to this effect when he reviewed the photographs of the Site. He admitted that he had never seen the Site after construction[294] and therefore it can be inferred that although he was a consultant to the company for a period after he left in the spring of 1994, he was not intimately involved in the project. Mr. Deets noted further:

> A: "...a lot of what we're looking at seems to be scaled back from the last design drawings that I saw."
>
> Q: "I see. So this is a smaller facility than what you recall?"
>
> A: "Yes[295]."

(3) The Company's Lack of Good Faith

390. There is another unusual factor that is relevant to deciding whether to employ a DCF calculation: that is the Claimant's demonstrated propensity for misstatement and deceptive practices. Running a hazardous waste landfill requires truthful reporting and scrupulous compliance with regulations concerning the wastes that properly may be deposited.

391. The Tribunal has ample evidence of misstatements by senior officers.

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289. Reply witness statement at paragraph 12.

290. "Actually, I wasn't aware of that, but I wouldn't argue it," said Mr. Deets. See Transcript, Vol. VII, at p. 48.

291. Ibid. at pp. 46-50.

292. Ibid. at p. 49.

293. See Transcript, Vol. V, at p. 241.

294. Transcript, Vol. VI, at p. 231.

295. Ibid, at p. 232.

392. Leaving aside the company's misleading securities disclosures, the Tribunal also has ample evidence of deceptive practices: establishing an improper relationship with a senior federal official; trying to appoint the auditor to the company's Board while he was conducting the audit; appointing the university professor who was chairing the company's committee of professors to the Board of ECOPSA while his committee was giving technical advice; implying to the Governor in an introductory meeting that the company had vast experience in the business when it had none[296]; and so on.

393. In addition to the lack of experience, therefore, Metalclad's behavior gives rise to questions about the Claimant's reliability, a relevant factor in considering whether to use a DCF calculation.

(4) Alternatively, Applying the DCF Valuation Method

394. Given that the Claimant submitted a discounted cash flow (DCF) valuation, the Respondent did so as well. Mr. John Butler, the Respondent's expert witness, was cross-examined by the Claimant[297]. The Respondent was content to rely on Mr. Butler's oral and written testimony and released the Claimant's expert witness, Mr. Nichols, from attending for cross-examination. The Respondent also relies on a number of serious flaws in Mr. Nichols' two reports that can be seen upon comparing his findings to the evidence in this case.

395. Before addressing this issue, the Respondent wishes to record that it requested copies of the DCF charts projected by Metalclad during the Hearing, both orally and in writing. Metalclad did not provide copies of the exhibits to the Respondent[298]. Accordingly, the Respondent submits that because it has been precluded from making submissions on the accuracy and probity of those documents in its oral argument and post-hearing submission, the Claimant should be precluded from relying upon any of them.

396. The Respondent urges the Tribunal to re-read Mr. Butler's Counter-memorial Report and his Rejoinder Report to understand the key differences between his opinion as to DCF value (from zero to 10.8 million dollars, were the date of expropriation to be found to be any date other than that which the Claimant has pleaded —a date that would be unsupported by the evidence)[299] and that postulated by Mr. Nichols (90 million dollars, irrespective of the date of expropriation)[300].

397. As Mr. Butler noted in his first report (and confirmed under cross-examination), modest changes to the key assumptions in a DCF model can have a profound effect on the resulting

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296. Mr. Deets thought that it was not relevant to tell the Governor that the company had never sited, constructed, or operated a landfill. Mr. Kesler also thought that it was irrelevant to the Embassy and to this Tribunal.

297. Mr. Nichols of American Appraisal Associates (AAA) filed two reports, one with the Memorial (the AAA Memorial Report) and one with the Reply (the AAA Reply Report). John Butler of Putham, Hayes and Bartlett (PHB) also filed two reports, one with the Counter-memorial (the Butler Counter-memorial Report) and one with the Rejoinder (the Butler Rejoinder Report).

298. See Transcript, Vol. I, at p. 77, and the letter from Mr. Perezcano to Mr. Pearce dated September 5, 1999.

299. See Butler Counter Memorial Report at paragraphs 101-114 and Table 6.

300. See AAA Memorial Report at paragraphs 232-234.

projected value of any business valued as a going concern[301]. It is for that reason he sought "hard" data for the three key assumptions —annual waste volume, price and operating costs— the data that a properly informed purchaser would employ in projecting the DCF value of the La Pedrera landfill. He also provided alternate figures to account for special contingencies that Mr. Nichols simply ignored (if he was aware of them at all) such as the fact that there was no guarantee that the five year federal permit would be renewed and the fact that the State land use license may restrict the operator of La Pedrera to accepting only 36,500 tonnes per year[302].

398. Mr. Butler's approach is consistent with the remarks of the Iran-U.S. Claims Tribunal in *Phillips Petroleum* that "any ... analysis of a revenue-producing asset ... must involve a careful and realistic appraisal of the revenue producing potential of the asset over the duration of its term" and "must also involve an evaluation of the effect on the price of any other risks likely to be perceived by a reasonable buyer at the date in question..."[303]. [Emphasis added]

399. If the Tribunal sees fit to use a DCF valuation for a start-up venture that has no operating history, then it must employ a "careful and realistic" appraisal of the key assumptions. Even a cursory review of the expert opinion evidence in this case shows that the AAA reports are neither careful nor realistic. Upon a review of the evidence, it can also be seen that Mr. Nichols uncritically accepted the information he used for key assumptions and that he was mis-instructed on a variety of important factual premises.

400. The following is a comparative analysis of the validity of the key assumptions – annual volume, price and operating costs. Mr. Butler has not taken issue with the AAA reports on other criteria, such as working capital requirement, depreciation, amortization, taxation rate, projected remediation costs, and the discount rate, even though he notes that remediation costs could easily exceed the 3 million dollars estimated by Metalclad and that the discount rate used by AAA does not truly reflect the risks associated with this particular investment[304].

(1) ANNUAL VOLUME

401. AAA projected that the La Pedrera facility would "ramp up" to its revised federally authorized capacity of 360,000 tonnes per annum within three years and would continue at that capacity for all of its projected 20 year economic life. Mr. Nichols insists "there are at least 6 million tonnes of 'untreated' or 'improperly disposed of' waste per year floating around in the Mexican environment for La Pedrera to work on!" and thus he assumes it would not be difficult for La Pedrera to meet its permitted capacity once its operations were in full swing. Although the AAA report noted in passing that the RIMSA facility (Metalclad's future competitor) was operating substantially beneath its permitted capacity, Mr. Nichols made no effort to examine how existing market conditions or competition with RIMSA might affect La Pedrera's projected volume[305].

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301. Ibid. at paragraphs 35-36.

302. Ibid. at paragraphs 26-27, 113-114 and Table 6.

303. Reply at paragraph 514.

304. See Butler Counter Memorial Report at paragraphs 98-99 and 110 and Butler Rejoinder Report at paragraphs 28-31.

305. See Butler Counter-memorial Report at paragraphs 14 and 54-66.

402. Mr. Butler noted that AAA's projected annual volumes would make La Pedrera the largest hazardous waste landfill (by volume) in North America in less than three years, notwithstanding the nearby presence of a well-established competitor that was operating well beneath its permitted capacity[306]. He noted that national waste production figures are not determinative of actual demand for landfill disposal because only a small percentage of the hazardous waste produced annually is suitable for landfill disposal. He obtained the actual waste volume figures for RIMSA and Cytrar and found that actual demand exceeded existing supply by about 200,000 tonnes per annum. He then used reasonable projections for growth in demand (through increased economic output in Mexico and increased enforcement of environmental regulations) to determine that the La Pedrera facility would achieve its later permitted capacity in its tenth year of operations[307].

403. The Claimant did not challenge the waste volume evidence relied upon by Mr. Butler — that RIMSA's hazardous waste receipts in were only 152,024 tonnes in 1994, 134,485 tonnes in 1995 and 205,852 tonnes in 1996, despite its permitted capacity of 420,000 tonnes per annum. Rather, Mr. Deets conceded that these figures, supplied by INE, are "undeniably true"[308].

404. The evidence at the Hearing confirmed that Mr. Butler's assumptions and projections relating to annual volume were reasonable, if not generous. Secretary Carabias testified the national hazardous waste production estimate has been reduced from 8 million tonnes to approximately 4 million tonnes per annum (due to improved assessment methodology) and that most of the hazardous waste produced in Mexico derives from solvents and petroleum products that are incinerated, not landfilled[309]. She also testified that her budgetary priority as Secretary of the Environment has been to develop hazardous waste reduction and recycling programs and to promote the establishment waste treatment facilities, not to promote or enforce landfill disposal of hazardous waste. She testified that there are 5 to 7 CIMARI's (integrated waste treatment and recycling centres) undergoing evaluation at the present time and that "several dozen" other waste treatment and recycling facilities have been opened during her administration.[310].

405. Ms. Williams and Mr. Butler both testified that sophisticated waste reduction, recycling and treatment technologies have been developed in the U.S. over the past two decades. They noted that these technologies are immediately available to Mexican industry and should have a dampening affect on demand for landfill disposal of hazardous waste in the future[311]. Ms. Williams confirmed that less than one percent of the hazardous waste generated in the United States goes to commercial hazardous waste landfills for disposal[312]. If that ratio is applied to Mexico's current annual waste estimate of 4 million tonnes, demand for landfill disposal would be only 400,000 tonnes per annum, less than the existing permitted capacity of RIMSA alone.

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306. Ibid. at paragraph 32 and Table 1.

307. Ibid. at paragraphs 57-80 and Butler Rejoinder Report at paragraphs 31-49

308. See second witness statement of Lee Deets (filed at the hearing over the objection of the Respondent) at paragraph 32.

309. Transcript, Vol. I, at pages 75, 79 and 92-93.

310. Ibid. at pages 87-88, 91-93 and 96-97.

311. See, for example, Ms Williams Counter-memorial Report at 125-127 and Mr. Butler's Counter-memorial Report at paragraph 41 and Table 4.

312. Transcript, Vol. III at page 205.

(2) PRICE

406. The AAA Memorial Report adopted RIMSA's price list and applied it to estimated waste stream ratios supplied by Metalclad to arrive at a projected average price of 150.88 dollars per tonne. Mr. Nichols made no effort to determine whether these waste ratios were accurate or what effect competition with RIMSA would have on price[313].

407. Mr. Butler accepted the RIMSA price list but did his own study of waste stream ratios by examining the monthly waste manifests that RIMSA submits to INE to find that there was actually a lower percentage of high revenue waste streams than Metalclad had represented to AAA. He also made an allowance of 10 percent for price competition with RIMSA, while noting the price reductions could actually be much greater in the event of increased competition with RIMSA and other factors, such as new entrants to the market. His projected price was 113.04 dollars per tonne[314].

408. Mr. Nichols' failure even to consider the effect of price competition with RIMSA is demonstrative of the unrealistic approach taken in his report. He simply accepted what he was told by Metalclad and failed to take into account obvious negative factors. It is submitted that any prospective purchaser, prudent or not, would foresee the certainty of price competition with RIMSA.

409. In the AAA Reply Report by Mr. Nichols attempted to soften the impact of this omission by contending that La Pedrera's better proximity to México City would result in a transportation cost advantage that he contended "ultimately determines landfill of choice". However, Mr. Nichols failed to provide any evidence of transportation costs or how the incremental cost of trucking waste an additional 550 kilometers north on Highway 57 to RIMSA would impair RIMSA's ability to discount its prices to retain existing customers or compete for new ones[315].

410. Mr. Butler referred to an INE study that shows trucking costs in México only amount to 20 percent of the cost of trucking hazardous waste in the United States where, in his experience, waste management companies offer a package of services that often include transportation costs in order to compete in the national market. He expressed the view that La Pedrera's modest location advantage would not be a determinative factor in the fight for market share[316].

(3) OPERATING COSTS

411. The AAA Memorial Report refers to an unexecuted landfill management contract between BFI-Omega and ECOPSA as support for projecting La Pedrera's operating costs at 30% of revenue[317]. This is another example of Mr. Nichols' willingness to uncritically accept information on key assumptions by Metalclad instead of obtaining reliable, verifiable data from independent sources.

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313. See Butler Counter-memorial report at paragraphs 67-70.

314. Id at paragraphs 67-70, 81, and 104.

315. See AAA Reply Report at paragraph 142.

316. See Butler Counter-memorial Report at paragraphs 64-65 and Butler Rejoinder Report at paragraphs 21-24.

317. See AAA Memorial Report at 184 and Exhibit 8.

412. In his Counter-memorial report, Mr. Butler noted that there was absolutely no support for this figure in the contract appended to the AAA report on in any document supplied by Metalclad in response to the Respondent's request for supporting documentation. Mr. Butler examined publicly traded large hazardous waste management companies —waste management companies such as Laidlaw—and looked at the average costs of those companies. They averaged 72%, not 30% as estimated by Metalclad. Mr. Butler settled on a similar (but not in Mexico) Laidlaw facility in arriving at an estimate of the cost of 65%[318]. (See Tab 11 of the Closing exhibits.) This approach was supported by the studies by INE that lead it to conclude (and publish on its website) that the cost of operating hazardous waste management facilities in México was very similar to the cost of operating such facilities in the Untied States[319].

413. In the AAA Reply Report, Mr. Nichols referred to a new document that purported to justify the 30% figure. His explanation for its late production indicates that the "La Pedrera Expense Budget" dated January 1, 1997 was prepared by Mr. Dabbene to substantiate the figure for this litigation, not for the BFI Omega joint venture as he had earlier claimed[320]. Of additional interest:

a) according to the witness statement of Paul Mitchener, BFI had already decided to withdraw from the joint venture to operate the landfill in the latter part of 1996, making it unlikely that BFI would be involved in preparing an expense budget for La Pedrera on January 1, 1997[321];

b) this case was submitted to arbitration day following the creation of this "budget", the Notice of Intent to Submit a Claim having been filed three months earlier; and

c) as Mr. Dabbene admitted under cross-examination, like Mr. Kesler, he had a personal contingency interest in the outcome of this proceeding[322].

414. Mr. Pearce nonetheless placed great emphasis on the significance of the BFI-Omega joint venture as supporting AAA's 30% operating cost assumption. In closing argument he declared that the BFI/Omega contract with ECOPSA, whereby BFI would manage the La Pedrera facility, was "signed and initialed on every page"[323] the implication being that that the agreement was executed by the parties. As pointed out to the Tribunal in the Respondent's closing, while the agreement was initialed on every page, it was undated and unsigned. Moreover, a perusal of the draft shows that there are terms missing.

415. Ms. Williams testified on re-examination that when she was a Director of BFI, the company decided to withdraw from the hazardous waste disposal business (retaining one landfill

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318. See Butler Counter-memorial Report at paragraphs 86-94.

319. See AAA Reply Report at paragraphs 50-53 and Exhibit 17.

320. See AAA Reply Report at paragraphs 50-53 and Exhibit 17.

321. Id at Exhibit 14.

322. Mr. Dabbene's employment contract entitles him to 1 percent of any amount recovered in these proceedings.

323. Transcript, Vol. VIII, pp. 145-146. The Statement "signed and initialed on every page" was recorded in counsel's notes. It must have been made during the tape break.

in Italy) and made commitments to the United States Securities Exchange Commission that would make a reversal of that decision costly[324].

416. In the Respondent's submission, the unsigned BFI-Omega draft is not, therefore, a reliable document on which to base the margin estimate —particularly since the 30% figure is so much lower than the industry average of 72%. Moreover, the fact that the cost estimate (prepared when litigation was contemplated) is not appended to or referred to in the draft contract and not attested to by any BFI witness, makes it unacceptable as a genuine cost estimate that a valuation expert could properly rely on.

417. Even if the agreement had been completed and had entered into force, it had important exclusions that would have directly affect cost[325]. At page 79 of the report, AAA glossed over these excluded costs (Tab 14 of the Closing exhibits at paragraph 184).

418. In addition, Mr. Butler testified on re-examination (as he had pointed out in his Report) that Metalclad's own projections in a February 1995 Project Status Report (a month prior to the hoped-for opening of the facility) indicated operating expenses of 54% to 58%[326]. Given Metalclad's penchant for making overly optimistic predictions to existing and prospective investors, even this estimate should be regarded with a degree of caution. Even so, it bears noting that it is nearly double the operating cost estimate proffered by the Claimant two years later, three months after its intentions to litigate had been announced.

419. There are other anomalies in the two AAA reports that undermine Mr. Nichols' opinion:

a) having noted that the presence or absence of local opposition is an important valuation criterion, he demonstrates he was misled as to the existence of genuine opposition to the La Pedrera project, stating that "paid protestors" were responsible for the March 10, 1995 demonstration[327];

b) having acknowledged that the status of a hazardous waste facility's permits and licenses is an important valuation criterion, he demonstrates that he was misled as to the true state of COTERIN's affairs, stating that construction began on May 16, 1994 "with full approval of the Federal, State and Municipal authorities"[328];

c) he seems to have been instructed that from February 2, 1995 onward "there were delays and obstruction by State and local authorities", apparently unaware that the results of the environmental audit where not known until May, 1995, the

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324. Transcript, Vol. III, at pp. 241-242.

325. At page 12, paragraph 4(F), ECOPSA is solely responsible for monitoring. At paragraph 4(E), ECOPSA is solely responsible for all costs caused by changes in operation or maintenance requirements. At the top of the next page, 4(I), the contractor and ECOPSA are jointly responsible for sales and marketing, and they may each retain separate sales and marketing departments for this purpose.

326. See Butler Counter-memorial Report at paragraph 90 and Transcript, Vol. III at pages 101-105.

327. See AAA Memorial Report at p. 73.

328. Ibid.

Convenio was not executed until November, 1995 and the federal closure order was not lifted until February 1996[329];

d) he willingly accepted Metalclad's schedule of amounts invested in COTERIN and ECOPSA as proof that 20.5 million dollars was directly expended in the acquisition and construction of the landfill, "the bricks and mortar if you will", apparently failing to notice that over 6 million dollars of the claimed expenditure was incurred before Metalclad even acquired an option to purchase COTERIN[330]; and

e) his Reply Report is replete with accusations against Mr. Butler – complaining, for example, that "his 'market basket' approach fails to understand the realities of the Governor of San Luis Potosí" – demonstrating that Mr. Nichols is confused as to the proper role of an expert witness on valuation issues[331].

420. The final shortcoming of the AAA reports is Mr. Nichols' insistence that the date of expropriation is January 2, 1997 (the date the claim was submitted to arbitration) and that the value of the La Pedrera facility would not have been materially different between March 10, 1995 and January 2, 1997[332]. Obviously:

a) the valuation must be taken "as of" the date immediately prior to the occurrence of the measure the Claimant alleges is tantamount to expropriation, not the date the Claim is submitted to arbitration which, under NAFTA Article 1120, must be at least 6 months after the occurrence of the events giving rise to the claim; and

b) the legal status of the landfill varied significantly during that period of time as a result of the continuance of the federal closure order until February 6, 1996 and the approved operating capacity being limited to 36,500 tonnes per annum.

421. As the Claimant has asserted that all hope of resurrecting its project was lost on December 5, 1995 when the Municipality denied COTERIN's application for a construction permit, the only evidence of DCF value is that of Mr. Butler who took care to include, for the Tribunal's assistance, a valuation based on the assumption that the permitted capacity would be restricted to 36,500 tonnes per year, either because the valuation would have to be taken "as of" a date prior to February 8, 1996 when an increase was granted by INE, or in case the terms of the State land use license (which incorporates by reference the 36,500 tonne annual capacity upon which federal approval of COTERIN's environmental impact study is based) were held to prevail.

422. Mr. Butler has assessed La Pedrera's "existing capacity" DCF value as zero to 1.4 million dollars, depending on whether the five year permit is expected to be renewed to allow a 20 year

329. Ibid.

330. Ibid. at paragraphs 176-178.

331. See AAA Reply Report at paragraph 21.

332. See AAA Memorial Report at page IV and paragraph 234 and AAA Reply Report at paragraph 152.

economic life for the facility. The figure includes the cost of remediation, estimated at 3 million dollars, subtracted from a royalty payable to the prior vendors (as per the AAA model)[333].

423. It is not surprising the Claimant has not proffered its own DCF valuation based on COTERIN's pre-February 1996 permitted capacity. There would be no debate about annual volume (the facility would operate at full capacity from the beginning) and disputes over the other key variables —such as price per tonne and operating costs— would not make a substantial difference.

424. It is also instructive to look at the DCF valuations in light of the evidence of asset value and declared tax value to determine whether the valuation experts' projected future cash flow on a realistic basis. The evidence indicates that Metalclad's expenditure incurred in acquiring and developing La Pedrera was far less than the amount claimed and that the declared tax value of COTERIN is only 136,339 dollars and ECOPSA, inclusive of the Eco-Administración project, is only 3.4 million dollars.

425. Common sense dictates that an investor who expended at most somewhere from some hundreds of thousands of dollars to, at most, a few million dollars over a two year period could develop a facility (never operated) worth 90 million dollars, realizing a return on investment of about 3,000 percent[334]. Common sense dictates that those sorts of returns –though frequently predicted by stock promoters– simply do not occur, except in prospecting for rare minerals, oil exploration and the development of patented technology. The Respondent submits that, in all the circumstances, it is clear that the quantum claimed is grossly overstated.

C. Alleged Loss of Market Capitalization

426. Mr. Nichols, who has no expertise in market capitalization analysis, asserted in his report that there was an additional loss of 20-25 million dollars as a result of lost market capitalization[335].

427. This claim raised the question of the company's operating history, the accuracy of its disclosures to the market, the *bona fides* of its directors and officers, and other related matters. This required the Respondent to direct the Tribunal's attention to Metalclad's pre- and post-COTERIN acquisition activities.

428. The evidence reviewed in the pleadings and explored with Mr. Kesler and Mr. Neveau during cross-examination, shows the following:

1) After Mr. Kesler (and Mr. Neveau) acquired control of the company[336], which at that point had no hazardous waste experience[337], he acquired an interest in Environ Technologies Inc. (ETI).

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333. See Butler Counter-memorial Report at paragraphs 98, 113-114 and Table 6.

334 In his Rejoinder witness statement, Mr. Hermosillo expressed surprise at the amount claimed to have been spent on the landfill.

335. First AAA Report at paragraph 235.

336. In the course of doing so, they misrepresented to investors who actually owned the control bloc and also failed to inform investors that they were directors, and in Mr. Neveau's case, an officer, of another money-

Footnote continued on next page

2) ETI then acquired an interest in Eco-Administración, which was to build an incinerator at Santa María del Río, SLP. Three months later, Mr. Kesler arranged for the sale of ETI to Metalclad at substantial cost to Metalclad even though ETI's assets were found to be "insignificant" by the company's auditors[338].

3) Metalclad then announced that Eco-Administración would use (untested) "revolutionary cutting-edge technology" developed by Molten Metal Technology, Inc.

4) Over the next ten months it was discovered that the MMT technology did not work[339]. Metalclad did not disclose this problem to its investors in its SEC filings. During this period, Mr. Kesler announced two more joint ventures in Mexico that were to also use the "revolutionary" technology[340].

5) These projects were to be built in Veracruz and Tamaulipas[341]. Although Metalclad claimed that it was the market leader in the Mexican hazardous waste business, none of these projects broke ground.

6) During 1992, the NAFTA was being negotiated and environmental issues became a political issue. The effect of Metalclad's announcements was to "pump" the stock up.

7) None of the three investments came to fruition. There were major disputes between the shareholders and Mr. Hermosillo was forced out[342]. None of this was disclosed to Metalclad investors.

8) By the beginning of 1993 Metalclad had been promoting its stock for fourteen months and had no financing and no ground-breaking, despite repeated predictions. It needed a project.

9) Mr. Rodarte, who was on "commission" to the Aldretts and had been affiliated with Mr. Kesler and the other original investors since at least August 1991,

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Footnote continued from previous page

losing publicly traded company. Before this Tribunal, they contradicted each other as to when Mr. Neveau's interest arose. Mr. Neveau said that it happened on March 1, 1991 (the date that the SEC filings say that Mr. Kesler only acquired the interest) whereas Mr. Kesler said that he bought the shares and then he and Mr. Neveau agreed in 1993 to retroactively split the shareholding interest. See Transcript, Vol. V, at p. 157 and, Vol. VII, at pp. 89-90.

337. The company's SEC filings stated that the Mexican hazardous waste business was a new business for it.

338. As found by Metalclad's auditors in the company's annual report. In breach of his fiduciary duty to Metalclad, he set up and appropriated a corporate opportunity which he then sold to Metalclad.

339. See Rejoinder, paragraphs 86-99.

340. Ibid. paragraphs 99-119.

341. As Mr. Hermosillo testifies, the third company was not even fully incorporated, yet Mr. Kesler issued a press release announcing it.

342. See Mr. Hermosillo's Rejoinder witness statement at paragraph 37.

introduced the two parties. He did not do so in the discharge of his duties as a federal official.

10) Careful review of the company's SEC filings shows that after Metalclad acquired COTERIN, it began to "migrate" the Santa María del Río project over to La Pedrera (the company spoke of the "integrated waste facility in San Luis Potosí" project). This terminology obscured the abandonment of the Santa María del Río site in favor of La Pedrera.

11) Metalclad did not inform investors of the "contingencies" upon which it had conditioned three-quarters of the payment of the purchase price. In fact, Mr. Borner testifies that Mr. Kesler did not even inform the Board of these amendments to the terms of the option[343]. (The Board minutes support Mr. Borner's account, rather than Mr. Kesler's.) At the same meeting at which the Board ratified the purchase of COTERIN, it approved the payment of 230,000 dollars to Mr. Robertson. He had withdrawn from the company because he was concerned about what Mr. Kesler and Mr. Neveau were doing in the company's name and the accuracy of the company's press releases and securities filings[344].

12) Throughout the 1993-96 period, the company repeatedly made misleading statements to investors as to the state of progress of the COTERIN venture[345].

13) During this time, it engaged in off-shore sales of stock, principally to U.K. investors, using offering memoranda which failed to disclose the true state of affairs. In the February 1996 offering, Messrs. Kesler, Neveau and Guerra personally profited by selling 950,000 shares (while failing to disclose the Municipality's lawsuit against SEMARNAP and the injunction now complained of)[346].

14) During this time, there were numerous irregular payments to company insiders and others such as Lucía Rátner (many labeled as "Legal Expenses"). (These are documented by Mr. Dages and were reviewed in part during Mr. Dabbene's cross-examination.)

15) Eventually, investors began to understand the nature of the company's disclosures and its inability to bring any project to fruition, and were able to calculate how much dilution of stock had occurred while it was under Mr. Kesler's control.

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343. See Mr. Borner's Rejoinder witness statement at paragraph 9.

344. See Mr. Robertson's Rejoinder witness statement at paragraphs 57-58 and 92.

345. See Mr. Dages' first report in this regard. See also Annex One to the Rejoinder and the letter from Mr. Charles Landy to the Tribunal dated September 3, 1999 responding to the evidence of Mr. Richard Falk, the lawyer tendered as a securities expert by the Claimant.

346. See Rejoinder at paragraphs 378-383. During the closing, counsel inadvertently described the *amparo* noted in Mr. Kesler's letter to Mr. Tisshaw as the Municipality's *amparo*; in fact, it was the company's *amparo* against the State (which it lost). The error does not detract from the force of the point made. See Transcript, Vol. IX, at p.190.

429. During Mr. Kesler's cross-examination, the President asked why counsel sought to elicit testimony about the company's other Mexican ventures and the truthfulness of its disclosures[347]. The matters were pursued, not only because the Respondent wished to demonstrate the many false and misleading statements made by Mr. Kesler before this Tribunal, but because the company's market capitalization depended on the assumption that true and accurate information was being communicated to the marketplace.

430. Dr. Mark Zmijewski, a University of Chicago professor who is an expert in market capitalization valuation, stated that his analysis assumed that all disclosures to the markets were truthful[348]. The evidence is overwhelming that they were not[349].

431. In the Respondent's submission, the market capitalization claim is wholly inflated and the company's demonstrated failure to comply with the securities laws undermines the credibility of the rest of the Claim[350].

D. Summary

432. In summary, the Claimant failed to proffer an independent expert (with independent analyses and conclusions) on damages; admitted to misrepresenting expenditures (to the extent that they were identified at all) as La Pedrera expenses; admitted to numerous misrepresentations (which collectively show a strong *prima facie* case of tax and securities fraud) which undermine its market capitalization analysis; and has been shown to have reported a tax value of the asset which, net of its own estimated remediation liability, yields a negative value for COTERIN.

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347. Transcript, Vol. V, at pp. 45 and pp. 161-162.

348. See first Zmijewski Report at p. 7 and second Zmijewski Report at p. 5.

349. Dr. Zmijewski pointed out that there were three very specific causes of the collapse of the share price and the market capitalization of this company: misrepresentations to investors, enormous dilution of the stock, and multiple operating disappointments at Química-Omega, including peso devaluations, the BEI joint venture, and the lack of growth. When Mr. Kesler and Mr. Neveau took over the company in March of 1991, it had roughly 5 million shares outstanding. It had over 34 million shares outstanding, plus warrants and options prior to a 10 to 1 "reverse stock split" necessary to keep the company listed on the NASDAQ exchange.

350. In his third witness statement, Mr. Kesler claimed that the company had had its filings reviewed by the SEC and SFA. The Tribunal is directed to the carefully worded responses of those two agencies. The SEC's letter was dispatched to the Tribunal after the Hearing was completed. They do not support Mr. Kesler's claims.

PART VII: THE CLAIMANT FAILED TO ADVANCE ITS CLAIM IN GOOD FAITH

1. Does a Private Claimant Have a Duty of Good Faith?

433. Article 1131 empowers this Tribunal to decide the issues in accordance with "applicable rules of international law". Does Article 1131 authorize the Tribunal to treat private party claimants as subject to international law requirements, specifically, the duty upon a state to advance international claims in good faith?

434. In discussing Article 42(1) of the ICSID Convention (similar to Article 55 of the Additional Facility Rules), the President of this Tribunal stated:

> "The central question here is: to what extent does this paragraph authorize the Tribunal to apply public international law to the disputes brought before it, not simply as a source of rules to be applied by analogy for the interpretation of an agreement, but as if the Tribunal were sitting to consider the matter as an international claim of the investor espoused by his own national state against the state party to the agreement.[351]"

2. The Applicable Principles of International Law

435. In *The Diversion of Water from the Meuse*, Judge Manley O. Hudson discussed the role of equity in public international law. He concluded that it did form a part of international law and went on to state:

> "...The principle finds expression in the so-called maxims of equity which exercised great influence in the creative period of the development of the Anglo-American law. Some of these maxims are, "Equity is equality"; "He who seeks equity must do equity". It is in line with such maxims that "a court of equity refuses relief to a plaintiff whose conduct in regard to the subject-matter of the litigation has been improper". 13 Halsbury's Laws of England (2nd, ed., 1934), p. 87[352]."

436. In legal disputes between states, the claimant state has a duty to advance its claim in good faith. As noted in the Introduction, Bin Cheng stated in *General Principles of Law*:

> "A state, first of all, has the right to expect from another that "no claim will be put forward that does not bear the impress of good faith and fair dealing on the part of the claimant"[353].

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351. Elihu Lauterpacht, "The World Bank Convention on the Settlement of International Investment Disputes" in *Recueil d'études de droit international enhommage à Paul Guggenheim* (1968) 660 at 665.

352. PCIJ (1937) Series A/B No. p. 70 at p. 77.

353. Bin Cheng, *General Principles of Law*, at p. 159.

437. Historically, states have been quick to act once evidence of fraud or deception arises in a claim which they are espousing comes to light:

> "Nations can not afford to have the intercourse which the interests of their citizens require to be kept open, subjected to the annoyances and risks which would result from the admission of fraud or duplicity into such intercourse. It has therefore become a usage, having the authority of a principle, in the correspondence between enlightened governments, in relation to the claims of citizens or subjects, that any deception practised by a claimant upon his own government in regard to a controversy with a foreign government, for the purpose of enhancing his claim, or influencing the proceedings of his government, forfeits all title of the party attempting such deception to the protection and aid of his government in the controversy in question, because an honourable government cannot consent to complicate itself in a matter in which it has itself been made or attempted to be made the victim of a fraud, for the benefit of the dishonest party[354]." [Emphasis added]

438. Learned publicists and the decisions of national courts and international arbitral tribunals have found that fraud in the presentation of a claim cannot be accepted. As the United States District Court, District of Delaware, stated in *National Oil Corporation v. Libyan Sun Oil Company*[355], a case involving the enforcement of an international arbitral award:

> "Intentionally giving false testimony in an arbitration proceeding would constitute fraud[356]."

439. More recently, Zoller wrote:

> "La bonne foi interdit à un État d'obtenir réparation pour un dommage à la réalisation duquel la victime qu'il entend protéger a, en réalité, contribué. Nul ne peut profiter de son propre tort et le droit international accueille cette règle par la théorie des mains propres (*clean hands*). La conduite blamâble de la victime, *a fortiori* sa mauvaise foi, est une cause d'irrecevabilité de la demande en réparation[357]."

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354. Mr. Seward, Sec. of State, to Lord Lyons, British min., May 30. 1862, MS. Notes to Gr. Brit. IX. 187. See also the comments of Commissioner Hassaurek of the Ecuadorian-United States Claims Commission (1862). 3 Int. Arb., at pp. 27389. Hassaurek's opinion was cited and the same principle was applied in the U.S.-Venezuela Mixed Claims Commission (1903): Jarvis Case, Ven. Arb. 1903, p. 145.

355. 733 F. Supp. 800 (D. Del. 1990).

356. Ibid. at page 222.

357. "Fraud prohibits a State from obtaining reparation for damage to which the victim whom [the State] intends to protect, has in reality contributed. The blameworthy conduct of the victim, *a fortiori*, his bad faith, prohibits the admission of his claim for reparation"). E. Zoller: *La bonne foi en droit international public*, p. 298.

440. In the case of arbitrations between states, it has been said that:

> "Qu'il s'agisse du règlement judiciaire ou du règlement arbitral, on s'accorde à reconnaître qu'il existe à la charge de l'Etat, une obligation générale d'agir de bonne foi[358]."

441. Zoller elaborates on this statement by quoting the international jurist, Paul de Visscher, who as counsel for Honduras in the case of the *Arbitral Award made by the King of Spain on December, 1906*, stated that:

> "Dès l'instant où deux Etats s'engagent à régler un différend sur la base du droit et à la base du droit et à la plus entière loyauté. Dès ce moment, ils doivent savoir que leurs déclarations, leurs attitudes, leurs comportements pourront être retenus contre eux. La justice, à la différence de la politique, ne s'accommode pas de faux-fuyants, de déclarations équivoques, de réserves mentales. La justice vit de sécurité, et s'il en est ainsi, c'est en définition parce que la fonction judiciaire est, au tout premier chef, une fonction sociale. Elle existe dans l'intérêt général autant que dans l'intérêt des parties[359]."

442. Elsewhere it has been stated that "L'exigence de bonne foi enveloppe tout le procès international"[360].

443. Once a State has invoked the jurisdiction of the international tribunal, it must accept all the consequences arising from such invocation:

> "Il doit s'y prêter de bonne grâce et, à cette fin, d'une part, ne pas entraver la mise en œuvre du procès international et, d'autre part, accepter toutes les suites de celui-ci, c'est-à-dire les décisions rendues par l'arbitre ou le juge international[361]."

444. The duty to act in good faith in international proceedings is heightened because of the voluntary nature of the proceedings. Although this principle has been modified in the case of proceedings under Chapter Eleven in that, the NAFTA Parties having expressed their consent beforehand in accordance with Article 1122, they are initiated by unilateral action on the part of an investor of a Party, the proceedings themselves can only be meaningful if the parties co-operate:

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358. "Whether it is a question of judicial or arbitral regulation, the State is under a general duty to act in good faith". *Ibid.*, p. 123.

359. "From the moment that two States agree to settle differences according to the law and with the intervention of a judge, they have bound themselves to act with total loyalty. From that moment, they have to understand that their declarations, attitude and actions can be held against them. Justice, as opposed to politics, does not accommodate prevarication, ambiguous statements, mental reservations. Justice lives by security, and if it so, it is because the judicial function is, first and foremost, a social function. It exists for the general interest as much as for the benefit of the parties." Zoller, *supra*, p. 123.

360. "The requirements of good faith encompass the whole international process". Olivier Pirotte, *La notion d'équité dans la jurisprudence récente de la Cour internationale de Justice*, R.G.D.I.P., 1973, p. 112.

361. "[The State] has to submit to it with good grace and to this end, it must not, on the one hand, obstruct the international process and on the other, it has to accept all the consequences thereof, that is, the decisions of the arbitrator or the international judge." Zoller, *supra*, p. 141.

"Contrairement à ce qui se passe en droit interne, le juge international est la création des parties. Il n'est pas imposé aux parties puisque ce sont elles qui décident librement d'y recourir et qui créent, hormis le cas du règlement judiciaire, l'organe appelé à trancher le différend qui les oppose.

Aussi les Etats ont-ils une double obligation dont il conviendra d'examiner les liens qui l'unissent au principe de la bonne foi: tout d'abord s'abstenir de tout usage abusif des moyens de procédure, ensuite collaborer sincèrement avec le juge ou l'arbitre dans la recherche d'une solution à leur différend.[362]"

445. "Les Etats, parties à une procédure internationale, ont le devoir de collaborer de bonne foi dans l'établissement des preuves"[363]. This principle was referred to in the case of the *Lehigh Valley Railroad Company*[364], in which the Commission declared:

"It is well recognized that governments who have agreed to arbitrate, are under an obligation in entire good faith to try to ascertain the real truth."

446. Given the relative lack of mechanisms for the establishment of facts in international arbitrations, the obligation of good faith is all the more important:

"La bonne foi est donc un élément fondamental du mécanisme de la preuve. Le juge ne peut décider que sur la base d'une collaboration sincère entre les parties et lui-même[365]."

447. The Respondent submits that the Tribunal can find under Article 1131 that the duty of good faith is owed by a private investor claiming under Chapter Eleven.

3. The Evidence of Lack of Good Faith

448. At the Tribunal's First Session held on July 15, 1997, Mr. Pearce state that the facts of this case were not at issue. Messrs. Pearce and Kesler proposed that the Memorial, which had circulated in draft since at least September of 1995, be filed within thirty days and that the Counter-memorial be filed thirty days thereafter. In the Respondent's submission, Metalclad

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362. "Contrary to what happens under domestic law, the international judge is the creation of the parties themselves. He is not imposed on the parties, since it is they who freely decide to have recourse to him and who create the body, except in the case of judicial proceedings, which is to resolve their dispute.

States also have a dual obligation which is worth considering in terms of its links to the principle of good faith: above all, to abstain from every abuse of procedure, in addition to co-operate sincerely with the judge or arbitrator in searching for a solution to their dispute." Elizabeth Zoller, *supra*, pp. 141-2.

363. "States which are parties to an international proceeding are under a duty to co-operate in good faith in order to ascertain the facts." Charles de Visscher, *Problèmes d'interprétation judiciaire en droit international public*, Paris, 1963, p.34.

364. *Recueil des sentences arbitrales*, Vol. VIII, p. 85.

365. "Good faith is thus a fundamental element in the mechanism of proof. The judge can make his decision only upon the basis of sincere co-operation between the parties and himself." E. Zoller, *supra*, p. 149.

proposed the short time period in the hope that the Respondent would not be able to uncover the misstatements in, and omissions from, the case as presented[366].

449. As has been demonstrated in the Facts noted above, the case as first presented was falsely presented in a number of material ways.

450. Some of those misstatements and omissions were pointed out in the Counter-memorial. Over the Respondent's objections, the Claimant was permitted to file a Reply without limitation[367]. In the Reply, Metalclad continued to mislead, primarily by material omission, and presented a revised case.[368] Three examples suffice:

1) First, it continued to claim it was a victim of an opaque legal system[369], without disclosing to this Tribunal the legal advice that it had received prior to acquiring COTERIN and prior to commencing construction.

2) Second, the Reply attempted to justify the falsely described U.S. 20.5 million dollar alleged expenditure by a number of new descriptions[370], by a witness statement from the company's CFO which contained "doctored" exhibits in an attempt to obfuscate the changes in the presentation of expenditures in the company's annual reports, and by the inclusion of hand-written schedules[371] which, *inter alia*, mislabeled as "legal expenses" substantial payments to insiders and improper payments to Ms. Rátner and others, and incorporated alleged payments related to the Claimant's other announced projects in Mexico (which projects Metalclad had not disclosed to the Tribunal).

3) Third, although the Memorial had asserted that RIMSA corrupted State officials, the local NGO (Pro San Luis Ecológico), university professors, and municipal officials, the Reply barely mentioned these allegations.

   The Respondent interviewed all those who were alleged to have been involved. It filed specific denials from former Governor Sánchez Unzueta, Dr. Pedro Medellín

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366. Had the request for a 30-day period been granted, the Respondent would never have had the opportunity to investigate the facts. Even with the time that has elapsed, given the lack of subpoena power and discovery, the Respondent considers that it has been able to uncover only a part of the Claimant's unlawful and acts relating to the investment in dispute.

367. In view of the Parties' earlier agreement to file a complete case in the first set of pleadings, the Respondent requested that the Tribunal issue directions to Metalclad as to what was properly the subject of reply. The Tribunal declined to do so.

368. Although required by Article 38(3) of the Additional Facility Rules to admit or deny the facts alleged in the last previous pleading, Metalclad's Admissions and Denials were in many cases non-responsive and misleading, so much so that they failed to narrow the factual issues in dispute. This was one of the reasons for the Respondent's letter of objection, dated October 5, 1998.

369. See Reply paragraph 448.

370. See Mr. Dages' Rejoinder report at paragraph 9 for a list.

371. Reviewed in Mr. Dabbene's cross examination. See Mr. Dages' Rejoinder report at paragraph 49.

(on his own behalf and on behalf of his late wife), Dr. Angelina Núñez, Municipal President Juan Carrera, Ing. Sergio Alemán, and Lic. José Mario de la Garza[372].

At the Hearing, the Claimant *never* mentioned the "RIMSA conspiracy" in its opening, in cross-examination, or in its closing. Thus ended the once central role of RIMSA in the Claimant's case[373]. The only evidence of an improper relationship with a government official was adduced by the Respondent and implicated Metalclad in the documented improper payments to Lucía Rátner, Humberto Rodarte's wife.

4. The Misconduct at the Hearing

451. The Claimant and its counsel engaged in misconduct at the Hearing. The Respondent notes the following:

1) Mr. Elgin Williams' telephone "hot-line" which disclosed the progress of the Hearing to callers in contravention of the Tribunal's confidentiality ruling[374].

2) An excluded witness as to fact[375], Mr. Dabbene's admission that he reviewed the prior testimony of the Respondent's witness, Mr. Butler, with counsel for Metalclad, in contravention of the Tribunal's exclusion ruling[376]. The alacrity with which Mr. Dabbene gave clearly orchestrated answers when presented with slides of complex financial information by Mr. Cling during re-examination showed that he had been coached extensively.

3) Mr. Neveau's admission that he discussed with Mr. Kesler the latter's testimony on the circumstances surrounding the termination of the relationship between Metalclad and its local counsel[377].

This evidence related to the testimony of Messrs. De la Garza and García Leos that Mr. Kesler proposed to bribe the Governor with a payment of 1 million dollars US and the circumstances surrounding the cessation of Bufete de la Garza

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372. At the Claimant's request, Messrs. Sánchez Unzueta, Medellín, Carrera, and de la Garza were required to attend to Washington, D.C. All did so. In the end, Messrs. Carrera and de la Garza were excused and Messrs. Sánchez Unzueta and Medellín were cross-examined—but not about RIMSA.

373. In the Respondent's submission, RIMSA provided an easy scapegoat for Mr. Kesler and his colleagues, particularly in their dealings with US Embassy officials. It allowed them to blame a would-be competitor for Metalclad's ill-advised acts. However, when put to proof, Metalclad was unable to come up with any such proof. The Respondent notes that Mr. Kesler's testimony, particularly in his second and third witness statements, shows an extraordinary capacity to lay blame at the feet of everyone else but himself. Note his attacks on Messrs. Robertson, Borner, and Hermosillo in his third statement, his list of the "the Governor's lies" in his second statement, and his attacks on Dr. Medellín.

374. Transcript, Vol. V, at pp. 77-78.

375. At the opening, President Lauterpacht specifically ordered Mr. Dabbene and Mr. Carvajal to leave the Hearing room before the Claimant's opening. See Transcript, Vol. I, at pp. 5-6.

376. Transcript, Vol. VI, at pp. 223-225.

377. Transcript, Vol. VII, at pp. 154-159.

as Metalclad's local counsel[378].

The significance of counsel's coordinating a witness' responses was the subject of prior comment by President Lauterpacht. When Mr. Pearce sought to confer with Mr. Kesler before re-examination, the President commented: "...it would be better if you did not discuss the matter with your witness, and I think it's better from your point of view, too. Quite apart from the fact that the other side are objecting, from your point of view it means that your witness is giving clean, unadulterated evidence without there being any suggestion that he's been in any way influenced"[379].

Notwithstanding President Lauterpacht's comments about influencing witnesses when the subject arose with the first of the Claimant's witnesses, Metalclad then coached at least Mr. Dabbene and Mr. Neveau.

4) Mr. Pearce's misrepresentation of the BFI-Omega "contract" as "initialed and signed on every page" implying that it was an executed contract when closer examination showed that it was undated, incomplete, and unsigned[380].

5) Mr. Pearce's misstatement of the evidence of Salomón Ávila Pérez in his closing "vignette", in which he implied that the Governor to which he was referring was Governor Sánchez Unzueta, when in fact Mr. Ávila Pérez served as Municipal President two years before Mr. Sánchez Unzueta was elected and his statement expressly referred to Governor Leopoldino Ortiz Santos[381].

6) Metalclad's refusal to provide copies of the materials used in the cross-examination of the Respondent's witnesses to the Respondent so that they could be reviewed for their accuracy and fidelity to the record, notwithstanding the Respondent's oral and written requests and the President's noting of the request[382].

The Respondent therefore has had no opportunity to check the cross-examination exhibits against the record evidence in order to determine whether they include additional evidence, not properly before the Tribunal given the President's earlier order. It would be improper for the Tribunal to rely upon any evidence elicited in cross-examination based on evidence that is not shown to be on the record.

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378. An issue which Mr. Kesler felt important enough to discuss with Mr. Neveau in contravention of the President's exclusion order.

379. Transcript, Vol. V. at p. 231.

380. In light of Mrs. Williams' testimony that while she was a BFI Board member, that company withdrew from the hazardous waste business and that given commitments that it made to the SEC it would be difficult for it to re-enter the business, there is a serious question as to whether BFI headquarters ever gave approval to conclude such an agreement.

381. See Transcript at pp. 154-155. Witness statement of Salomon Ávila Pérez at paragraphs 5, 12.

382. See Transcript, Vol. I at pp. 77-78 and p. 220, and Vol. IV, at p. 105. See the letter from Mr. Perezcano to Mr. Pearce dated September 5, 1999. At Vol. IV, p. 105, the President stated: "I'm sure that Mr. Cling can provide you with the documents." Counsel did not do so.

5. What the Claimant Did Not Do at the Hearing

452. Having made extremely serious allegations against many individuals, the Claimant backed away from confronting the key witnesses at the Hearing. Notably, Messrs. Sánchez Unzueta and Medellín were not cross-examined on the alleged corrupt relationship with RIMSA.

453. In addition, notwithstanding that Mr. Kesler denounced Messrs. Hermosillo and de la Garza thoroughly in his written testimony, Metalclad chose to excuse both witnesses after they traveled to Washington to be cross-examined.

454. In his written testimony, Mr. Kesler had testified that Mr. Hermosillo did "things that made us uncomfortable" and took "kick-backs"[383]. As for Mr. de la Garza, he had testified that if his conduct had occurred in the United States "he would be disbarred and liable for civil and criminal prosecution"[384].

455. Both witnesses had testified that Mr. Kesler had engaged in acts which could constitute criminal conduct under U.S. and Mexican law: Mr. Hermosillo testified that Mr. Kesler was fully aware of and approved making Lucía Rátner a shareholder of Eco-Administración while her husband was the local SEDUE sub-delegate. He also testified that the purported sale of shares in two of the original ventures by one José de Jesús de la Torre to Eco-Metalclad (in another agreement signed by Mr. Kesler alone) did not make sense because no shares in those companies were ever issued to such an individual while he was the General Director of the companies[385].

456. Mr. de la Garza, when informed that he was accused of having conceived the idea of "influencing" the Governor, denied the allegation and said that it was Mr. Kesler's idea to propose a bribe of 1 million dollars to the Governor. Mr. de la Garza's testimony was buttressed by his law partner, Lic. García Leos. Thus arose the dispute over who terminated whom at the end of April 1995 and Mr. Kesler's disavowal of Mr. Neveau's testimony about the sending of the April 28, 1995 letter.

457. Given the seriousness of the allegations, the Tribunal could reasonably expect that the allegations would be put squarely to the witnesses. They were not. The witnesses were excused after they showed that they were willing to be cross-examined. The Respondent considers that it was no coincidence that they were placed last in the order of witnesses after the Respondent's experts. In its submission, the Claimant never intended to run the risk of cross-examining these witnesses (and Mr. Dages). The Claimant intended only to see whether the witnesses would appear and had they not, would have called for adverse inferences to be drawn.

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383. Third witness statement at paragraphs 29-30.

384. Reply witness statement at paragraph 66. Mr. Kesler apparently assumed that even in the U.S., a lawyer who was alleged to have engaged in a criminal act (as alleged by Mr. Rodarte in his first witness statement) would be bound by privilege and unable to defend himself.

385. Rejoinder witness statement of Jorge Hermosillo at paragraphs 14-18.This is discussed at Rejoinder, paragraphs 155-159.

6. The Relevance of the Claimant's Misconduct Outside of the Hearing

458. During the Hearing, the Respondent explored the Claimant's other misconduct (including improper payments to insiders, misstatements, omissions and worse, to a number of different bodies: the IRS, the SEC, the U.S. Embassy and the Mexican authorities).

459. The President requested that Respondent's counsel demonstrate the relevance of certain cross-examination. Counsel was reluctant to respond fully to the President's questions because of the fear (rightly as events transpired) that the Claimant and its counsel would coach witnesses on what to expect in cross-examination.

460. It is hoped that the relevance of Metalclad's misconduct is now more apparent to the Tribunal, as follows:

A. It Goes to Credibility

461. In the events giving rise to this proceeding, the company repeatedly made false statements to Mexican authorities, the U.S. Embassy, US legislators and its own investors. This propensity for misstatement, omission and misconduct has continued before this Tribunal.

462. The evidence of Messrs. Kesler, Neveau, Dabbene, and Mr. Rodarte, in particular, should be disregarded. In manifold ways, they have shown that their written and oral testimony cannot be considered to be credible.

463. At the least, where there is a conflict in testimony, the Tribunal should prefer the evidence of the contemporaneous documents and the witnesses who have tendered statements at the Respondent's request. The Tribunal should pay particular attention to the testimony of persons who were previously affiliated with the Claimant: the former Chairman of the Board, Mr. Ronald E. Robertson, a former Member of the Board, Alan Borner, the former General Director of Eco-Administración and the other two pre-COTERIN ventures, Descontaminadora and Eliminación, Mr. Jorge Hermosillo, and the company's former legal counsel, Lic. de la Garza and Lic. García Leos[386].

464. The expert reports on Mexican law have been shown to have been based on false factual premises and should be rejected. Similarly, the AAA Report's reliance on data prepared by Mr. Dabbene makes it not credible.

B. It Explains Why Metalclad Ignored Its Own Legal Advice and the Municipality

465. The evidence showing Mr. Kesler's (and Mr. Neveau's) promotion of Metalclad as the hazardous waste "market leader" in Mexico, yet failing to have realized any of the three ventures announced prior to the COTERIN acquisition, explains why Metalclad was in such a hurry to construct without seeking the Municipality's concurrence.

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386. Two of these witnesses, Lic. de la Garza and Ing. Jorge Hermosillo, were present in Washington to be cross-examined. They were excused.

466. Significant expenditures of moneys borrowed or raised in stock offerings and then spent in undisclosed ways, substantial and irregular compensation of company insiders and others, and repeated premature announcements of imminent "ground-breakings" which did not occur, all put pressure on Messrs. Kesler and Neveau to have some kind of facility open[387].

467. While the existence of local opposition was significant enough to lead Metalclad to condition three-quarters of the purchase price on obtaining the Governor's support to commence construction, resolving the municipal permit issue, and inserting a "violence of the neighbors" clause in the option agreement, the imperative to have some kind of facility constructed led the company to ignore the Municipality and the advice of its local counsel[388].

C. It Reveals Improper Acts Relating to Facts at Issue[389]

468. At the Hearing, the Respondent explored Mr. Kesler's, and then Metalclad's, relationship with Mr. Rodarte, while the latter was a federal official in San Luis Potosí and Mexico City. The Respondent considers that Mr. Rodarte's role in arranging the sale of COTERIN is central to testing the credibility of the company's claim that assurances were given by federal officials[390]. Having improperly affiliated itself with a federal official who sought to advance the company's interests, Metalclad sought to obscure the true nature of that relationship in this proceeding[391].

D. The Evidence of Stock Manipulation Directly Relates to the Claim of Lost Market Capitalization

469. As Dr. Zmijewski pointed out in his expert reports, analysis of market capitalization must be based on the assumption that Metalclad's disclosures to the market were accurate and truthful. The evidence is overwhelming that they were not. The company's market capitalization collapsed, not for reasons attributable to the Respondent, but because of repeated false and misleading statements to the market, because of projects that were not realized by Metalclad, both before and after COTERIN, and because of the company's poor performance in other areas of its business.

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387. A landfill was particularly attractive as it was much cheaper to construct that an incinerator (the type of project that Metalclad had announced for Santa María del Río, Veracruz and Tamaulipas and abandoned at Santa María del Río in the faces of local opposition).

388. It explains why the company invoked the assistance of the U.S. Embassy (again misstating the facts and omitting to inform it of certain material facts) in the hope of pressuring the Mexican federal authorities to in turn pressure the State and municipal authorities.

389. The Respondent's expert, Mr. Kevin Dages, showed that Mr. Kesler created a corporate opportunity whilst in a fiduciary position, then arranged for the sale of that opportunity to Metalclad. This cost Metalclad over $5 million for an investment whose assets and liabilities were, in the company's own auditors' words, "insignificant". Mr. Kesler then sought to appropriate another corporate opportunity in proposing the establishment of a separate company to licence Molten Metal's technology in Mexico (after agreeing that Metalclad would pay to test its commercial viability).

390. A prime example being the June 11, 1993 meeting with Governor Sánchez Unzueta in which Mr. Rodarte initially described his own attendance was as a result of being sent by SEDESOL.

391. And who, the evidence shows, the local people mistrusted because they suspected that he was corrupt. See the witness statement of Anthony Talamantez, a Metalclad witness. See also the Rejoinder at paragraph 334.

470. The Tribunal should place no reliance on Mr. Kesler's assurances that Metalclad has not encountered difficulties with securities lawsuits and regulations. When read closely, the letters from the U.K. Securities and Futures Authority and the Securities Exchange Commission do not confirm Mr. Kesler's claims[392].

392. Both were filed with the Tribunal during and after the Hearing (the SFA's on August 25, 1999 and the SEC's on September 10, 1999).

PART VIII: SUMMARY

471. At the first meeting of the Tribunal, the President commented that this was a historic arbitration, not only because it was the first under Chapter Eleven but also because it was the first under the Additional Facility Rules. The Tribunal will be aware of the ramifications of its decision.

472. The right which NAFTA confers upon investors to have direct access to international arbitration is a valuable and a remarkable remedy in the North American context. NAFTA's predecessor agreement in the region, the Canada-U.S. Free Trade Agreement, did not have investor-state arbitration.

473. Thus, Chapter Eleven was an extraordinary development. It should not be debased by misrepresented claims such as the one which has been advanced in this proceeding.

474. The Respondent and the other NAFTA Parties have a genuine policy concern that claimants come to tribunals such as this with clean hands. If a state has the duty to make a claim with clean hands and to act in good faith, why not a private litigant?

475. This Tribunal must reflect carefully how it could find that this Claimant, with this documented history of misconduct, and this demonstrated propensity to misstate the facts, omit material evidence, and file false testimony and experts' reports, has the requisite clean hands to advance this Claim[393].

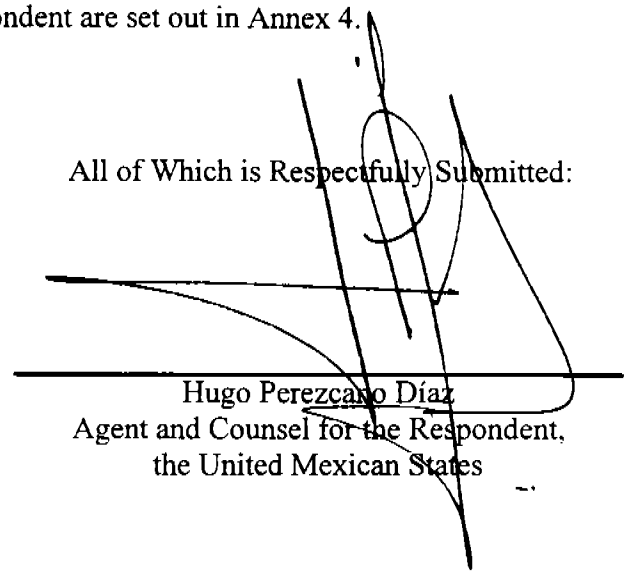
393. The Respondent notes that in the *Southern Pacific Properties* case, relied upon by the Claimant, the respondent asserted that the claim was not "receivable" and was ill-founded due to irregular contacts and corruption. This defence did not prevail in that case because of the absence of concrete evidence and the absence of a specific allegation of unlawful conduct on the part of the claimants. [See the Award at paragraphs 127-132.] The facts of this case are categorically different. The documentary evidence of the improper relationship between Metalclad and Mr. Rodarte, is unusually cogent evidence.

RELIEF REQUESTED

A. The Respondent requests that the Claim be dismissed with the Tribunal's costs and the Respondent's costs awarded to the Respondent.

B. The costs claimed by the Respondent are set out in Annex 4.

All of Which is Respectfully Submitted:



Hugo Perezcano Díaz
Agent and Counsel for the Respondent,
the United Mexican States

ANNEX 1

1. Introduction

1. Contrary to Mr. Pearce's contention in closing, the Claimant is not entitled to ask the Tribunal to infer, on the allegation that the Respondent refused to produce copies of RIMSA's municipal permits, that RIMSA was not required to obtain a municipal construction permit to establish a hazardous waste landfill in the State of Nueva León.

2. The Tribunal specifically set out a means for resolving disputes over disclosure of documents and the point at which it could draw an adverse inference for the non-disclosure of a document. It will be seen that the Claimant did not follow that means.

3. Equally importantly, Metalclad's attempt to direct the Tribunal's attention to how the State of Nuevo León addresses state and municipal permitting issues is legally irrelevant to the question of how the State of San Luis Potosí does so. Under the NAFTA's national treatment obligation, the standard of treatment is not what a state does in comparison to what other states of a federation do, but only what the state does in relation to the investor in question in comparison to other investors in like circumstances: See Article 1102.3.

2. The Claimant's Request for Production of RIMSA's Federal, State and Municipal Permits, Environmental Audits, Monthly Waste Manifests, Tax Returns and Other Documents

4. In its "Second Request for Documents" the Claimant requested production of several broad categories of documents relating to RIMSA's operations, expressly for the purpose of assessing the accuracy of information concerning RIMSA's permitted capacity relied on by Mr. Butler in the preparation of his first report.

5. Mr. Pearce's letter to Mr. Perezcano dated May 25, 1998 stated as follows:

> ... The first request was for documents that were either omitted from the Counter-memorial or were defective. The Second Request for Documents is for information apparently relied upon by witnesses (expert and lay) which information is essential for analysis of the Counter-memorial and in the preparation of Claimant's Reply. [Emphasis added.]

6. The Claimant's Second Request for Documents stated at page 6:

> "Wit. Stmt. Butler, p.18, n.19, ¶56
>
> 7. RIMSA's current permitted capacity of 35m/mo. Or 420m/yr. "per INE". Please provide the documents so establishing viz. a copy of all RIMSA's operating and construction permits authorizing its annual tonnage including any and all modifications or extensions to the RIMSA permits; a copy of the Nueva León State land use permit; and the applicable municipal construction permits. [These documents are important in evaluating the assumptions made by Butler as well as his analysis and comparisons.]" [Emphasis added]

8. At page 7 it stated:

"Wit. Stmt. Butler, p. 27, ¶92

...

Copies of any audits past or current performed on RIMSA. Any and all "public documents" on RIMSA and any of its subsidiaries relied on, used or gathered by Respondent. To the extent said documents do not include the following, also please provide: copies of all RIMSA permits, federal state and local; with all modifications and amendments thereto; audits past or present by INE, Nueva León or RIMSA, manifests, tax returns for the years 1994, 1995, 1996." [Emphasis added]

9. By letter dated July 16, 1998, the Respondent provided some of the documents pertaining to RIMSA requested by the Claimant and gave its reasons for not producing others.

10. As to the documents requested at page 6 of the Claimant's request, the Respondent replied as follows:

"We have confirmed that Mr. Butler relied on information from INE as to RIMSA's authorized annual tonnage, which was confirmed by a RIMSA representative who also confirmed that RIMSA was not operating at full capacity. Mr. Butler did not consult state or municipal authorities, nor did he have access to or rely on any of RIMSA's state or municipal permits, licenses or authorizations given that the landfill is situated in a different Mexican State. Therefore, only a copy of the federal authorization that allows RIMSA to accept up to 420,000 tonnes of waste per year is provided." [Emphasis added]

11. As to the documents requested at page 7 of the Claimant's request, the Respondent replied as follows:

1. "The only documents concerning RIMSA that the Respondent "relied upon, used or gathered" are the monthly reports referred to in paragraph 16 above[1]. The Respondent declines to seek, gather and produce the additional documents requested for the following reasons:

- the request is in the nature of broad discovery rather than a request to produce specific documents that have been shown to be relevant to matters properly arising in the Reply to the Counter-memorial;
- the requested documents pertain to the business affairs of the Claimant's primary competitor;
- RIMSA's tax returns are confidential documents that are not available to the Respondent."

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1. These documents consisted of monthly manifests submitted to INE by RIMSA that Mr. Butler used to determine the kinds and relative amounts of hazardous waste that were then being sent for landfill disposal. These documents were produced to the Claimant in their entirety.

12. The Claimant issued a further request for documents on May 17, 1999, after the Written Procedure had been completed, wherein it requested the Claimant to produce 50 further documents and classes of documents. The only request for a document relating to RIMSA was for "a copy of the most recently issued INE permit for the RIMSA facility"[2]. That permit was previously provided to the Claimant with the Respondent's July 16, 1998 response to the Claimant's Second Request for Documents. It was also filed as an appendix to John Butler's Rejoinder report on valuation.

13. On the question of production of documents, the minutes of the First Session of the Tribunal provide as follows[3]:

> The question of the disclosure of documents or witnesses was raised. The President noted that, if one party sought the disclosure of a document by another party, it should request that party to disclose it. If the requested party did not disclose the document, the requesting party could ask the Tribunal to request the disclosure of the document. If the requested party did not comply with the Tribunal's request, then the Tribunal might draw certain inferences therefrom. [Emphasis added.]

14. The Claimant did not request any other RIMSA documents, nor did it request the Tribunal to direct production of any RIMSA document at any time during the Written Procedure.

15. The Claimant's Marshalling of Evidence Memorandum did ask the Tribunal to direct the Respondent to produce 15 classes of documents. However, none of the documents pertained in to RIMSA and in any event the President refused to order that any documents be produced because the Written Procedure was closed.

16. Therefore, there is no basis for Mr. Pearce's request that the Tribunal infer that RIMSA was able to construct its facility in Nueva León without obtaining municipal permits and thereby enjoyed more favorable treatment than COTERIN, contrary to Article 1102 (National Treatment) of the NAFTA, or at all.

17. As demonstrated above, the Claimant has never made a specific request for production of RIMSA's municipal permits or a request for such permits in connection with national treatment issues. It requested documents that it claimed were necessary to assess Mr. Butler's findings. The Respondent duly produced everything that Mr. Butler relied on. To the extent that Metalclad requested broad classes of documents, the Respondent gave a reasoned response to the request.

18. The Claimant has never reiterated a request for production of any of RIMSA's permits (save the INE permit which had already been produced), nor did it seek the aid of the Tribunal to compel the production of such documents pursuant to paragraph 13 of the minutes of the First Session. Accordingly, the Claimant cannot now contend that the Respondent has deliberately withheld such documents, nor can it properly ask the Tribunal to infer that RIMSA was not required to comply with the municipal permitting requirements in effect in the State and Municipality where it carries on business.

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2. Letter from the Law Offices of Clyde C. Pearce to Lic. Hugo Perezcano Díaz, July 16, 1998, paragraph 16.

3. Minutes of the First Session of the Tribunal, Washington, D.C., July 15, 1997, at paragraph 13.

19. The Respondent observes in closing that there were many documents requested of Metalclad that were not produced. Throughout this proceeding, the Respondent was careful to specify why it sought a document and its expected relevance to the facts at issue

ANNEX 2

QUESTIONS POSED BY TRIBUNAL

On September 7, 1999, the Tribunal invited further argument from the parties on a series of questions. The following are the Respondent's answers in summary form, together with references to the Closing Submissions.

QUESTION 1:

Is the Federal Government of México internationally responsible for any conduct of the State or the Municipal authorities that leads to a breach of NAFTA?

ANSWER 1:

The Respondent is prepared to proceed on the basis that Chapter Eleven applies to all levels of the Mexican State. It notes that there is an alternative reading available; according to that interpretation, the only obligation in Chapter Eleven that is expressly applicable to municipal authorities is the national treatment obligation. See Part VI of the Respondent's Closing Submissions, at paragraphs 234 to 242.

Even if it is covered by the NAFTA, an act by a municipal authority, whether lawful or unlawful under domestic law, cannot amount to a breach of NAFTA (unless it is a formal act of expropriation for which compensation has not been given or a denial of fair and equitable treatment), where effective local remedies exist in the court system, are exercised, and are abandoned by a claimant with no complaint concerning fair treatment by the domestic court system.

In other words, an action by the first level of municipal government cannot amount to a measure tantamount to expropriation or a denial of fair and equitable treatment in the absence of evidence that the legal system as a whole has failed: see *ELSI* ; see also Respondent's Closing Submissions, at paragraphs 275 to 277.

In addition, conduct that does not amount to a "measure" is not subject to review by the Tribunal. For example, political speech, for or against an investment, by a political candidate does not constitute a "measure". To the same effect, conduct by anyone other than an official organ of the State, and not imputable to the State, does not amount to a measure and is not subject to review by this Tribunal.

Moreover, the response of local officials to local public pressure does not *per se* constitute arbitrary conduct: see *ELSI* at paragraph 126.

Lastly, an exercise of regulatory powers by a municipality does not constitute expropriation: See paragraphs 273 to 296.

QUESTION 2:

Is there still any relevant difference between the Parties on the questions of retroactivity and anticipatory breaches discussed in the written pleadings?

ANSWER 2:

The Claimant abandoned its reliance upon retroactive application of the NAFTA. The Respondent agrees that pre-NAFTA conduct cannot give rise to a breach of the NAFTA, although pre-NAFTA conduct may be considered as part of the factual matrix. The Claimant's decision to invest was made prior to NAFTA's entry into force and in the face of known risks, which risks materialized. In the result, the Claimant abandoned the project. The Claimant's pre-NAFTA conduct, and misconduct, can be examined by the Tribunal.

Insofar as anticipatory breaches are concerned, the Respondent maintains the position set out in the Counter-memorial. The ecological decree, promulgated one year after the Notice of Intent, and not contained in the Claimant's Submission, is outside the scope of this Tribunal's jurisdiction.

It is a separate question whether this Tribunal has jurisdiction to grant an amendment to the submission to consider ancillary claims under ICSID Additional Facility Rules, Article 48.

In the instant case, any application to amend would be moot since on the facts, the Claimant alleges that the project was taken well before the promulgation of the ecological decree.

Alternatively, if an amendment were allowed, on the facts before this Tribunal, the ecological decree has been shown to have no effect tantamount to expropriation on this investment.

See paragraphs 338 to 346 of the Closing Submission.

QUESTION 3:

What does "tantamount to expropriation" mean under NAFTA 1110?

ANSWER 3:

Both the Claimant and the Respondent agreed that "tantamount" means "equivalent". Accordingly, all of the elements of an expropriation must be present: see Respondent's Closing Submissions, at paragraphs 251 to 254.

The Respondent also notes that, unlike its regional predecessor, NAFTA speaks of a singular measure tantamount to expropriation. The deletion of the words "or series of measures" indicates the drafters' intention to preclude the cumulation of acts in order to find such a measure.

The Respondent also considers that, while a sub-national measure that is expropriatory on its face may be taken to a Chapter Eleven tribunal, an act of a sub-national government that is alleged to be a measure tantamount to expropriation should be first tested in the domestic courts because the response of such courts to the act will be bound up into a determination of whether the act could be transformed into a measure tantamount to expropriation. See Closing Submission at paragraphs 275 to 277.

QUESTION 4:

If Claimant asserts a violation of NAFTA 1105, what exactly was the violation?

ANSWER 4:

This was a question for the Claimant. In its closing speech, the Claimant did not identify any precise violation, preferring to rely upon the "totality of the circumstances" and the "cumulative effect" principle so as to avoid answering this question. In the Respondent's submission, no violation of Article 1105 has been demonstrated, either precisely or on the basis of any so-called cumulative effect: see the Respondent's Closing Submissions, at paragraphs 301 to 330.

QUESTION 5:

Does NAFTA 1114 have any material bearing on the issues in this case?

ANSWER 5:

The language of 1114 shows that Chapter Eleven was not intended to undermine the ability of governments to take regulatory actions, including actions based upon environmental concerns, even when that regulation may affect the value of an investment. Any such action should not be considered to amount to expropriation requiring compensation since NAFTA was not intended to undermine the ability of governments to regulate for the protection of health, safety and the environment.

Article 1114 also means that the fact that a government authority may have been motivated by environmental concerns, in and of itself, cannot be held to be a violation of international law.

The phrase "otherwise consistent with this Chapter" in Article 1114 ensures that, if a nation were to apply an environmental measure in a manner that, for example, denied national treatment, that measure could still be a violation of Chapter Eleven. The phrase "otherwise consistent with the Chapter" however, cannot be interpreted so broadly as to make Article 1114 meaningless. That would conflict with the principle of effectiveness, recently explained by the WTO Appellate Body as follows:

> ... interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility[1].

See Closing Submission at paragraph 248.

1. U.S.-Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R. p./ 23, adopted May 20, 1996.

QUESTION 6A:

With regard to hazardous waste, did the federal authorities have exclusive jurisdiction to grant or deny construction and operational permits based on the environmental impact of the project on the community? Please recall briefly the relevant legal authorities and the evidence.

ANSWER 6A:

As a general point in response to this question, the Respondent directs the Tribunal to the *ELSI* case and to the comments of the former President of the International Court of Justice at paragraphs 11-12, 225-226, and 303 to 309 in the Closing Submission.

The federal authorities did not have exclusive jurisdiction in the case of hazardous waste. The Claimant's legal advice is reviewed in detail in paragraphs 50 to 55 and 63 to 71.

The relevant statutes are reviewed at paragraphs 199 to 210.

The expert opinions are reviewed at paragraphs 211 to 229.

QUESTION 6B:

Conversely, is it true that, whatever authority the local municipality had regarding the grant or denial of construction permits, that authority did not lawfully extend to consideration of environmental concerns in the case of hazardous waste?

ANSWER 6B:

The authority of the local municipality did lawfully extend to consideration of the impact on the environment in the case of any construction project having significant impact.

See Respondent's Closing Submissions, at paragraphs 199 to 210 and 220 to 224.

QUESTION 7:

If Metalclad were held entitled to receive the fair market value of its total investment in México, what happens in law to the ownership of that investment, i.e. does México acquire ownership or does Metalclad continue to own the facilities?

ANSWER 7:

Metalclad today owns, and would after an award of damages, continue to own the facilities. This tribunal has no jurisdiction to make an order vesting in México's ownership of Metalclad's investment. See Article 1135.

The Site is subject to an existing liability by reason of the prior contamination. Metalclad would, no doubt, be pleased to be free of responsibility for remediation of that contamination. That explains its closing speech offer to quit claim its interest in the Site in exchange for a damages award. It is not open to this Tribunal to assume Metalclad should be free of the liability to remediate.

This question uses the phrase Metalclad's "total investment in México". This Tribunal is aware that Metalclad has numerous separate ventures in México, and that Metalclad has totaled all of its alleged (but unproven) expenditures in México, claiming all those expenditures as damages (after falsely describing them as the cost of acquisition and construction of La Pedrera.)

What would happen to the ownership of all those other investments? Does México acquire ownership of Metalclad's "total investment in México"?

This phrasing highlights the limits of this Tribunal's jurisdiction. It has no jurisdiction to transfer ownership of any investments, much less Metalclad's total investment in México.

QUESTION 8:

Is the subject-matter of the claim in this arbitration an allegation of a breach of an obligation under NAFTA 1105 or under NAFTA 1110, or both, and would the quantum of damages or compensation differ according to whether liability might be found under the one or the other?

ANSWER 8:

Metalclad relies on both Articles 1105 and 1110, repeating the same allegations of fact under both articles, without identifying exactly the violation of either article, preferring to rely upon the "totality of the circumstances" and the "cumulative effects" argument.

In the Respondent's submission, the quantum of damages or compensation will differ according to the precise violation found, and the economic effects caused by that violation, and that this principle would apply to both Articles 1105 and 1110.

In the case of Articles 1110, the compensation would vary with the precise identification of the "investment" that was expropriated and the date of the expropriation. In the case of Article 1105, the compensation would vary with the identification of the precise violation and its effects.

By way of example, under Article 1110, if an expropriation was found to have occurred by the denial of the municipal permit on December 5, 1995 –the date pleaded by the Claimant-- any damages calculation must reflect that, as of that date, COTERIN's federal permits restricted the capacity of the landfill to 36,500 tonnes per annum for a period of 5 years.

By way of example, under Article 1105, if a denial of fair and equitable treatment occurred by the Municipality's institution of the domestic proceedings against the *Convenio*, the only appropriate compensation might include the legal costs incurred by Metalclad in those proceedings and any loss of revenue arising from the delay occasioned by those proceedings.

This question also contains the possibility of a breach of an obligation of "both" Articles 1105 and 1110. If the same facts alleged amount to a denial of national treatment also amount to a compensable expropriation, the Claimant would be fully compensated by compensation under Article 1110.

QUESTION 9:

In relation to NAFTA 1110, does the evidence support all the methods of determining market value referred to by the experts, e.g.,

1) comparable sales;

2) cost less depreciation;

3) capitalization of net income to present value (DCF); or

4) reduction of market capitalization value;

or are the methods reduced to a lesser number and, if so, which methods survive.

ANSWER 9:

1) No evidence.

2) According to the Claimant's own tax return for 1996, COTERIN had a tax declared value of a total of 136,339 dollars, before the cost of remediation is included. When the remediation cost is included, COTERIN has a negative value.

   See Closing Submission at paragraphs 371 to 377.

3) DCF: The decided cases have held against employing a DCF method when the investment is not a going concern. Many factors militate against doing so in this case.

   See Closing Submission at paragraphs 378 to 394.

   If a DCF method is used, on the date of expropriation (December 5, 1995) with a 5-year permit, COTERIN was worth zero; with a 20-year permit, it was worth 1.4 million dollars.

   If the DCF method was used for a subsequent date of expropriation—which by virtue of an estoppel cannot be employed—COTERIN was worth at most 10.8 million dollars. See Closing Submission at paragraph 397.

4) Market capitalization: The Dages Reports and Zmijewski Reports show that the lost market capitalization claim is wholly without merit.

   See the Closing Submission at paragraphs 427 to 432.

QUESTION 10:

What are the respective ranges of damages under each method, and why?

ANSWER 10:

See answers to Question 9 above.

ANNEX 3

THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, DC, SEPTEMBER 7, 1993

Hon. Henry A. Waxman, Chairman
Subcommittee on Health and the Environment
Committee on Energy and Commerce
Washington, DC

DEAR CONGRESSMAN: Thank you for your letter of June 23, 1993, in which you raise a number of questions concerning the interpretation and application of the provisions of the North American Free Trade Agreement (NAFTA) in connection with several environmental concerns...

... *Question 5.* Section 105 of NAFTA provides that the parties are to insure "all necessary measures are taken in order to give effect to (its) provisions ***, including their observance *** by state and provincial governments." Does this require the U.S. to pre-empt any state and local laws, and does the Administration intend to include any pre-emption provisions in its implementing legislation?

Response. Article 105 is intended to ensure that the federal government in each of the three NAFTA countries is fully accountable for any state or provincial measures covered by the agreement. This provision is drawn virtually verbatim from the United States-Canada Free-Trade Agreement (CFTA).

Article 105 does not establish or require federal preemption of state or provincial measures. It does mean that the federal government will be held accountable if it cannot secure state or provincial compliance with NAFTA obligations.

The precise legal relationship between the NAFTA and a country's domestic law is a matter for each participating government to decide. For example, we understand that México intends to adopt NAFTA into its domestic law, thus superseding any pre-existing, inconsistent Mexican federal or state law.

In the United States, this issue will be addressed in the NAFTA implementing bill. The Administration will be working with the Congress to develop the NAFTA implementing legislation, including any provisions necessary or appropriate to implement Article 105.

It is important to note that where a question arises concerning the consistency of a state law with U.S. international trade obligations, the Executive Branch works with the state through co-operation and consultations. We ensure that our states are fully briefed on any discussions with other governments concerning state laws and are kept involved in any dispute settlement proceedings that may be initiated. In the case of the NAFTA – as we have done in connection with the CFTA – we would expect state representatives to be full participants in any panel proceedings concerning their laws.

In the one instance where state measures were successfully challenged before a GATT panel, we have not had recourse to preemption or lawsuits. Rather, we have worked with the state involved to see what, if any, solutions to the question can be found that would fully protect state interests in the matter. We expect our practice of consultations and co-operation to continue under the NAFTA.

We would note that there is no preemption under the NAFTA in another sense, which is that state and local laws are free to differ from federal regulations and still be consistent with the NAFTA. In fact, there is nothing in the NAFTA that refers to federal standards as any point of reference for state standards. Instead, the same NAFTA requirements that guard against standards being used to provide a special advantage to domestic producers are applied to federal standards and to state standards.

Thank you for this opportunity to clarify these issues. I look forward to continuing to work with you in preparing for the implementation of the NAFTA.

Sincerely,
MICHAEL KANTOR

ANNEX 4

REQUEST FOR AN AWARD OF COSTS

1. The Respondent observes that Metalclad's claim was for 90 million dollars, not including its lost market capitalization claim, before interest. The size of the claim, the breadth of the allegations made against Mexican officials and ordinary citizens, and the discovery of its falsity and misleading nature required a comprehensive and thoroughly documented response by the Government of México. The vast majority of the allegations have been shown to be unproven, and in many cases false, malicious and vexatious.

2. An award of costs serves the dual function of reparation and dissuasion.

3. Accordingly, the Government of México seeks an award of the full costs of the arbitration and its reasonable costs incurred in its representation. With respect to the latter it requests an award of:

1) The sum of 2,100,000 dollars for cost of legal representation;

2) the sum of 520,000 dollars for the costs incurred for the preparation of four expert reports and the attendance at the Hearing by Chicago Partners' Mr. Kevin Dages; and

3) the sum of 225,000 dollars for the costs incurred for preparation of four expert reports and the attendance at the Hearing of Ms. Marcia Williams and John Butler III.

4. In the event that the Tribunal decides to make only an award of partial costs for costs thrown away (in responding to the false, misleading and vexatious pleadings and in seeking to vouch the false claim that 20.5 million dollars were spent on acquiring the land and constructing the landfill), the Respondent would bear part of the costs of its legal representation (that part not devoted to responding to the case as falsely presented), the costs of retaining Ms. Williams and Mr. Butler, and part of the costs incurred in retaining Chicago Partners. In such circumstances, the Respondent requests an award as follows:

1) The sum of 1 million dollars for legal costs thrown away; and

2) the sum of 350,000 dollars for experts' costs thrown away (for responding to the market capitalization claim, trying to vouch the claimed expenses through alternative means, analyzing SEC filings to understand the company's activities in México, and analyzing Mr. Dabbene's misleading testimony).

5. Finally, in addition to an award of costs as set out above, in the event that the Tribunal were to award any damages to the Claimant, the Respondent requests that such an award be placed in trust until the Site has been fully remediated by Metalclad in accordance with the terms of the audit.