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

METALCLAD CORPORATION

CLAIMANT,

VS.

THE UNITED MEXICAN STATES,

RESPONDENT

COUNTER MEMORIAL

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ORGANIZATION OF THE RESPONDENT'S COUNTER-MEMORIAL

The Respondent's Counter-memorial will be divided into five parts and nine annexes:

I. Overview of the Case
II. The Statement of Facts
III. The Respondent's Summary of the Relevant Facts
IV. The Legal Submissions
V. The Relief

Annex One: The Respondent's Admissions and Denials to the Claimant's Allegations
Annex Two: The Statements of the Witnesses Called by the Respondent

I. Federal witnesses:
   A. Secretary Julia Carabias Lillo
   B. Ambassador Santiago Oñate Laborde
   C. Federal Attorney Antonio Azuela de la Cueva
   D. Ramiro Zaragoza García
   E. Francisco Enrique Hernández Sánchez
   F. Lic. René Altamirano Pérez

II. State witnesses:
   A. Former Governor Horacio Sánchez Unzueta
   B. Dr. Pedro Medellín Milán

III. Municipal witnesses:
   A. Salomón Avila Peréz
   B. Juan Carrera Mendoza
   C. Leonel Ramos Torres
   D. Hermilo Méndez

IV. Non-governmental witnesses:
   A. Ing. Sergio Alemán González
   B. Ing. Joel Milán
   C. Dr. Angelina Núñez
   D. Fernando Bejarano
   E. Dr. José Antonio Ortega Rivero
   F. Leonel Serrato
   G. Lic. José Mario de la Garza

Annex Three: Expert Report of Ms. Marcia Williams of Putnam, Hayes & Bartlett
Annex Four: Expert Report of Lic. Ulises Schmill Ordóñez, Lic. Carlos de Silva and Dr. José Ramón Cossío Díaz
Annex Five: Expert Report of Dr. Sergio López Ayllón
Annex Six: Expert Report of Mr. John Butler III of Putnam, Hayes & Bartlett
Annex Seven: Expert Report of Mr. Kevin Dages of The Chicago Partners
Annex Eight: Expert Report of Dr. Mark Zmijewski of The Chicago Partners
Annex Nine: Exhibits

I. OVERVIEW OF THE CASE

Introduction

1. The Respondent does not accept the Claimant's statement of facts.

2. The essential facts are: A small under-capitalized company with no experience in the hazardous waste disposal business in the United States, let alone elsewhere, was breaking even or losing money in its existing business of industrial insulation sales and installation. It entered the hazardous waste landfill business (known throughout the world as a highly regulated and difficult business) in Mexico. It had never gone through, in the United States or elsewhere, the process of seeking permits, developing consensus and, as often happens to the most experienced proponents with well-planned hazardous waste projects, failing to win approval to proceed.

3. The Claimant entered Mexico with grandiose plans. It misrepresented its credentials and experience to Mexican officials. It purchased a site with a pre-existing environmental liability. It, in turn, misrepresented its Mexican investments to its investors. It borrowed funds at high rates of interest and under onerous terms. Under pressure to meet its commitments to investors, it acted in inappropriate and, the evidence suggests, unlawful ways.

4. The Claimant's investment in Mexico, the object of this dispute, has not opened. The Claimant attempts to recover the losses attributed to the failure to open the landfill from the Respondent. The Respondent's position is that the failure to open the landfill is not the result of a NAFTA breach.

5. In short, this case is an attempt by the investor to recover losses caused of its own making. The evidence in support of this conclusion is overwhelming.

6. Even if this Tribunal were to accept entirely the statement of facts in the Claimant's case as presented by Mr. Kesler, those facts disclose no NAFTA breach. The Claimant acknowledges that prior to its purchase of COTERIN:

> "... we investigated the federal climate, the local community environment and whether there would be available political support from the state of San Luis Potosí whose support we deemed would be essential to the success of any project in the state."[1]

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1. Witness statement of Mr. Grant Kesler at page 2.

7. Mr. Kesler's statement goes on to record the company's failure to obtain the support of the local community and the State governor for a hazardous waste landfill at La Padrera (he fails to note that the municipality was prepared to allow a landfill that received non-hazardous industrial waste). The Tribunal will become aware of the important distinction between hazardous and non-hazardous waste. The Tribunal should also note that the Claimant acknowledged that it was necessary to obtain not only the necessary legal permits to construct and operate the landfill, but in addition, the support of the State government and of the local community.

8. The failure to obtain local support is a universal and commonplace occurrence in attempts to site hazardous waste facilities. The Tribunal will hear expert evidence that the risk of failure to overcome local opposition is the single biggest risk facing hazardous waste landfill project proponents. In general, federal governments (in Mexico as in the United States and Canada) are more willing to approve such projects as being in the national interest. However, the people living near the proposed site are naturally most concerned about it. For example, at one time, the United States Environmental Protection Agency (EPA) had an ambitious plan to establish nine regional hazardous waste landfills. Due to local opposition, not a single facility was established. In circumstances such as these, the Claimant's failure to obtain the necessary permits and support cannot constitute a breach of the NAFTA.

9. But this Tribunal will find that it is not possible to accept the Claimant's statement of the facts. The Tribunal will see that the Claimant's own documents (not disclosed with its Memorial, and not referred to by Mr. Kesler) contradict Mr. Kesler's version of events on a number of fundamental points. Three examples will be given by way of introduction:

A. Alleged Declaration of Support for La Pedrera by the Governor in June 1993

10. The Claimant's Memorial alleges that in a meeting in June 1993 with the Governor, Metalclad's officers:

> "... fully explained their project in La Pedrera, with engineering plans and drawings, maps, photos, and video. They left with the Governor's endorsement and commitment of support."[2]

11. Mr. Kesler's witness statement puts it this way:

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2. Memorial at page 67, paragraph 49.

> "The meeting was held, support was offered and a letter was given by the Governor to us after review of the project itself and all that it entailed."[3]

12. In fact, the Claimant's own documents show that no details of the La Pedrera proposal were provided at the June 1993, meeting; these details were not provided to the State Government until January 1994, if they were provided at all.

13. To understand this point, the Tribunal should be aware that at one time the Claimant was promoting two projects in the State of San Luis Potosí, a landfill and incinerator at Santa María del Río, and later on, the landfill at La Pedrera.

14. In one of its own public statements published in local newspapers on January 11 and 12, 1994, Metalclad described its representatives' June 1993 meeting with the Governor as follows:

> "... the company presented the investment project for the installation of an incinerator in the municipality of Santa María del Río [an entirely separate project] and the possibility of acquiring and operating the controlled facility already approved by SEDESOL located in the municipality of Guadalcázar, SLP."[4]

15. Thus, it was only the possibility of the acquisition of La Pedrera that the company claimed that it had raised with the Governor in June 1993. The Governor says it was not raised at all. Moreover, the Claimant publicly acknowledged in January 1994 that the documents respecting the La Pedrera project had not been submitted to the State Government and would be submitted to the Governor later that month, stating:

> "The copies of the legal documents which show the acquisition carried out by Metalclad Corporation regarding the 'La Pedrera' facility; the copies of the corresponding authorizations from SEDUE, INE, and SEDESOL to construct and operate, the request to construct and operate the La Pedrera facility; the request to the government of San Luis Potosí to construct and operate the facility in 'La Pedrera' municipality of Guadalcázar; the document that shows our legal status/personality; the respective technical

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3. Kesler witness statement at page 3.

4. Exhibit 1, "Enormous Misinformation" and "What is Really Happening in Guadalcázar?", advertisements published by the Claimant on January 11 and 12, 1994, respectively. The Tribunal will receive evidence that the Claimant did not deliver the documents as promised. [Emphasis added]

studies regarding the matters of environmental impact and risk assessment; the geological, geohydrological, climatic, topographical, basic engineering and detailed engineering studies; as well as our operation and management manuals and plans for public health, and a safe and secure environment, will all be submitted to your office next week."[5]

16. At the time that it acquired COTERIN (on October 7, 1993), the Claimant knew the Governor had not yet reviewed the La Pedrera project nor authorized it. The Claimant confirmed this by an amendment to its Agreement for the purchase of COTERIN, made September 9, 1993, some three months after the June 1993 meeting at which the Claimant now says the Governor gave his complete support.

17. The amendment changed the conditions for the payment of the three-quarters of the purchase price that would be owing after the agreement closed, delaying those payments until "20 days after the government of San Luis Potosí, through its current Governor, has authorized to proceed with the construction needed for the operation of a controlled confinement of hazardous wastes know as La Pedrera..."[6].

18. Obviously, in September Metalclad did not consider it already had the Governor's support. Otherwise, why would it provide for that contingency in the payment schedule? The reason is that the Governor's letter of June 11, 1993 — now described as expressing full support — is actually couched in general terms, does not refer to La Pedrera, and expresses important qualifications for any project that Metalclad might seek to undertake in the State.

B. Alleged Lack of Awareness of Municipal Permitting Issue

19. The Memorial implies that the Claimant had no knowledge of the need for a local municipal construction permit at the time that it acquired COTERIN.

20. Again, the Claimant's own September 1993 Amendment Agreement shows that the company was fully aware of this issue. Just as the Promise Agreement was amended to require the Governor's approval as a condition precedent for the payment of the balance of the purchase price, it was also amended to defer payment until "the Municipal permit for the building of the aforementioned confinement has been obtained by

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5. Exhibit 2, "To the Public Opinion," an advertisement published by the Claimant on January 14, 1994.

6. Exhibit 3, Amendment Agreement, dated September 9, 1993, at page 7, paragraph 6. This is identified as document 1D by Mr. Kesler in his letter of November 17, 1997.

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..."[7].

C. Lack of Genuine Local Opposition

21. Once again, the Claimant's own documents contradict its allegation that local opposition was not genuine but rather was contrived by the arbitrary actions of the Governor. In an exchange of public statements in January 1994, the Governor referred to the State's earlier contact with the Claimant and stated:

> "The state government also warned that it is absolutely necessary to have the agreement of the people of Guadalcázar, who have repeatedly expressed their opposition in the media."[8] [Emphasis added]

22. The Claimant did not take issue with the Governor's assertion but rather responded publicly:

> "We agree with you that the consent of the people of Guadalcázar is needed in order to be able to construct and operate such a facility."[9] [Emphasis added]

23. The Claimant had already included a provision in the September Amendment Agreement allowing it to defer paying the balance of the purchase price to the vendors in the event that:

> "...the construction of the confinement indicated in section b) above is suspended by order of the authority or the operation of such confinement is suspended, or the foregoing occurs by reason of the physical situation or situation of violence of the neighbors of the location of the confinement."[10]

24. The pre-existing local opposition was well-known and taken into account by the Claimant.

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7. Ibid.
8. Exhibit 4, "To the Public", Statement by the State Government of San Luis Potosí, January 13, 1994.
9. Exhibit 2.
10. Exhibit 3 at page 8. Indeed, the evidence that the Claimant's attempt to assuage local concerns did not succeed and opposition continued is contained in the company's January 10, 1996 Amendment Agreement with the former owners of COTERIN. By that agreement, the Claimant purchased the remaining 6 per cent of COTERIN's shares held by the Aldretts.

The Siting of Hazardous Waste Landfills

25. In preparing its defense, the Respondent engaged Ms. Marcia Williams as one of its experts to assist the Tribunal. Ms. Williams has extensive experience in the hazardous waste field, first as a senior U.S. government official, then as an executive in one of the major U.S. waste management companies, and now as a consultant. As a government official, Ms. Williams was the Head of the Office of Solid Waste of the United States EPA. In that capacity, she oversaw the federal permitting of hazardous waste projects throughout the United States.

26. Ms. Williams testifies that the opposition of which Metalclad complains is typical in the siting of a hazardous waste landfill and is in no way restricted to Mexico, or unique to Guadalcázar. It is, to use her words, "universal". She notes that: "Hazardous waste disposal facilities, among all industrial facilities, are perhaps the most difficult and costly to successfully site"[11].

27. Her expert report recounts the fundamental factors that make the siting of a hazardous waste landfill risky:

a) communities in which such projects are proposed to be sited are almost always adamantly opposed to such projects;

b) not only are the communities opposed, their level of intensity is usually extremely high; and

c) they will devote considerable time and effort to blocking the project, using any legal means available, and including protests and litigation[12].

28. She notes that multiple approvals are almost always required of proponents and an approval by one level of government in a federal state by no means ensures that approvals will be forthcoming from another level. In particular, municipal councils are often the focal point for local community opposition. She observes that the "fact that multiple approvals and permits are required necessarily increases the difficulties associated with successfully siting a new facility as it only requires one disapproval to block or delay the entire project"[13].

11. Williams Report at page 6, paragraph 32.
12. Ibid. at Section V.A.
13. Ibid. page 9, paragraph 38.

29. Ms. Williams points to the experience in the United States and Canada where numerous projects —technically sound and using state-of-the-design technology— have been defeated by local opposition. Her evidence is that:

a) more siting projects fail than succeed;

b) siting commercial off-site facilities (such as COTERIN's project) is considerably more difficult than siting on-site disposal facilities; and

c) siting hazardous waste landfills or incinerators is more difficult than siting other types of hazardous waste treatment facilities such as metals recovery plants or solvent recycling facilities[14].

NAFTA Does Not Guarantee the Establishment of Hazardous Waste Landfills

30. The expert evidence is that the siting of a hazardous waste landfill is notoriously risky and difficult. Local opposition is universal and often extensive. Multiple levels of approvals are required. Numerous projects, endorsed as technically correct by one level of government, have failed to succeed due to the resistance of local residents and non-government organizations (NGOs). More projects fail than succeed[15].

31. The Claimant's proposed project at La Pedrera was no exception and failed to obtain the necessary local support and approvals. This failure was the result of many causes, none of which are attributable to the Respondent, and does not give rise to liability under the NAFTA.

32. In this regard, the Tribunal is reminded of the distinction between hazardous and non-hazardous waste facilities. While the latter are not universally welcomed into communities, it is the former that are the most alarming and which generate the most opposition. The Tribunal will learn that the distinction is key and, in fact, is illustrated in this case.

33. The La Pedrera landfill was not just another industrial project. The Memorial discusses it in glowing terms; however, to many people, a hazardous waste landfill raises fears of threats to health and safety. They do not relish the prospect of toxic substances being disposed of in perpetuity near their homes and farms. They question the science. They question whether the proponent has the experience, finances, and the integrity to be able to operate the site with care. They are aware of 'fail-safe' projects that have caused

14. Ibid. page 15, paragraph 49.
15. Ibid.

great harm to the environment and human health[16]. They do not necessarily trust the advice of experts or government officials. They wonder what will happen to them after the site is filled with waste and the operator leaves. It is not surprising, therefore, that a hazardous waste landfill is one of the most difficult and costly of all industrial facilities to site.

34. The Respondent admits that some local residents were supportive of the project. They believed the Claimant when it promised them hundreds of jobs in an area where there many residents eak out a subsistence living. However, the Claimant's own documents show that it considered that the 90-employee workforce of the COTERIN transfer station was "several times the anticipated size of the EMI [Eco-Metalclad] staff required for operations"[17]. Similarly, a Metalclad document, apparently used to attract investors, stated: "By applying current operating techniques from the U.S. for both material handling and cell construction, a smaller work force is expected to be sufficient"[18]. A project plan listed the on-site jobs as 33.

Establishing the Facts

35. The Claimant's Memorial contains numerous misstatements and unsupported allegations. Indeed, in preparing the defense to this claim, having reviewed the evidence (much of it of the Claimant's own making) thoroughly, the Respondent questions whether Mr. Kesler was kept properly informed of developments by his own officers and employees throughout the relevant period.

36. In the Respondent's submission, many of the Claimant's allegations are irrelevant to the subject matter of a proper Chapter Eleven claim. The Respondent will correct all of the misstatements, both the irrelevant and relevant, since the irrelevant still reflect upon the credibility of the Claimant. The essential facts, from the Respondent's perspective, can be gleaned substantially from the Claimant's own documents.

37. The Claimant's own documents show that:

a) it agreed that "the consent of the people of Guadalcázar is needed in order to be able to construct and operate such a facility"[19];

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16. Exhibit 5 contains a newspaper article about problems encountered by Canada's only hazardous waste treatment plant.

17. Exhibit 6, Eco-Administración Operating plan, March 1993, 4th chart after page 31. This is identified as Exhibit 2I by Mr. Kesler.

18. Exhibit 7, Metalclad Corporation Project Status Report, October 1993, at page 15. This is identified as Exhibit 2H by Mr. Kesler.

19. Exhibit 2.

b) it was aware at the time of the acquisition of COTERIN that there was local opposition to the operation of a landfill at La Pedrera based in part on COTERIN's unauthorized deposit of 20,000 tons of hazardous waste at the site in 1991; and

c) in its contract with the previous owners of COTERIN, it distributed the risk of the failure to gain the Governor's support, to obtain necessary local permits or a court order dispensing with local permits, and the potential that community opposition might prevent it from constructing and operating the site.

38. As of the date of the filing of this Claim, the Claimant had failed to persuade two levels of government, the majority of a skeptical local community, and two NGOs —one with local and one with worldwide presence— of the merits of opening a landfill for toxic substances at a previously contaminated site. The Claimant now seeks to persuade this Tribunal that its failure was due to denial of rights under NAFTA by the actions of "one official, the Governor of San Luis Potosí"[20].

39. The Respondent will answer fully the allegations made against the Governor, but it may be that the Tribunal will not be required to decide this case on the basis of preferring his evidence over that of Mr. Kesler. Rather, the Respondent will demonstrate to the Tribunal that undisputed facts taken from the Claimant's own documents do not support its portrayal of the project that had received widespread public support and all necessary permits only to be frustrated by opposition contrived by the Governor. Instead, the essential facts reveal a commonplace phenomenon encountered by environmental authorities and project proponents in many countries, namely, the legitimate resistance of local residents and NGOs to the establishment of hazardous waste landfills in their communities.

La Pedrera was a Contaminated Site

40. The La Pedrera site suffered from an additional flaw. As Ms. Williams testifies, the fact that COTERIN had a history of environmental misconduct prior to its acquisition by Metalclad greatly exacerbated and complicated the problems that the proponent faced when compared with a project starting with bare land. COTERIN was originally given a federal permit to construct a storehouse at La Pedrera for use as a waste transfer station. It was never constructed. Instead, in 1991, without authority, at least 55,000 drums of hazardous waste (some 20,500 tons) were placed on the open land. The waste was eventually buried in three cells that do not meet federal technical standards. There is a

20. Memorial at page 28.

100 per cent risk of explosiveness in each of them[21]. Although the Claimant points out that there were two distinct sites, the fact is that they are on the same piece of land and the "new landfill" overlaps with the "old transfer station". The three cells containing the buried waste are located in the midst of the landfill.

41. The Claimant recognized the existence of this problem in 1993. In the agreement for the sale and purchase of COTERIN, the eleventh clause addressed the issue of liability to "compensate COTERIN for all damages and losses that such company may suffer by reason of any liabilities before third parties, including fines and other penalties imposed by any authority, derived from or related to the confinement, already made by COTERIN..."[22].

42. Moreover, in an advertisement published in the local newspapers on January 11, 1994, aimed at diminishing local fears, the Claimant stated:

> "...we recognize that a serious danger exists in the event that the facility, approved by the Federal Government, cannot be operated given that the number of containers existing on the site may reach up to 120,000 in number representing close to 30,000 tons of dangerous and toxic waste deposited only in ditches that do not meet the construction standards and are only covered with dirt, without complying with the minimum safety conditions and standards and which may pose a great danger to the health of the inhabitants of the communities..."[23]

Pre-existing Local Opposition

43. The unlawful deposit and retention of this hazardous waste caused great concern and anger on the part of the local people. The evidence is that long before Metalclad arrived in Guadalcázar, the Municipality and the eleven other municipalities of the *altiplano* (the highlands) region of San Luis Potosí expressed clear and consistent concerns about the site[24].

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21. This means that gases generated at the site would instantly ignite if put in proximity to a flame.
22. Exhibit 8. Promise Agreement, dated April 23, 1993, at page 8. Document 1C as identified by Mr. Kesler.
23. Exhibit 1.
24. Exhibit 9 contains letters written by regional authorities and community leaders between 1991 and 1995 requesting the site to be cleaned and not re-opened.

44. Moreover, although the Claimant does not advert to this fact, in late 1991, the *Ayuntamiento* (the Municipal Council) denied COTERIN's application for a construction permit for the site. In January 1992, the newly-elected *Ayuntamiento* confirmed that decision.

The Need for Local Approval

45. As the Tribunal will know from reviewing the Memorial, one of the most important allegations that the Claimant has made is that it detrimentally relied upon representations allegedly made by federal officials to the effect that the federal government possessed exclusive jurisdiction over hazardous waste, and therefore Metalclad need only obtain federal permits. In the section entitled "The Question" (at page 37 of the Memorial), the Claimant complains:

> "...where Claimant received both construction and operating permits from the federal government, they signed an Agreement to Remediate and Operate the landfill with the Mexican Government after meeting with high-ranking Mexican officials who told Claimant over a period of four years that the federal Government's exclusive authority as to hazardous waste matters rendered its award of federal approval and formal agreement for construction and operation of the landfill fully sufficient for Claimant, upon which representations Claimant detrimentally relied; and, that and state and local issues, including political opposition, were matters for the Federal Government, not Metalclad, then refused to allow Claimant to operate because of political opposition of the Governor of San Luis Potosí; ..."[25] [Emphasis added]

46. This claim is repeated in the Memorial (see paragraphs 5, 12, 13, 21, 24, 25).

47. Mr. Kesler swore in his witness statement that federal government representatives indicated that all that Metalclad had to obtain were the necessary federal permits and state assurances. At page 4 he testifies that:

> "Now [in the summer of 1993] that we had received all of the legal permits required to construct and operate and assurances of the political support necessary, we exercised our option to purchase the site and went forward with the exchange of cash for property. But for the strong and

25. Memorial at page 37.

repeated assertions from both federal and state governmental officials, we would not have exercised our option."[26] [Emphasis added]

48. He testifies further (at page 7) that during the negotiations with the State:

"At no time during any of our negotiations with the state did anyone ever mention the need for a local construction permit."[27]

49. In the Memorial, it is stated in reference to Secretary Carabias' comment published in the press on September 5, 1997, that the company erred in not getting a municipal license:

"To Claimant's knowledge, this is the **first** and **only** statement by a Government of Mexico official that the Company was informed from the beginning that it was constructing unlawfully without a local construction permit."[28] [Emphasis in original]

50. These allegations, which are calculated to lead the Tribunal to conclude that the Claimant had no idea of the municipal permit issue, are misleading. At the time of Metalclad's acquisition of COTERIN, the shut-down transfer station at La Pedrera had been a notorious local controversy due to the detection of the hazardous waste deposited and buried in unprotected conditions not meeting the requisite standards[29]. As noted above, COTERIN had applied for, and had been denied, a municipal construction permit in 1991 prior to Metalclad's arrival in San Luis Potosí. The evidence is that after having complained to federal authorities and urging SEDUE to close the unlawfully operated transfer station, the *Ayuntamiento* also resolved in January 1992 not to grant a permit that would allow COTERIN to operate in the community.

51. The extent of local opposition and the previous denial of the municipal permit was a notorious fact that would be evident to any investor that performed even a modest

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26. Witness Statement of Mr. Kesler at page 4.
27. Ibid. at page 7.
28. Memorial at page 105.
29. Exhibit 10(N), Metalclad's 10-K describes for the fiscal year ending May 31, 1995, the situation at La Pedrera as follows: "In 1991, COTERIN operated the landfill for a three-month period prior to a change in the General Ecology Law which required it to obtain a permit from SEDESOL. Although the cells of the landfill were lined and have been closely monitored, it is likely that these cells will require additional attention in the next few years. The costs associated with the remediation of these cells, when compared to the anticipated earnings of the landfill, are not expected to be significant" (at page 10). This was, the evidence will show, a rather sanguine description of the situation.

amount of due diligence. At the outset of this proceeding, the Respondent thought that perhaps the Claimant's due diligence had failed to discover the fate of the first permit application. Why else would the Claimant imply in its Memorial that it was unaware that the Municipality had already asserted its permitting authority in 1991-92 and plead that it had relied on alleged representations to the effect that it need only worry about federal approvals?

52. The Claimant's own documents (many of which were not referred to in its Memorial or not provided initially) reveal that Metalclad was well aware of this issue:

a) First, the express language of the two federal permits issued to COTERIN in 1993 provides that they were expressly without prejudice to the need to obtain permits from other levels of government (see the evidence of Mr. Altamirano, the federal official who issued the permits in 1993).

b) Second, in response to the Respondent's request for certain documents to which the Memorial referred but which were not provided with it, the Claimant provided copies of some of its due diligence documents. A review of these materials shows that it received advice on the local permits issue[30].

c) Third, the Governor's letter of June 11, 1993, which Metalclad characterizes as providing the assurances that it required to exercise its option, is on its face clearly qualified.

d) Most importantly, however, the Tribunal has already been directed to Exhibit 3, the Promise Agreement (the "option agreement") for the purchase and sale of COTERIN, which was not initially provided by the Claimant.[31] The option agreement is not only directly relevant to the issues in dispute, it is

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30. Exhibit 11. The Tribunal will see these in the document identified as 2C in Mr. Kesler's letter of November 17, 1997. At page 3 of the IFC Kaiser report it is noted:

> "In the area of hazardous wastes, the involvement of local authorities at the county level and the municipal council level (*condados y ayuntamientos municipales*) is pivotal in the selection of the location where a particular plant will operate, through the issuance of a land use permit (*permiso de uso del suelo*)."

It goes on to note at page 12:

> "Sources interviewed as part of the preparation of this review indicated that SEDESOL, and in general the Federal government, is very helpful throughout the process, assisting the applicant to ensure the compliance with all applicable regulations and standards. According to the sources interviewed, SEDESOL is not in any way antagonistic. However, opposition to the project may be expected at the state and/or local level" .

31 On November 11, 1997, the Respondent requested the counsel for Claimant to provide a list of necessary documents, including the Promise Agreement and any other documents related to the COTERIN purchase.

dispositive as to Metalclad's state of knowledge of the approval and permitting issues at the time that it exercised the option.

The September 1993 Amendment to the Option Agreement

53. On April 23, 1993, Metalclad entered into the Promise Agreement with the then-shareholders of COTERIN. That agreement specified a purchase price of 2 million U.S. dollars, to be paid as follows: 50,000 dollars for the option, a payment of 450,000 dollars on the date of closing if Metalclad exercised its option, then three additional payments of 500,000 dollars to be paid thirty, sixty, and ninety days after the date of closing. Having entered into the option agreement, Metalclad then performed its due diligence.

54. The Tribunal will recall that Metalclad describes the June 11, 1993 letter from the Governor to Mr. Kesler as an expression of support for the La Pedrera project. It relies on this as evidence of the State's alleged arbitrariness "after inviting and approving Claimant's landfill investment"[32]. It claims that having obtained the State Land Use License and the federal permits and then the Governor's full support in June of 1993, it was confident enough to exercise its option and it would not have done so but for the assurances that it received.

55. As noted above, the Memorial alleges that at the June 11th meeting, Metalclad officers "fully explained their project in La Pedrera, with engineering plans and drawings, maps, photos and video. They left with the Governor's endorsement and commitment of support"[33]. Metalclad itself contradicted this in its advertisement published on January 13, 1994.

56. The Tribunal will see that the hazardous waste landfill and incinerator planning that had been done by ECO-Metalclad was for its Santa María del Río site. Thus, the company "presented the investment project" for that site and in its own words, raised "the possibility of acquiring and operating" La Pedrera —if it did at all. (The Tribunal will see that Governor Sánchez Unzueta testifies that La Pedrera was not discussed in that thirty minute meeting).

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32. See page 38 of the Memorial at paragraph (2). See also page 2 of the Memorial's Chronology: "The Governor gives Metalclad a letter of support, welcoming the company to the State and encouraging the development of the La Pedrera site by Metalclad". This letter is called a "written declaration of support" on which the Claimant exercised its option to purchase COTERIN (Memorial at page 67).

33. Memorial at page 30.

57. The Claimant's documents reveal that, when Metalclad did exercise its option on September 9, 1993, it amended the contract to provide for a different payment schedule. It still agreed to pay 450,000 dollars on the date of closing; but instead of the previous schedule of subsequent payments, it was agreed between the parties that the next payment of 500,000 dollars would be made within 20 days after:

> "...the government of San Luis Potosí, through its current Governor, has authorized to proceed with the construction needed for the operation of a controlled confinement of hazardous wastes located in the lot of land... known as La Pedrera... and that 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 to legally proceed with the building of such confinement..."[34]

58. Contrary to the Claimant's pleadings and Mr. Kesler's sworn testimony, therefore, by the time that it exercised its option on September 9th, Metalclad recognized that it did not yet have the Governor's support for the La Pedrera project. It also recognized that there was a need to either obtain a municipal construction permit or a definitive judicial decision in the form of a writ of *amparo* allowing COTERIN to proceed with construction, should the *Ayuntamiento* deny the permit. The amended contract is a contemporaneous act by the Claimant showing that the company itself realized the federal government did not have exclusive and paramount authority, such that only its approval was necessary.

59. Thus, the Claimant's own documents show that the Claimant did not "detrimentally rely" on federal and state officials' representations, nor did it believe that it had the Governor's full support at the time that it exercised its option, nor was it unaware of the legal requirement to obtain a municipal construction permit in order to proceed. Rather, the Claimant amended the option agreement to reduce its financial risk in the event that it was unable to obtain the Governor's support or a municipal permit.

60. In fact, by doing so, Metalclad avoided paying three-quarters of the purchase price to the previous owners of COTERIN. Its SEC filings show that it later declared that the contingencies that would require it to make such payments were not expected to materialize. Thus, Metalclad risked only one-quarter of the 2 million dollar purchase price for COTERIN and the landfill.

The June 1993 Meeting

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34. Exhibit 3 at page 7. [Emphasis added]

61. As noted above, the Claimant's present description of the June 1993 meeting and its January 1994 description differ significantly. In addition, the former Governor testifies that he neither invited Metalclad to invest in the State (the meeting was sought by Metalclad, not him; he had never heard of Metalclad before), nor did he express support for the Guadalcázar project. Another project, the Santa María del Río project, was discussed (in terms of plans, etc.).

62. The Governor's letter of June 11th cannot reasonably be construed as expressing unqualified support for the La Pedrera site. It does not even refer to COTERIN or to the site. It speaks of the State's Development Plan. It generally declares support for Metalclad as a potential investor so long as its projects meet the requirements of all levels of Mexican law and respect the genuine interests of the community. Finally, as noted above, the September 9th amendment to the option agreement is evidence that at the time Metalclad did not consider that it already had the Governor's support. Otherwise, why would it provide for that contingency in the payment schedule.

63. In addition, the former Governor testifies that one month after his thirty minute meeting with Metalclad representatives, he was surprised to find that at a conference in San Antonio, Texas, Metalclad issued a press release entitled, "Metalclad is Cornerstone of Industrial Plan Announced by Mexican Governor". In the press release, Metalclad announced that it "had agreed to participate with governor Horacio Sánchez Unzueta... in a program that he created". The release goes on to list the facilities that would be constructed under the governor's "program" and states "all of [these] will be developed by Metalclad"[35] .

64. The former Governor emphatically denies that he agreed to anything of the sort in the thirty-minute conversation that he had with representatives of a company with whom he had never before met[36].

Local Opposition was Genuine and Widespread

65. Metalclad also alleges that primarily two state officials, whom the Claimant also alleges engaged in corruption, fomented the opposition to the project. This contention ignores the large volume of incontrovertible evidence that shows that:

a) the community consistently opposed the La Pedrera site from the beginning (long before the site was taken over by Metalclad);

35. Exhibit 12 at page 2. [Emphasis added]
36. Witness statement of Mr. Sánchez Unzueta at page 3.

b) the initial handling of the transfer station was the subject of an investigation by the National Human Rights Commission, a complaint to the Office of the President of the Republic, and a criminal complaint by Greenpeace about the permitting activities of the INE;

c) the candidates who ran for municipal office and opposed the landfill in Guadalcázar all were elected, while those candidates who supported the project (in one case supported by the Claimant) were defeated;

d) COTERIN's unlawful conduct had damaged both its ability to obtain the necessary local permits and the Federal Government's ability to resolve the hazardous waste problem in the State;

e) Metalclad/COTERIN's conduct damaged its credibility in the State and the local community;

f) PROFEPA found it necessary to have a complete audit of the site done before it could contemplate giving the necessary Federal approvals for its opening; and

g) the *Convenio de Concertación* entered into by PROFEPA and Metalclad/COTERIN on November 24, 1995 was the subject of court action and another criminal complaint by Greenpeace.

66. Metalclad was aware of existing local opposition when it exercised its option to purchase COTERIN on September 9, 1993.

67. The controversy pre-dated Metalclad's acquisition of the site, went far beyond the Governor or his Ecology Coordinator, and in the eyes of all of the federal, state, and local officials and citizens who have filed witness statements in this case, the opposition was genuinely and strongly held. While federal officials expressed the view that the landfill could be operated without substantial risk, they agree that the local, state and national opposition was not contrived.

68. As Ms. Williams testifies, this phenomenon is by no means unique to Mexico. She observes in her testimony that at one time the U.S. EPA had an ambitious plan for the establishment of nine regional hazardous waste landfills. Due to local opposition, not a single one was established[37].

69. The evidence shows that there were many other opposition forces at work long before Governor Sánchez Unzueta came to office. It is correct that he and his Ecology

37. Williams report at page 45.

Coordinator ultimately opposed the Guadalcázar project. They were operating in a larger political and social context in which such factors as the contaminated site, local opposition, resentment of federal actions, distrust of the opinions of technical experts, and other factors affected the decision-making environment. As shall be seen, Metalclad's own actions exacerbated the situation. Moreover, the evidence of the two leaders of the non-governmental organizations, Greenpeace and Pro San Luis Ecológico, is that they urged the State to express opposition to the project.

70. The evidence of Dr. Medellín is that he repeatedly referred the Claimant to a March 1993 study of potential alternative sites in San Luis Potosí by the local university's Faculty of Engineering. He encouraged Metalclad to examine those sites and offered the State's support in the approval process. In fact, on May 27, 1994, the State and Metalclad announced an agreement to that effect, whereby the State agreed to lend all necessary support to locate an alternative site and to expedite the approval process in relation thereto. However, the evidence is that Metalclad never seriously looked for another site. Rather, despite State warnings, it decided to try to convince the local people and the *Ayuntamiento* that the Guadalcázar site could be operated safely.

71. The Claimant also claimed publicly in January 1994 that it would remedy the site at a cost of 5 million dollars. Its implication that it actually had 5 million dollars to perform the remediation was unsupportable and to the present day, it has yet to perform any remediation of the site. Similarly, in the same advertisement, the Claimant claimed that it intended to invest the sum of 250 million dollars in the State. As Mr. Dages' expert report shows, the Claimant had nowhere near the financial resources to make that representation.

Alleged Corruption

72. The Claimant also alleges that certain state and municipal officials were corrupt. The persons who are alleged to have solicited or accepted bribes categorically reject the allegations. The allegations of purported corruption are unfounded.

73. The Governor categorically denies the allegation against him. In fact, he points out that Metalclad's lawyers informed him that Mr. Kesler wanted them to offer 1 million dollars to solve the problem and that they refused to do so and terminated their retainer with the company. The Governor was so concerned about the company's activities that he went so far as to provide then U.S. Ambassador to Mexico, James Jones, with a document in which he set out his concerns about the company's actions[38].

38. Witness statement of Mr. Sánchez Unzueta.

74. With respect to Dr. Medellín's wife who is alleged to have accepted bribes from RIMSA, Dr. Medellín testifies that during most of the relevant period he was a widower. His first wife died in January 1992 after a long bout of illness. He did not remarry until October 1995. Dr. Medellín testifies that neither he nor either of his wives has ever had any contact with, financial arrangement, or any other relationship with RIMSA. Similarly, other former State and local officials have also testified that neither they nor members of their families have had such contacts, financial arrangements, or relationships with RIMSA[39].

75. Mr. Juan Carrerra, the municipal president whom the Claimant alleges solicited a bribe, also denies the allegation.

76. The Claimant's former legal counsel, against whom the company makes a number of serious allegations, was provided a copy of the excerpts of the Memorial in which the allegations are made. Mr. José Mario de la Garza, the responsible partner, has reviewed them and has provided a witness statement. He categorically denies the allegations made against the firm and provides a different account of the facts[40].

The Claimant's Attempt to Subvert the Environmental Audit

77. Moreover, there is independent evidence that the Claimant took inappropriate steps in attempting to obtain approvals. For example, in 1994, it was decided that it was necessary to conduct an environmental audit of the site. Metalclad entered into an audit agreement with the federal agency, PROFEPA, to this end. Under the terms of the agreement, Metalclad would pay for the audit but the audit company would actually be PROFEPA's advisor. Given the intense controversy that La Pedrera had generated, the audit had to be performed in an independent and neutral manner[41].

78. The company that was retained was a respected one, Corporación Radian S.A. de CV., and the managing director of the company, Dr. José Antonio Ortega Rivera, was to oversee the audit. Dr. Ortega commenced preliminary work on the audit in March 1994.

79. After Radian had been retained but before the audit got fully underway, Metalclad's Chairman, Mr. Daniel Neveau, asked Dr. Ortega to join Metalclad's Board of Directors. Metalclad's Form 10-K for 1994 filed with the SEC went further and actually reported that Dr. Ortega joined the Board in August:

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39. Witness statement of Dr. Medellín at paragraphs 8-10.

40. Witness statement of José Mario de la Garza.

41. Metalclad's Memorial refers to the audit as being conducted by "independent" companies under supervision of the federal government in "a further good faith effort to satisfy the continual criticisms" publicly raised by the Governor (at page 31).

> "José Luis Ortega Rivero has been a Director of the Company since August 1994. He has been a consultant with Corporacion Radian S.A. de C.V., with a focus in the fields of air quality, environmental impact assessment, risk analysis, vehicle and stationary emissions, waste management and environmental services since 1990. Mr. Ortega is also a professor of Environmental Pollution and Project Evaluation at the Universidad Iberoamericana in Mexico city where he has been a member of the faculty since 1984..."[42]

80. The first sentence of this statement to the SEC was false. Dr. Ortega refused Mr. Neveau's invitation. Attached to Dr. Ortega's witness statement is a letter written on September 30, 1994 to Mr. Neveau, in which Dr. Ortega stated that:

> "In reference to your kind request for my self to be a member of the Board of Directors of MetalClad (sic) Corporation, I would like to thank you for such distinction, but due to the work that I am currently conducting, it is impossible for me to accept such a position; therefore, I have to decline the offer."[43]

81. Dr. Ortega states that Mr. Neveau acknowledged receipt of this letter. His witness statement attests that the signature on the letter is, to his knowledge, that of Mr. Neveau[44].

82. Dr. Ortega declined an appointment to Metalclad's Board during a time when what was likely the most politically and socially sensitive environmental audit in the entire country was being undertaken by his firm. The Claimant's attempt to induce the director of the audit to simultaneously assume fiduciary obligations to it was reprehensible. The only inference that can reasonably be drawn is that the Claimant sought to take all possible steps to ensure that the audit results were completely favorable to it. In fact, they were not: they showed that while the site was adequate, the buried waste was highly toxic and explosive, the cells were substandard and leaking, and the costs of remediation would be substantial.

83. Federal Environment Secretary Carabias testifies that while Dr. Ortega's refusal to join the Board eased her initial concerns about his professionalism (having heard of the SEC disclosure) "it did not eliminate my uneasiness as I consider the mere fact that the

42. Exhibit 10(L),Form 10-K for the year ending December 31, 1994 at pages 16-17.
43. Exhibit 1 of the Witness statement of Dr. José Antonio Ortega Rivero.
44. Ibid.

company would try to influence the objectivity that an independent audit is based upon to be an unethical action"[45].

Other Misdeeds and Misrepresentations

84. There is a pattern of conduct on the Claimant's part that is perhaps unlawful and, at a minimum, highly unprofessional and unethical. For example, the evidence shows that in addition to the offer to Dr. Ortega to become a Board member:

a) When Dr. Rodarte Ramón introduced Metalclad to the Aldretts (the former owners of COTERIN), he was a federal official at the time. The Claimant entered into an option to purchase COTERIN in April 1993. In May, some four months before purchasing COTERIN and while he was still a federal official (he resigned in September 1993), Metalclad established a consulting company with Dr. Rodarte Ramón. On June 16th, Metalclad issued a press release announcing that Dr. Rodarte Ramón was the Managing Director of its new consulting company, CATSA[46]. Its now self-described "consultant" was in fact one of the company's main representatives in its dealings with federal, State, and local authorities in the effort to have the project proceed. It is this witness who testifies that "assurances" were given at the June meeting with the Governor. Mr. Rodarte, a person whom, the evidence shows, the local people distrusted, and had a financial interest in ensuring the successful opening of the project. However, leaving aside the denials of the federal and state witnesses, Dr. Rodarte Ramón's claims are contradicted by the Claimant's own documents.

b) Metalclad makes much of its allegation that Dr. Roberto Leyva, the UASLP professor supposedly "resigned in protest" when the UASLP "Commission" report was "suppressed". The Respondent both denies this characterization of the events and draws the attention of the Tribunal to the fact that the Claimant has also represented that Dr. Leyva was a member of the Board of its Mexican subsidiary, Ecosistemas del Potosí (ECOPSA)[47].

c) The Memorial makes a number of very serious allegations against the Claimant's former local legal counsel. The Respondent brought these to the attention of the law firm and its senior partner has prepared a witness statement in response thereto. His evidence is that the retainer was terminated not by Metalclad but by the firm after Mr. Kesler asked him to

45. Witness statement of Secretary Carabias at paragraph 7.

46. Exhibit 13, "Metalclad Announces Opening of Environmental Consulting Group", PRNewswire, June 16, 1993.

47. Exhibit 14, Document 7(c) A, Response to Respondent's Request for Documents, entitled, Metalclad Corporation PROJECT STATUS, MEXICO, June 15, 1994 at page 9.

offer the Governor 1 million dollars to solve the problem. Mr. de la Garza's witness statement addresses the Claimant's later attempt to characterize what had occurred. The Tribunal will see that the reasons given for the purported termination of the retainer in 1995 are different from those now asserted by the Claimant.

Alleged Experience

85. The Memorial repeatedly alludes to the Claimant's extensive experience in the hazardous waste landfill business. In fact, Metalclad had no experience whatsoever in the hazardous waste landfill business. It represented to federal and state officials that it had extensive experience and has continued to do so even in this proceeding. Mr. Kesler, has testified, for example, that:

> "I joined Metalclad on March 1, 1991 and became the President and Chief Executive Officer on June 1, 1991. Metalclad, at the time, was more than 50 years old, had completed more than One Billion Dollars worth of environmental construction projects all over the world and had a reputation with the Environmental Protection Agency... that was as perfect and clean as any company in America[48]." [Emphasis added]
>
> Mr. Kesler continues in his sworn testimony:
>
> "In our negotiations with federal and state officials we knew and they knew everyone would benefit from our purchasing the site because they knew we had the capital and technology to properly remediate the site as part of our agreement to move forward."[49]

86. The former senior federal official in charge of permitting hazardous waste landfills, Mr. René Altamirano Pérez, testifies that when he met Mr. Neveau, he "spoke

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48 Declaration of Grant S. Kesler, page 1. [Emphasis added.]

49. Ibid. at page 2. [Emphasis added.] Metalclad's SEC filings repeatedly note that the company did not have the funds on hand to undertake the Mexican investments. For example, its Form 10-K filed for the fiscal year ending December 31, 1992, stated: "Management believes that the Insulation Business will generate adequate cash flows to meet its future obligations and expenses relating to such operations; however, the Company will require substantial additional financing to enable the Company to construct and operate its Mexican Business. The current year debenture offerings have financed the Mexican Business. The continued funding of the Mexican Business is contingent upon the Company obtaining additional capital from outside sources." (at page F-19).

about Metalclad's experience in the field of industrial waste in the United States". [50]Both Federal Attorney Azuela and Secretary Carabias testify that they too thought that Metalclad was a highly experienced hazardous waste landfill operator.

87. The intended implication from Mr. Kesler's statements and numerous other statements is that Metalclad was a highly experienced and well-funded landfill operator with hazardous waste projects around the world. This was not true.

88. The Respondent has researched Metalclad's corporate history. As the cover page to its SEC 10-K filings reports, from 1947 until 1973, it was a company incorporated under the laws of Arizona known as Phoenix Gems Inc.; in 1973 it became Bower Industries Inc.; and in 1985 it became Metalclad. Neither of the earlier incarnations of Metalclad had any hazardous waste disposal experience at all; nor did the latest version of the company when it began to seek to invest in Mexico.

89. According to the company's filings with the SEC, Metalclad's principal business until it began to explore various investments in Mexico was the sale and installation of insulation, industrial installation services, and for a short period of time, asbestos abatement services. The asbestos abatement business was abandoned when Metalclad began to pursue the hazardous waste business.

90. Although the company's foray into the asbestos abatement business was unsuccessful, this did not deter Mr. Kessler from writing to Governor Sánchez Unzueta on February 2, 1994, in an effort to prove its waste management credentials, and representing that:

> "We are one of the largest and most respected contractors in the area of asbestos removal and separation in the western United States and have successfully carried out more than one billion dollars in such work."[51]

91. This claim was made when the company had already abandoned the asbestos abatement business. The *Orange County Register* published an article on Metalclad two years earlier in which it quoted Mr. William R. Nordstrom of the National Investors Council as saying that Metalclad had been changing rapidly since Mr. Kesler took control. According to the article, "In addition to streamlining operations, Kesler has cut unprofitable divisions, such as the asbestos abatement operation"[52].

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50 Witness Statement of René Altamirano at paragraph 25.

51. Exhibit 15, Letter to Governor Horacio Sánchez Unzueta from Grant S. Kesler, dated February 2, 1994. [Emphasis added]

52. Exhibit 16, "Metalclad of Anaheim says it's close to deal on Mexican waste plant". The Orange County Register January 10, 1992, reprinted in Dow Jones News Retrieval.

92. Similarly, an internal Metalclad document prepared in 1995 (and delivered to the Respondent after its request for documents) recorded the fact that the asbestos abatement business did not materialize:

> "Approximately five and one-half years ago, when MLTC went public, they did so with a view toward raising capital to be used in competing as a commercial asbestos abatement contractor. That market never materialized as expected; and when present management took over MLTC in 1991, that division was closed. The Seattle office was sold and MLTC returned to its basic core business, serving the re-insulation market for the oil-refining business and the electrical power generating business."[53] [Emphasis added]

93. Metalclad developed an interest in the Mexican hazardous waste market in November 1991 only after Mr. Kesler became President and CEO and Metalclad acquired Environ Technologies Inc. (a company organized by Mr. Kesler and others that, once acquired, became ECO-Metalclad).

94. The company's 10-K filed with the SEC for the year ending December 31, 1992 stated:

> "The Company's revenues were generated primarily by contract revenues from industrial insulation services and sales of insulation products and related materials."[54]

95. Similarly, in a prospectus filed with the SEC on August 31, 1993, just days prior to the exercise of the option to purchase COTERIN, stated:

> "The Company's acquisition of EMI and participation in the ownership of the Mexican Subsidiaries through EMI represents a new business activity for the Company and is subject to all of the risks inherent in the commencement of a new business activity. There can be no assurance that the Mexican Subsidiaries in which EMI has an ownership interest will be successful in obtaining the required additional permits from the government of Mexico or the capital required to construct the facilities as contemplated. If the Mexican Subsidiaries are successful in constructing

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53. Exhibit 17, Metalclad Corporation, MEXICO PROJECT STATUS, February 1, 1995, at page 27. Document 7(c) D as identified in Mr. Kesler's response to the Respondent's first document request.

54. Exhibit 10(C), Form 10-K for year ending December 31, 1992, at page 17.

> the facilities, there can be no assurance that they will be successful in implementing their business plans or that the participation in the ownership and operation of the Mexican Subsidiaries through EMI will result in any revenues to the Company... Because the business to be conducted by the Mexican Subsidiaries is still in the formative stages, the Company cannot yet evaluate all of the specific investment considerations and risk factors of the proposed business and there can be no assurance that any such unanticipated considerations or factors will not have a material adverse impact on the proposed business of the Mexican Subsidiaries and EMI."[55]

96. At the time that it acquired COTERIN, therefore, Metalclad had no experience in the waste management industry, much less being involved in the planning, permitting, construction, and operation of a hazardous waste landfill. As the Respondent's expert, Marcia Williams, testifies, the company was inexperienced and its complaints in this proceeding about having to perform additional studies, for example, is telling evidence of that inexperience[56].

97. The Respondent's expert, John Butler III, similarly points out that in some of its financial planning and representations to investors, Metalclad overestimated the amount of hazardous waste generated in Mexico by twenty times. Moreover, after it concluded the *Convenio de Concertación* with the federal government in November 1995, its Director of Investor Relations, Elgin Williams, was stating in interviews that the company could charge 325.00 dollars to 360.00 dollars per ton to receive waste. These figures were more than twice as high as the Claimant's own experts used in their report for this proceeding. They are approximately three times what Mr. Butler says is reasonable (it is also three times what the company was told by consultants in 1993 it could reasonably expect[57]).

The State of Metalclad's Finances

98. The quotation from Mr. Kesler's witness statement above also refers to the company's financial resources ("they [State and federal officials] knew we had the capital and the technology..."). The implication of this comment and others ("Metalclad... had

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55. Exhibit 10(E), Form S-3, filed on August 31, 1993, at page 6.

56. Williams expert report at page 6, paragraph 33.

57. Exhibit 18, Metalclad's own March 1993 study of the market in Mexico, noted: "After reviewing the current cost for disposal of hazardous waste in Mexico with a variety of hazardous waste generators, ECO representatives discovered that most report hazardous waste disposal costs at plus-or-minus 25 per cent of the current disposal price for similar materials in the U.S."

completed more than One Billion Dollars of environmental construction projects around the world") is that the company had significant financial resources to commit to its Mexican investments.

99. Not only did Metalclad have no experience in the business, it was hard-pressed for capital throughout the whole of the 1991-96 period. In fact, at one time it defaulted with its key creditor, CVD Financial Corporation[58]. In preparing its defense for this proceeding, the Respondent retained Professor Mark Zmijewski of the University of Chicago's Graduate Faculty of Business Administration and a leading expert in accounting practice and his colleague, Mr. Kevin Dages, of the Chicago Partners consulting firm. They have analyzed the company's records, including those filed with the SEC and the tax returns for the various Mexican subsidiaries filed with the *Secretaría de Hacienda y Crédito Publico* (the Secretariat of Finance and Public Credit)[59].

100. Mr. Dages' expert opinion on this point is that the company was forced to pay an extremely high effective rate of interest to finance the landfill project. Eighteen months after announcing it had "nearly" secured financing of 250 million dollars from Chaes Manhattan Bank, the Claimant borrowed 2.5 million dollars from CVD Financial Corporation. Mr. Dages estimates tht it paid an effective rate interest rate of 45.5%[60] for a loan of only 2.5-3 million dollars (it was refinanced up to 3 million dollars after the company defaulted).

101. Mr. Dages notes the company's former auditors, Grant Thornton, who concluded in 1995 that there was substantial doubt as to whether Metalclad was a going concern[61]. This is because it had been consistently losing money in its 'core' insulation business and was borrowing heavily at high rates of interest to finance its foray into the hazardous waste business[62].

102. During the 1990-96 period, Metalclad lost money or barely broke even in its existing insulation business. It also repeatedly stated in its SEC filings that it would

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58. Exhibit 10(N), Loan Modification Agreement, an attachment to the company's Form 10-K for the fiscal year ending May 31, 1995 at page 142.

59. The latter were delivered to the Respondent on December 10, 1997, in response to its second request for documents relevant to the Claim.

60 Export report of Kevin Dages.

61. Exhibit 10(N), Form 10-K for the fiscal year ending May 31, 1995. The auditors commented:

"The accompanying financial statements have been prepared assuming that the Company will continue as a going concern.

As shown in the financial statements, the Company has had substantial recurring losses from its operations and has been dependent upon external financing to sustain its operations. These factors, among others, as discussed in Note B to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern." (at page F-1)

62. Zmijewski and Dages expert reports.

require substantial additional capital to undertake the Mexican projects. For example, its 10-K for the period ending May 31, 1993, states with respect to its proposed hazardous waste landfill site at Santa María del Río, San Luis Potosí (not to be confused with the site at La Pedrera)[63]:

> "The Company anticipates construction of each hazardous waste treatment facility in phases and that the first phase of the San Luis Potosí facility will cost approximately $10,000,000 de dólares. Although the Company has not obtained final construction financing for any of its planned facilities, management of the Company has discussed various financing alternatives with investment bankers and potential joint venture partners and believes that it will be able to obtain debt financing or financing through a joint venture with a strategic partner. However, there can be no assurance that the Company will be successful in attracting the capital necessary to finance the construction of the facilities or that such financing, if acquired, will be on terms that will enable the Mexican Subsidiaries to achieve profitable operations, individually or in the aggregate."[64]

103. As the Claimant refocused its business from being a small insulation seller and installer to being a hazardous waste landfill operator in Mexico, it was viewed by lenders as a very high risk borrower.

104. It should be noted in this regard that Ms. Williams' expert report identifies an important feature of the companies that compete in this field. She observes that of the 18 hazardous waste landfills currently operating in the United States at present, 13 of them, handling approximately 80 per cent of all such waste disposed at such landfills are owned and operated by just two companies: Waste Management Incorporated and Laidlaw Environmental Services[65]. She notes that Waste Management had 1996 sales of $9.2 billion dollars and Laidlaw Environmental Services sales were $678 million for that year.

105. Ms. Williams testifies further that experienced waste operators in the United States fully expect that many of their projects will be stymied one way or the other. They accept this as a cost of doing business[66]. Since, unlike the Claimant, such companies are well-capitalized, they are able to weather these exigencies.

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63. As shall be seen, Metalclad originally planned a much more extensive facility at Santa María del Río. This site was never developed.
64. Exhibit 10(D), Form 10-K for the transition period ending May 31, 1993. [Emphasis added]
65. Williams' Report at page 12, paragraph 43.
66. Ibid.

Misrepresentations to the Public Markets

106. The Chicago Partners experts are also specialists in providing expert testimony in securities litigation. They have analyzed Metalclad's statements to the market during the relevant period. They were instructed to do so for four reasons. First, the AAA report has alleged that the value of the landfill investment is $90 million. Professor Zmijewski was asked to analyze this claim. Secondly, the AAA report alleges that the Claimant suffered damages of $23 million for a "loss of market capitalization"[67]. Professor Zmijewski analyzed this claim. Thirdly, the evidence shows, and the Respondent will argue, that the Claimant's missteps and inappropriate actions aimed at forcing the opening of the landfill were driven by its misrepresentations to its investors in the United States and abroad. The Tribunal will see that the Claimant exaggerated its activities and prospects in Mexico and omitted to report its difficulties. Mr. Dages reviewed the Claimant's finances, SEC filings, and press releases to inform the Tribunal what the Claimant was doing and saying to investors. Fourthly, since the company's financial disclosures, through press releases, SEC filings and other documents used to raise equity or debt, are by law to be "full and fair", they provide a means for examining the Claimant's credibility[68].

107. There was a consistent pattern in the company's statements to the market. In the light of the evidence of what was occurring in Mexico, they were unduly optimistic, to put it most charitably. For example, the Tribunal will see that an agreement on a process for dealing with State and local approval for locating the Claimant's proposed landfill in the State was declared in categorical terms as clearing the way for the construction of a state-of-the-art facility. In another case, the company announced that it had "nearly" secured financing for its Mexican operations (it held a press conference to announce that it had "nearly" secured financing of 250 million dollars from Chase Manhattan Bank; the financing did not materialize). The Claimant repeatedly made announcements on the imminent "ground breaking" of land for the construction of three other major facilities in Mexico; none of those facilities were constructed. In another case, the Claimant told investors that a November 24, 1995 agreement with the federal government "insured" the operation of the landfill, even though the federal government described the agreement was a "necessary but not sufficient" requirement for its operation.

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67 The Claimant's expert report on alleged damages includes an estimated 20 to 25 million dollars "as measured by the company's loss in market value as a result of the constrained opening of the La Pedrera site". See the Summary of the AAA Report at page IV.

68. The Preamble to the Securities Act of 1933 states that the purpose of the law is "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails; and to prevent frauds in the sale thereof..." 15 U.S.C. Sec. 77a-77aa, 48 Stat. 74 (1933).

108. Professor Zmijewski cross-referenced the Claimant's stock prices over the relevant period to the key events in the period and examined what Metalclad said or omitted to report to the market. His report demonstrates how the company's stock price was grossly inflated.

109. The Respondent's experts' testimony is consistent with the evidence that, with full knowledge of the municipality's opposition and the likely rejection of an application for a construction permit, the Claimant accelerated its construction at the La Pedrera site in light of highly charged social opposition because of needs to justify its claims to its investors.

Miscellaneous Misrepresentations and Errors

110. The Claimant's propensity for exaggeration and misrepresentation is demonstrated time and again in the Memorial and witness statements. The clear implication of the case is that but for the blandishments of federal officials Metalclad would not have invested in Mexico. In fact, the Claimant's own evidence (in the form of its SEC filings and various promotional documents that were provided in response to the Respondent's request for specific documents) is that it was already investing in Mexico well before any discussions were held with Mexican officials regarding the COTERIN acquisition.

111. The evidence is that Mr. Kesler's other company, ETI, which was acquired by Metalclad in November of 1991, had already invested in a hazardous waste landfill project in Santa María del Río, San Luis Potosí (on July 21, 1991)[69]. No significant work was done on that site and the project was apparently abandoned after Metalclad acquired COTERIN (although that did not stop its subsidiary ECO-Administración from placing an advertisement in *Prevención de la Contaminación* on September 1, 1993 —eight days before Metalclad exercised its option to purchase COTERIN— advertising its industrial waste treatment facility that was shortly to commence operations in Santa María del Río)[70].

112. The Claimant has exaggerated its contacts with senior Mexican officials and has mischaracterized Mexico's general invitations to the business world at large to invest in the nation, as if they were an invitation to grant Metalclad an exclusive monopoly in the

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69. Exhibit 19, The Orange County Register reported on October 19, 1991 Mr. Kesler's claim that ETI had been working for two years with ECO-Administración to negotiate rights to build a site near Mexico City. That would have placed Mr. Kesler's involvement in the market in 1989, some four years before the COTERIN acquisition. However, the evidence is that ETI and Mr. Kesler did not acquire an interest in Eco-Administración until July 21, 1991, a few weeks after he became President and CEO of Metalclad.

70. Witness statement of Mr. Kesler at page 1.

hazardous waste business. Ambassador Santiago Oñate is one such official to whom Metalclad refers. The implication of Mr. Kesler's statement is that Metalclad formed close relations with Dr. Oñate. Mr. Kesler claims that:

> "During 1992 we attended a conference in New York City sponsored by Mexico. One of the primary speakers was Santiago Oñate, who later invited us to come to Mexico to make investments in the environmental field. We later got to know Dr. Oñate as he became the first environmental attorney general, then head of the agency SEDESOL, then on to the department of labor as Secretary under the Zedillo administration, later to the head of the PRI party, after which he has been named as the Ambassador to Great Britain."[71]

113. Ambassador Oñate's recollection, as set out in his witness statement, is that he recalls meeting Metalclad officers at certain conferences. They were one of many companies that he met. He was introduced to many other American companies who were investigating environmental opportunities in Mexico. He believes that his various meetings with Metalclad amounted to a total of two hours at most. He does not recall the names of the individuals whom he met. He is not sure if he ever even met Mr. Kesler. He rejects the intimation that he specifically invited that company to Mexico and that he gave specific assurances to it. He is certain that he never met them in his current position, in his previous post as head of the PRI, and doubts that he met them as Secretary of Labor[72].

114. Ambassador Oñate doubts whether Metalclad representatives would have had any more extensive contact with other senior officials such as the late Luis Donaldo Colosio. It was not in the nature of a Secretary of State's schedule to have extensive discussions with a potential investor such as Metalclad[73].

115. The Respondent's experts have reviewed the documents provided with the Claimant's case as well as those provided in response to the Respondent's request for documents. Their evidence is that the Claimant committed major errors in building its business case, errors of such magnitude as to raise the question whether management deliberately intended to mislead investors. For example:

(1) On the important issue of the price that could be charged for the disposal of waste, the Claimant's expert settled on an average price per ton of 150.80 dollars (a figure that, in the Respondent's expert, Mr. Butler's,

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71. Ibid. [Emphasis added]
72. Witness statement of Ambassador Santiago Oñate at paragraphs 5, 6, and 7.
73. Ibid. at paragraph 7.

view, is too high). Yet in January 1996, after the *Convenio de Concertación* with PROFEPA was announced, Metalclad's Director of Investor Relations was using the figures of $360 and $325 dollars per ton when discussing the company's prospects. These figures, Mr. Butler testifies, are completely unrealistic. At one time, Mr. Kesler stated that the 120,000 ton capacity Santa María del Río plant would gross 150 million dollars[74]. This gross revenue figure amounts to 1,250 dollars/ton of waste!

(2) In some of its internal documents, which appear to have been written for investors, Metalclad over-estimated the amount of hazardous waste generated by Mexico by twenty times. While all other estimates are in the range of 5-8 million tons a year range, Metalclad estimated it could be as high as 154 million tons.[75]

(3) Mr. Butler points out that had the La Pedrera landfill opened and "ramped up" to the levels predicted by Metalclad, it would become the biggest landfill in North America. Yet the company evinces no understanding of the impact of bringing such capacity on-stream in a market where, on its own expert's analysis, there is an existing surplus of capacity. Nor does it even attempt to anticipate the additional impact of the four other landfills of the same size as La Pedrera that its SEC filings said it would be constructing.

(4) In his expert report, Mr. Dages reviewed the company's history of declaring pending approvals, pending financings, pending joint ventures, and pending "ground breaking," the vast majority of which never occurred. His analysis shows this to be a classic example of a company that was driving up its stock value on the basis of inflated market expectations rather than actual financial performance.

116. The Memorial repeatedly asserts the "state-of-the-art" nature of the facility in La Pedrera. The evidence of the Respondent's environmental experts, who have true expertise in the field, is that a hazardous waste *landfill* is by definition not state-of-the-practice. Ms. Williams testifies that:

> "By definition, placing hazardous wastes in landfills is not state-of-the-design waste management for most hazardous waste streams. In fact,

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74. Exhibit 20, Mexico Business Monthly, February 1, 1992.

75 Exhibit 21, Market Study Hazardous Waste Generation Nation of Mexico, Metalclad Corporation, 1993

beginning in 1986, the U.S. began to ban the placement of hazardous waste on the land until that waste received extensive treatment to minimize its hazardous characteristics."[76]

117. In addition, Mr. Butler, an expert in evaluating hazardous waste landfills, has reviewed the plans and has examined the company's financial projections. His expert evidence is that:

> "Metalclad has grossly overstated the fair market value of it hazardous waste storage/disposal business at La Pedrera by using unrealistic assumptions to grossly inflate revenues and to reduce costs of operation, thereby greatly exaggerating profits, and the value of Metalclad's claim for damages."[77]

118. Mr. Dages also examined the Claimant's claim that its total landfill costs were 20 or 25 million dollars. He has concluded that the figure claimed is grossly exaggerated. The Tribunal will recall that given that the Claimant filed a single page in the AAA report purporting to establish its out-of-pocket expenses on the landfill, the Respondent requested that the Claimant's Chief Financial Officer provide an itemized list of expenditures. The Claimant declined to do so.

119. With respect to the claim that federal authorities represented the federation's primacy and exclusivity of jurisdiction, the Memorial referred to representations allegedly made by federal officials and asserted further that "Claimant's legal advice and analysis confirmed the position taken by the federal government"[78]. Since the Claimant had performed due diligence before purchasing COTERIN, in preparing its defense, the Respondent wished to ascertain the Claimant's state of knowledge on the permits issue and whether in fact legal counsel did advise as claimed in the Memorial.

120. On November 11, 1997, the Respondent requested the Claimant to provide copies of certain documents to which the Memorial referred but which were not provided with it. Among the documents requested were those dealing with the Claimant's due diligence when it purchased COTERIN.

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76. Williams report at page 34.
77. Butler Report at page 2.
78 Memorial at page118, paragraph 166.

121. Mr Kesler replied by letter to his counsel on November 17th, enclosing certain documents, some of which pertained to the due diligence exercise.

122. After reviewing those documents, the Respondent noted that among them was a May 18, 1993 memorandum which stated "Barragan to finish legal due diligence of COTERIN (issue letter)"[79]. A due diligence letter had not been provided by Mr. Kesler so the Respondent requested a copy of it.

123. Mr Kesler replied in his letter of December 10th that his earlier document disclosure included the document(s) prepared by Mexican counsel: "I believe Attorney Garcia Barragan completed his work, which is reflected by the fact that the transaction was actually closed, but I know of no report that was made and believe the reference from Mr Fah's report was simply that he report verbally to him his findings of the various items he was asked to look into as we did due diligence."

124. There was, therefore, apparently no letter prepared by local counsel containing legal advice on the local approvals issue. However, as the September 9th amendment to the Promise Agreement shows, it is obvious that the Claimant received advice on the issue. (Such advice was inconsistent with the position now advanced by the Claimant).

125. The Respondent later requested further documents relating to certain private placements of common stock that the Claimant made to investors situated outside of the United States.

126. The Offering Memorandum for the private placement, dated February 12, 1996, disclosed that the landfill was facing political opposition at the State level. To similar effect as the Memorial, the Offering Memorandum represented that "...the Company has received 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..."[80]

127. On February 9, 1998, the Respondent directed the Claimant to this statement and requested a copy of each of the legal opinions to which the Offering Memorandum

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79 Noted in the Respondent's letter of December 9, 1997 at page 4.

80 Offering Memorandum, dated February 12, 1996, at page 6.

referred.

128. The Claimant responded on February 13, 1998, that "You were earlier provided with information from Claimant's Mexican counsel, Garcia Barragan. We are not aware of copies of further written legal opinions."[81]

129. Although the Claimant's counsel did not provide a definitive answer, it appears that the Claimant did not receive any legal opinions from "competent legal counsel", even though it had so represented in its Offering Memorandum. Alternatively, it did so and declined to provide them to the Respondent.

Misrepresentations to the Tribunal and the Experts

130. The Tribunal will see that the story that has been presented to it by the Claimant ignores many important facts fully within the Claimant's knowledge.

131. The Claimant's misrepresentation to the Tribunal that it was unaware of the municipality's requirement of a construction permit was also made to its own experts.

132. This goes to the very heart of Metalclad's claim and is telling evidence of the lack of the Claimant's credibility. One of the expert's reports that Metalclad filed in this proceeding, produced by The Legal Center For Inter-American Trade and Commerce (CENTRO JURICI) is entitled, "Lack of Clarity in Mexican Environmental Legislation in the Period of Transition: 1988 to 1996". It states that:

> "We will opine that, given this confusing regulatory environment, it was reasonable for METALCLAD to have faith in and act upon the federal government's assertion of supremacy in the areas of hazardous waste landfill permitting, licensing and oversight; and to be unaware of the need (if any) for a local construction permit."[82]

81 Letter of February 12, 1998, from Clyde C. Pearce to Hugo Perezcano.

82. This text does not appear in the Spanish version of the document. Page 8. [Emphasis added]

133. Indeed, the English version[83] of the opinion states in its concluding paragraph that:

> "It is not clear that a local construction permit was required for the La Pedrera landfill. But given these facts, we opine that, if it was required, it was reasonable and even highly likely that METALCLAD, diligently acting in good faith, would have been unaware of this requirement."[84]

134. Moreover, the concluding paragraph of the Spanish version of the opinion states:

> "It was not clear that a municipal construction permit was required for the La Pedrera landfill. But given these facts, we opine that if it was required, it would have been reasonable and highly obvious that METALCLAD would have requested it, in order to comply with the requirements provided for in the Law."[85]

135. A review of the amended Promise Agreement shows that the Claimant was well aware of the legal requirement and, of course, COTERIN requested the permit in 1991 but had been denied it that same year, and that denial was later confirmed in 1992.

136. The Claimant did not instruct its expert witness as to the true state of its knowledge on this central issue in dispute.

137. The Claimant has characterized the alleged representations of federal primacy on which it claims to have "detrimentally relied," as being "pivotal facts in this case; for the part of the basis upon which Claimant relied, in good faith and to its detriment, in exercising its option to purchase COTERIN, and in going forward with the construction of the landfill"[86].

138. It is evident that these "pivotal facts" are not facts at all. The Claim is based on false premises.

139. In addition to proffering an expert report that was based on an incorrect factual premise, the following features of the Claimant's case exemplify this conduct:

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83. The translation of the Spanish version of the expert report is not only deficient, but there are also substantive differences.
84. Ibid. at page 8 [Emphasis added].
85 Ibid. at page 7. [Emphasis added]
86. Memorial at page 123.

(1) The Claimant did not provide a copy of the instruments relating to the purchase of COTERIN to the Tribunal until so requested by the Respondent.

(2) The Claimant omitted to refer to its public pronouncements acknowledging the need for local support.

(3) The Claimant omitted to refer to its public acknowledgement that it had not supplied detailed information relating to the COTERIN acquisition to the Governor or to State officials.

(4) The witness statement of Dr. Humberto Rodarte Ramón misrepresents his role in the whole affair. It omits to note that at least three months prior to leaving SEDESOL in September 1993, he had already been appointed as the Managing Director of the Claimant's consulting company, CATSA. Dr. Rodarte Ramón's statement omits any testimony relating to critical events in which he participated from the end of 1993 until the beginning of 1996 when he ceased working for the Claimant.

(5) The Tribunal will see that the Memorial's description of the events leading up to the March 10th "Grand Opening" and the demonstration on that day is misleading and is contradicted by the videotape evidence that the Claimant itself submitted to the Tribunal.

(6) The Claimant's characterization of the May 27, 1994 agreement with the State Government is wholly misleading. The agreement was that Metalclad would remedy the La Pedrera site and the State would lend its assistance to find and expedite the permitting of an alternative site. The Memorial and witness statements obscure this and characterize the agreement as relating only to the opening of La Pedrera. The company also issued a press release in the United States implying that under the agreement, the La Pedrera site would open and announcing that the State would assist it in locating "additional sites" rather than an alternative site as agreed.

(7) The Claimant's Mexico City legal counsel, Mr. Gustavo Carvajal, testified as to the Claimant's negotiations with the municipal council. He asserts that an understanding was reached that could allow the company to operate the hazardous waste landfill. Mr. Carvajal's witness statement twice leaves out critical words that change the meaning of the understanding entirely. The Respondent concedes that an understanding was reached which contemplated the acknowledgement that the company was required to operate the site while it was being remedied, but only as a non-hazardous waste landfill. It was also acknowledged that any

agreements would need to be approved by the inhabitants of the Municipality and, more importantly, that the commencement of operations would have to be supported by a majority of the Municipality's inhabitants. In such case, the Municipality and Metalclad agreed that the remediation and operation would be carried out by a different company. Mr. Carvajal's witness statement makes much of the agreement, but omits the words "non-hazardous" when he recites the agreed provisions[87]. He also leaves out the words "if such were the case" when referring to the understanding that the operation would be carried out by another company[88]. These were not errors of translation in the English version of his statement. Mr. Carvajal's Spanish witness statement is also not faithful to the original understanding (a true copy of which is annexed to the statement of Mr. Leonel Serratto).

The Mixing Together of Different Events and Statements

140. The Respondent also directs the Tribunal to another misleading feature of the Claimant's pleadings, namely, its tendency to move forward and back in time in a way that presents an inaccurate image of the events. This temporal manipulation of the facts can be seen in the following four examples.

141. First, at paragraph 86, the Memorial alleges: "At last, in early 1995, having substantially completed construction, and with the Governor's public statement of support [the Memorial inserts a reference to footnote #37 at this point], Metalclad prepared to celebrate the opening of the facility."

142. The reader could be expected to conclude that the Governor must have made a public statement of support in early 1995 that indicated that the facility could now be opened. However, footnote 37 directs the reader back to paragraph 69 of the Memorial. Paragraph 69 attests to the "ceremony at the State Palace in San Luis Potosí [on May 27, 1994, almost a full year before], with the press in attendance, [where] the accord between Metalclad and the state Government (achieved during Medellín Milán's visit to Orange County), was publicly announced."

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87. Exhibit 143. Point 1.3 of the original "Memorandum of Understanding" states: "Both parties recognize that, to remedy the site, the Company needs, for technical and economic reasons, to operate the site in a controlled manner and as a deposit of industrial *non-hazardous* waste" [Emphasis added].

88. Ibid. Point 2.3 of the original "Memorandum of Understanding" states: "The Municipality and the Company agree that the remediation and, *if it were the case*, the operation of the industrial waste landfill located in the plot of land known as "La Pedrera" in the Municipality of Guadalcázar, S.L.P., will be performed by a company other that Metalclad Corp./COTERIN." [Emphasis added.]

143. The May 27th agreement, the evidence shows, contained the following major elements: the company would remedy La Pedrera; the State would lend all necessary assistance and support to find an alternative site; and La Pedrera would be permitted to receive new hazardous waste only if the local municipality approved. This is the agreement that the State publicly supported.

144. The Tribunal will be directed to the local newspaper accounts which confirm the State's understanding of the agreement. For present purposes, it is adequate to refer simply to the headline of the May 28, 1994, edition of *Momento*. It stated: "Metalclad Will Install A Waste Facility: But It Will Not Be At La Pedrera; That One Will Be Cleaned"[89].

145. It will be seen that the Governor in no way expressed unconditional support for the project on May 27th. To the contrary, the State's support was conditional upon the support of the local community. Thus, the evidence that is cited to support the allegation in paragraph 86 is taken out of context.

146. A second example of this propensity to mix together events is found in paragraphs 73-86. The Memorial moves forward and backward in time to prove that the construction that the Claimant launched in May of 1994 was done so openly and without objection until October when the municipality issued a shut down order. This is wholly misleading. The Tribunal will see that at least on three occasions during 1994, the Claimant represented to the federal authorities in writing that the work that it was doing at the site was maintenance work or work related to remediation. It was not until October that the municipality realized that the work was not in connection with the federal environmental audit, but rather was directed at constructing the landfill. Yet throughout this time, the Claimant was telling investors that it was constructing the landfill and expected to be in operation by the fourth quarter of calendar 1994.

147. The third example is found at paragraph 53 of the Memorial. The Tribunal will see that the Claimant alleges that: "In July 1993, Medellín Milán attended a pre-NAFTA border conference as a guest of the Company and approved a press release announcing state support of the company's project". This claim is clearly intended to mean that the project allegedly receiving Dr. Medellín's support was La Pedrera.

148. Leaving aside Dr. Medellín's denial of the allegation that he approved the press release, the Tribunal will see that the press release issued by the Claimant on July 16, 1993 dealt with the fact that the company had been "issued a final permit from the Ministry of Social Development (SEDESOL) to build a fully permitted hazardous waste treatment facility in the State of San Luis Potosí, using state-of-the-art technologies for

89. Exhibit 22, "El Momento", May 28, 1994, SLP.

the treatment of all hazardous wastes". However, the INE permit that was issued on February 26, 1993 (the date mentioned by the Claimant in its press release) was a permit issued to the Santa María del Río site, not to the La Pedrera site.

149. Nothing in the press release would have identified La Pedrera to the reader at the time. There was a reference to the company's expectation that it would "be able to announce the acquisition of an existing and operational hazardous waste landfill in the near future", but the reader would not take that as a reference to La Pedrera. It was neither identified by name and, of course, it was not an "existing and operational" landfill. It was a shut down transfer station that was partially permitted for construction of a landfill (even at the federal level, the authorities had not yet issued the August 10th permit).

150. Another example of this propensity to mix events together is found at paragraph 25. It notes that the NAFTA negotiations were intensifying in 1992-93 and states further that: "The personal assurances given to Claimant by various Mexican officials with federal authority over environmental matters, and of federal approval and support for the La Pedrera project, resonated with the public and official pronouncements concerning Mexico's restructured, NAFTA-enhanced environment for foreign investment".

151. The paragraph refers to footnote 10 which states:

> "Among the federal officials with whom Claimant met were: Herminio Blanco Mendoza, head of Mexico's Foreign Investment Ministry, (SECOFI), and Jaime Zabludovsky Kuper, Blanco's deputy; Julia Carabias Lillo, Secretary of Natural Resources, Environment and Fisheries, (SEMARAP); Dr. Sergio Reyes Luján, President of INE; Antoio Azuela de la Cueva, Attorney General of the Environment, (PROFEPA); and Dr. Reyes' successor Gabriel Quadri de la Torre, Santiago Oñate Laborde, Attorney General for the Environment; Ambassador Negro-Ponte; Jaime Alatore; Alejandro Beauchot; René Altamirano. Declaration of Grant S. Kesler."[90]

152. Keeping in mind that these were officials that were identified as being among those that the Claimant met during the 1992-93 period when it was doing its due diligence, the Tribunal is advised that:

(1) Dr. Blanco and Dr. Zabludovsky were respectively the Chief and Deputy Chief NAFTA negotiators at the time and were not promoted to Secretary

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90 See footnote 10 to paragraph 25 of the Memorial, page 171.

of Trade and Industrial Development and Undersecretary of International Trade Negotiations, respectively, until December 1, 1994;

(2) Ms. Carabias did not become Secretary of SEMARNAP until so appointed by President Zedillo on December 6, 1994;

(3) The same was the case for the appointments of Mr. Azuela and Mr. Quadri; and

(4) Ambassador "Negro-Ponte" (sic) was not a senior Mexican official. John D. Negroponte was the United States' Ambassador to Mexico appointed by President George Bush.

153. The Respondent's Admissions and Denials Annex responds to each allegation in the Memorial by paragraph and directs the Tribunal to the instances where events and statements have been taken out of context and combined in a misleading fashion.

D. Evidentiary Issues

154. In the Respondent's submission, although this claim can be rejected on the basis of the Claimant's own documents, the Respondent wishes to comment on the other evidence adduced by the Claimant. International arbitration does not rely on strict adherence to the rules of evidence used in the common law countries. At the same time, the Tribunal must be satisfied as to the probative value and cogency of the evidence adduced by each party. It must also form judgments as to the credibility of witnesses. The Tribunal will see that many allegations do not withstand serious scrutiny. Without even taking the Respondent's direct evidence on many points into consideration, the Claimant's allegations are often contradicted by its own evidence and statements made in other contexts.

155. The Respondent recognizes that, although international tribunals do not burden themselves with formal rules of evidence, they still concern themselves with matters of proof. The burden of proof is put upon the party who asserts a proposition. This burden has been described simply by Sandifer in his book, *Evidence Before International Tribunals*:

> "The broad basic rule of burden of proof adopted, in general, by international tribunals resembles the civil law rule and may be simply stated: that the burden of proof rests upon him who asserts the affirmative

of a proposition that if not substantiated will result in a decision adverse to his contention."[91]

156. Sandifer later states that this is especially the case in claims commissions (the form of international arbitration that NAFTA Chapter Eleven most closely resembles). He states:

> "And 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."[92]

157. The burden of proof assumes importance in this case because of the self-evident frailties of the Claimant's evidence adduced in support of its claim. Those frailties can be summarized as follows:

a) The Tribunal will see that the Claimant's case contains many unsubstantiated allegations and hearsay evidence. Mr. Kesler's statement is written in the first person plural with few indications as to when he is testifying as to his own personal knowledge or is relying upon second or third hand accounts. While the Respondent recognizes that rigorous application of the hearsay rule is not appropriate in an international arbitration, the sheer volume of hearsay, and the evidence showing its unreliability, should lead the Tribunal to reject the evidence of Mr. Kesler *in toto*.

b) As has and will be noted, there are instances where Metalclad's evidence is contradicted by highly probative independent evidence (such as the amended September 9th,1993agreement and the videotape of the March 8th, 1995, demonstration).

c) There is some evidence of attempts by the Claimant to manufacture evidence which it now purports to put before the Tribunal. For example, it cites newspaper articles published in a local newspaper *El Heraldo* as evidence of the events described therein. It was known in the State that the Claimant's local public relations advisor, Salomón Leyva, was planting stories in *El Heraldo*. Second, Dr. Angelina Núñez testifies that there was an effort to link her organization, Pro San Luis Ecológico, to the RIMSA landfill company. She draws the obvious inference that this was an attempt by the Claimant to

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91. Durward V. Sandifer, Evidence Before International Tribunals, revised edition (University Press of Virginia, Charlottesville), at page 127.
92. Ibid. at page 130.

discredit the NGO. Third, some of the newspapers cited as proof of the events reported therein do not contain the information for which they are cited.

d) Finally, there is clear evidence of falsehoods and inappropriate actions on Metalclad's part (the attempt to get the auditor to join the board, miscellaneous misrepresentations on COTERIN's operations made to the market, the suggested payment to the Governor, and the false premises of its expert's report).

158. Sandifer discusses how international arbitration tribunals deal with the frailties of evidence. He points out that international tribunals rarely refuse to admit evidence, but that they do evaluate it, once admitted, for its probative value. In his discussion of the hearsay rule, he notes that:

> "It seems self-evident that the approach of international tribunals to hearsay may be expected to be more comparable to that of the civil law. They are unlikely, in light of general international practice, to apply technical rules of admissibility. Their concern is relevance, credibility, and evaluation, taking account the absence of personal observation by the witness."[93] [Emphasis added]

159. He continues:

> "In implicit recognition of the foregoing principles, questions raised concerning hearsay evidence before international tribunals have been directed, in the main, to its value rather than to its admission. However, in some cases tribunals have refused to base awards on the second-hand statements of witnesses who had no opportunity to observe the events about which they testified."[94]

160. In those cases, the Tribunal has tended to reject the hearsay evidence as being unreliable:

> "The tribunal is free, in the exercise of its general powers in this respect, to attach such weight to hearsay evidence, once admitted, as it deems proper under all the circumstances of the case. In some instances tribunals have taken occasion to assert that evidence not based on personal observation

93. Ibid. at page 368.
94. Ibid. at page 369.

carries very limited weight, standing alone, as proof of the facts asserted."[95]

161. In the *Corfu Channel Case*, the International Court of Justice considered the evidence of a Mr. Kovacic tendered by the United Kingdom. His evidence concerned, *inter alia*, who laid the mines in naval shipping lanes. Parts of his deposition evidence were based on second-hand and third-hand conversations. In its decision of 9 April 1949, the Court said:

> "Without deciding as to the personal sincerity of the witness Kovacic, of the truth of what he said, the Court finds that the facts stated by the witness from his personal knowledge are not sufficient to prove what the United Kingdom Government considered them to prove... The statements attributed by Kovacic to third parties, of which the Court has received no personal and direct confirmation, can be regarded only as allegations falling short of conclusive evidence. A charge of such exceptional gravity against a State would require a degree of certainty that has not been reached here."[96]

162. In his Dissenting Opinion, Judge Krylov was less circumspect:

> "As regards Kovacic's testimony, it was found to be full of errors...
>
> ...Even if some part of Kovacic's deposition was true, his evidence is still not sufficient to prove that the mines in question were laid by Yugoslav ships...
>
> Kovacic's statement is therefore nothing more than what the British call hearsay; indeed it is hearsay in the second degree. Kovacic's deposition does not, and cannot, afford any kind of proof in the present case."[97]

163. In the Respondent's submission, the Claimant's case is based on such unreliable and misleading evidence as to justify its dismissal.

E. Claim for Costs of Defense

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95. Ibid. at page 369. [Emphasis added]
96. Corfu Channel Case, [1949] I.C.J. 16-17, 68-69.
97. Ibid. at pages 68-69.

164. In view of the factual distortions that have been uncovered in the preparation of this defense, the Respondent will request that the Tribunal dismiss the claim. In addition, having been put to considerable expense in terms of expert consultants and legal fees, the Respondent will request that the Tribunal order that all fees and expenses of the Tribunal, the fees and charges of the Secretariat, and the expenses incurred by the Respondent in the preparation and conduct of its defense be borne by the Claimant.

II. THE STATEMENT OF THE FACTS

A. INTRODUCTION

165. Throughout this Part, the Respondent will direct the Tribunal to the witness statements of the twenty witnesses who have provided testimony for this proceeding and to the many documents rendered contemporaneously with the events at issue. Some of these documents, such as Metalclad's SEC filings, contradict claims now made by the Claimant. They demonstrate conclusively that the evidence adduced by the Claimant is in many cases simply not credible. Fairly assessed, the evidence shows that there was no corruption or *mala fides* on the part of Federal, State, or local officials in this case, only irreconcilable differences as to whether the project should be permitted to proceed. These were caused by local opposition, differences of opinion over the site's merits, and by the actions of Metalclad, ECOPSA and COTERIN.

166. To assist the Tribunal in ascertaining the facts, the Respondent has divided the 1990-1996 period into three sections. The Tribunal is advised that the Respondent will argue that there are two temporal limitations on the legally relevant facts. First, the NAFTA did not enter into force until January 1, 1994, and therefore liability cannot be imposed for any acts or omissions which occurred prior to that date. Second, notice of the claim was filed on October 2, 1996. Under NAFTA, only those acts or omissions which occurred six months prior to the filing of that notice can be advanced in the ensuing arbitration.

For these reasons, the Statement of Facts is divided into three periods: (1) the events leading up to January 1, 1994; (2) the events occurring in the legally relevant period; and (3) the events occurring after April 2, 1996. Evidence relating to the events occurring in the first and third periods is provided for the Tribunal's information only.

167. To begin the pleadings of fact, the Respondent will describe the relevant Federal agencies and their powers, and the State and local agencies and their powers.

Federal Agencies Responsible for Environmental Matters

168. During the 1990-1996 period, the Federal government twice reorganized its agencies responsible for the formulation of environmental policy, and the administration and the enforcement of the laws.

169. The *Secretaría de Desarrollo Urbano y Ecologia*[98] (SEDUE) was the federal agency responsible for administration of environmental matters until May 25, 1992. It had

98. Secretariat of Urban Development and Ecology.

two semi-autonomous agencies within it: the *Procuraduría Federal de Protección al Ambiente*[99] (PROFEPA) and the *Instituto Nacional de Ecología*[100] (INE). The former was responsible for the enforcement of the law and the latter was responsible for the permitting of environmental projects.

170. On May 25, 1992, SEDUE was replaced by the *Secretaría de Desarrollo Social*[101] (SEDESOL).

171. SEDESOL in turn was replaced on December 29, 1994 when the *Secretaría de Medio Ambiente, Recursos Naturales y Pesca*[102] (SEMARNAP) was established and assumed responsibility for the administration of environmental matters from SEDESOL. Both INE and PROFEPA became semi-autonomous organs of SEMARNAP.

172. SEDUE, SEDESOL and SEMARNAP each had a regional office (a "delegation") in the State of San Luis Potosí at all material times.

173. Like its predecessors SEDUE and SEDESOL, SEMARNAP has overall responsibility for the formulation of federal environmental policy. Its jurisdiction over disposal of hazardous waste is established in Articles 5 and 150 of the *Ley General del Equilibrio Ecológico y la Protección al Ambiente*[103] (the "Federal Environmental Law") which state that the Federal Government, through SEMARNAP, has the authority to regulate and control the production, administration and final disposal of hazardous waste. In particular, SEMARNAP is responsible for the federal permitting of a hazardous waste landfill facility. SEMARNAP exercises this authority through INE.

174. The Federal Environmental Law was the principal federal legislation regarding environmental matters in Mexico. The Law came into force on January 28, 1988 and was amended on December 13, 1996 (when reference is made to the amended Law, it will be described as the 1996 Federal Environmental Law). The Law is further elaborated by a number of Regulations. Two Regulations are of particular relevance to this case: (i) the *Reglamento de la Ley General del Equilibrio Ecológico y Protección al Ambiente en Materia de Residuos Peligrosos*[104] ("Hazardous Waste Regulations"); and (ii) the

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99. Federal Attorney's Office for the Protection of the Environment.

100. National Institute of Ecology.

101. Secretariat of Social Development.

102. Secretariat of the Environment, Natural Resources and Fisheries.

103. Ecological Equilibrium and Environmental Protection General Act.

104. Regulations of the Ecological Equilibrium and Environmental Protection General Act concerning Hazardous Waste.

Reglamento de la Ley General del Equilibrio Ecológico y Protección al Ambiente en Materia de Impacto Ambiental[105] ("Environmental Impact Regulations"). The Regulations are further elaborated by Mexican Technical Regulations[106].

175. The Federal Environmental Law provides for a two-tiered authorization process to establish a hazardous waste disposal facility. First, INE must review and approve an environmental impact statement submitted by the applicant company. This is a necessary, but not sufficient, requirement. Article 28 of the Law establishes that the need to obtain this authorization and to observe the conditions set out in it is without prejudice to other authorizations that must be issued by other authorities, according to their own jurisdiction. Second, INE must issue an authorization prior to the establishment and operation of a hazardous waste system for the collection, storage, transport, deposit, reuse, treatment, recycling, incineration and final disposal of hazardous waste. This authorization is required pursuant to Article 151 of the Federal Environmental Law. Both authorizations are required prior to establishing and operating a hazardous waste landfill facility.

176. Neither of these two principal federal authorizations are defined or characterized by the Law as "construction permits". Legally, neither INE, PROFEPA nor SEMARNAP have authority to issue construction or operation permits. Federal environmental authorities only evaluate and approve the environmental impact that certain activities — including construction or operation of certain facilities— may have, based on an environmental impact statement prepared by the applicant. However, the applicant must still obtain any other necessary permits, licenses or authorizations from the competent authorities[107].

177. Indeed, the expert report prepared by INE's General Legal Counsel, Lic. Alfredo Domínguez Domínguez, states:

> "environmental impact authorizations are the State's acknowledgement OF EVERYTHING RELATED TO THE

105. Regulations of the Ecological Equilibrium and Environmental Protection General Act concerning Environmental Impact.

106. Normas Oficiales Mexicanas ("NOMS").

107. Other federal authorizations that a hazardous waste landfill facility would require to operate are, for example, authorization to transport hazardous waste, federal industrial operating license, registration in the registry to discharge waste waters, and registration in the registry for environmental pollution control (Article 150 of the Ley de Caminos, Puentes y Autotransporte Federal (Road, Bridges and Federal Transportation Act), and Article 5 and Title Eight of the Reglamento para el Transporte Terrestre de Materiales y Residuos Peligrosos (Regulations of Land Transportation of Dangerous Materials and Waste)).

MODIFICATION OF THE ENVIROMENT BY HUMAN ACTION..."[108]

178. It concludes that:

> "We may duly assert that the environmental impact authorizations, as previously defined, are limited to a non-objection to carry out a construction, which may only be done once the corresponding permits are obtained..."[109]

179. Lic. Ulises Schmill Ordóñez, Lic.Carlos de Silva Nava and Dr. José Ramón Cossío Díaz (the Mexican legal experts) corroborate this in their expert report:

> "The authorization issued by the Federal Government only means that a work or activity is permissible, once the environmental impact has been evaluated, but this does not preclude the participation of other authorities with specific powers in related matters, whose jurisdiction is established in other laws that must be applied together with the Ecological Equilibrium and Environmental Protection [General Act]."[110]

The Relevant Federal Permits Issued in this Case

180. On January 27, 1993, INE issued COTERIN a federal environmental impact statement authorization regarding a hazardous waste landfill with the capacity of 100 tons a day or 36,500 tons per year.

181. On August 10, 1993, INE issued the federal environmental impact statement authorization for the operation of the landfill. COTERIN was authorized to receive 3,043 tons of waste a month, a total amount equalling 36,516 tons annually.

182. On February 8, 1996, INE increased COTERIN's capacity to 30,000 tons a month.

183. On January 31, 1995, INE authorized COTERIN to construct a final disposal cell.

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108. Expert report of the National Institute of Ecology, at page 5.

109. Ibid., at page 8.

110. Expert report of Lic. Ulises Schmill Ordóñez, Lic. Carlos de Silva Nava and Dr. José Ramón Cossío Díaz, numeral 3, at page 7.

Local Authorities are Responsible for Environmental and Land Use Matters

184. Land use and zoning powers fall within the jurisdiction of State and Municipal governments. These powers are not vested in the Federal Government by the Constitution and thus are reserved to state and local authorities[111]. As the Mexican legal experts state:

> "In general terms, the system of distribution of jurisdictions between the Federation and the States is based on the premise that the latter maintain the powers that have not been expressly granted to the Federation through the federal pact (art. 124)."[112]

185. However, not satisfied with leaving these powers to state and local authorities in general, in 1983 the Congress amended the Constitution to expressly provide that Municipal governments have authority over zoning and use of land matters. Article 115, section V of the Constitution[113], as amended in 1983, establishes that:

> "The Municipalities, as provided for in the respective federal and state laws, have the power to elaborate, approve and administer zoning and the development of municipal plans for urban development; to participate in the establishment and administration of their territorial reserves; to control and supervise the use of land within their jurisdiction; to participate in the regularization of urban property; to grant construction licenses and permits, and to participate in the establishment and administration of environmental reserves..." [Emphasis added]

186. The constitutional amendment underscored that, *inter alia*, the power to elaborate, approve and administer zoning and development plans for municipal urban development, to control and supervise within their jurisdiction the use of land, and to grant licenses and permits to construct, were express constitutional powers necessary to strengthen and support the Municipalities' legal nature under Mexican law, as the primary (foundational) and autonomous representative body of the federal structure of government.

187. Article 83, section (V) of the Constitution of the State of San Luis Potosí restates the provision contained in Article 115 of the Mexican Constitution.

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111. Article 124 of the Mexican Constitution provides that "Powers not expressly vested by this Constitution on federal officials, are understood to be reserved to the States".

112. Expert report of Lic. Ulises Schmill Ordóñez, Lic. Carlos de Silva Nava and Dr. José Ramón Cossío Díaz, numeral 1, at page 4.

113. Constitución Política de los Estados Unidos Mexicanos (Political Constitution of the United Mexican States).

188. The State law of San Luis Potosí is faithful to the 1983 constitutional amendment. Article 5 of the *Código Ecológico y Urbano del Estado de San Luis Potosí*[114] ("SLP Ecology and Urban Code") establishes that the State Executive Branch and the municipalities have the authority to determine limitations for the use of the land and to construction of any kind, required for urban development purposes and to maintain the ecology's balance, within the territory of the state. Article 12, section VII of the SLP Ecology and Urban Code establishes that the State Ecology Secretariat has authority to issue land use licenses, and the municipalities have the authority to control and supervise their application; and Article 13, section XII establishes that the municipalities have authority to issue construction licenses and to inspect the progress of any construction or work within their territorial jurisdiction[115]. Similarly, Article 8, section XXI of the Environmental Protection Act of the State of San Luis Potosí provides that municipalities are empowered promote the environmental impact evaluation before the State government, for those works or activities to be carried out within the municipal territory and which may alter the environmental equilibrium or the environment, in order to issue the corresponding construction and operation licenses in terms of such evaluation and authorization.

189. The Claimant has asserted that "expert legal opinion on Mexican Law, concludes that pursuant to the Mexican Constitution and the applicable laws, including the 1988 General Ecology Law, primary [sic] of the federal government in matters of hazardous waste is unquestionable". The Claimant's expert report, prepared by the Legal Center for Inter-American Trade and Commerce (Centro Jurici)[116] states:

> "Article 115 (V) of the Mexican Constitution grants municipal government the authority to issue local construction permit. However, this must be done "in accordance with applicable federal law." Pertinent environmental legislation clearly states that the licensing and oversight of hazardous waste landfills (including the issuance of construction permits) in Mexico is the exclusive jurisdiction of the federal government... Additional constitutional doctrines require that the federal government preserve

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114. Ecology and Urban Code of the State of San Luis Potosí.

115. COTERIN applied for and obtained the State land use license on May 13, 1993. COTERIN applied and failed on two occasions (on September 30, 1991 and December 5, 1995) to obtain the Municipal construction license. There is no evidence that COTERIN applied or obtained a Municipal operating permit (the Municipal construction permit is a prerequisite for the operating permit).

116. The Tribunal should note that the Claimant has submitted two "expert" legal reports, both prepared by the Centro Jurici. Both are signed, among others, by Mr. David W. Eaton, who is not licensed to practice law in Mexico. Mr. Eaton has no professional studies in Mexico, and cannot be regarded as an "expert" in Mexican law. The report entitled "Lack of Clarity in Mexican Environmental Legislation in the Period of Transition: 1988-1996" is also signed by Dr. Martín Bremer, a geophysical engineer. This is indicative of the frailties of the purported "expert" opinion submitted by the Claimant.

'constitutional integrity and order' in which it failed and maintain its primary authority to the state and local governments to preserve and maintain its primary authority to regulate this area. Article 115 (V) of the Mexican Constitution, Mexican environmental law and actions of the federal government clearly establish the hierarchy of this 'constitutional integrity and order.' As a result: i.) the federal government 'occupied the field', ii) the local municipality had **no** right to require or issue a construction permit for *any* hazardous waste facility; iii) the local government overstepped its authority by insisting on the municipal construction permit; and iv) the federal government failed to exercise legal and enforcement options against the state and municipal governments therein constituting a violation of the Mexican constitution by failing to preserve constitutional integrity..."[117]

190. The Respondent's legal experts, however, state:

"The Mexican system provides for exclusive powers of the Federation and the States, and concurrent or coincidental ones, that is those that may be exercised by one or the others. Usually coincidental powers are expressly specified in the Constitution. But there are cases in which a constitutional provision delegates on the Congress of the Union the power to distribute jurisdictions between the Federation, the States and the municipalities, through issuance of common laws. Such is the case of article 73, section XXIX-G of the Constitution that empowers the Congress of the Union 'To issue laws that establish concurrence of the federal Government, the State governments and the municipalities, within their jurisdictions, concerning environmental protection and preserving and restoring ecological equilibrium'.

In principle, it should be accepted that this delegated power to distribute jurisdiction cannot be absolute, because it must respect the powers and jurisdictions expressly conferred by the Constitution on the Federation, the States and the municipalities; the distribution of powers and jurisdictions among these three orders can only be consistent and harmonious in this manner, thus avoiding jurisdictional conflicts that could otherwise arise. In this manner, the principle of constitutional supremacy is also respected...

As has already been expressed, issuance of measures that establish the distribution of jurisdictions regarding environmental protection is a power vested on the Congress of the Union by means of the issuance of secondary

117. "Administrative, Procedural and Legal Violations of Mexican and International Law concerning the Authorization and Oversight of the "La Pedrera" Landfill", by The legal Center for Inter-American Trade and Commerce (Centro Jurici). Executive Summary (by David W. Eaton, Esq.), at pages 2 – 3.

laws, such as the Ecological Equilibrium and Environmental Protection General Act, the only legal limitation being respect for constitutional provisions. It has also been stated that municipal jurisdiction is constitutionally established in article 115 of the Constitution, and it cannot be abrogated, or even contradicted, by the federal or local laws, given the principle of constitutional supremacy contained in article 133 of the Constitution. Thus, the first of the cited articles empower municipalities to grant construction licenses and permits, among others. For the above reasons, this power cannot be ignored or abrogated by any federal or state secondary legal provision...

... it should be understood that the permits or authorizations granted by the Federal Government operates without prejudice to those corresponding to other competent authorities. For such reason, it should necessarily be concluded that municipalities are among those competent authorities in view of their being empowered to grant construction licenses by constitutional article 115 and the local laws and regulations, this powers being recognized by the Ecological Equilibrium and Environmental Protection General Act, in compliance with article 115. But even if under the assumption, which is not possible in this case, that federal Law did not respect such power, because of hierarchical reasons, the constitutional text must prevail."[118]

191. In summary, the Mexican Constitution empowers municipalities to issue construction permits. This power may be regulated by the federal, state and local laws and regulations, but cannot be superseded or ignored. In the event that there was any inconsistency (this not being the case) the constitutional text would prevail. In the instant case, however, consistent with the Constitution, the Federal and State laws regulate the distribution of powers in a detailed manner, including the issuance of municipal construction permits by municipalities. Specifically:

- Article 1 of the Federal Environmental Law provides that its provisions apply without prejudice to other provisions contained in other laws concerning issues specifically related with the matters regulated therein.

- Article 28 provides that development of public or private works or activities that may cause ecological imbalance or exceed the limits and conditions established in the ecological rulings and technical regulations issued by the Federation, are subject to the authorization of the federal government, without prejudice to other authorizations that competent authorities are entitled to

118. Expert report of Lic. Ulises Schmill Ordóñez, Lic. Carlos de Silva Nava and Dr. José Ramón Cossío Díaz, numeral 1, at pages 4 – 7.

grant.

- The San Luis Potosí Ecological and Urban Code clearly establishes the municipalities' power to grant construction licenses (articles 1(IV), 5, 13 (XII), 57, 63 and 64, among others).

- Article 8 of the San Luis Potosí Environmental Protection Act also empowers municipalities to issue construction licenses.

State Permits

192. On May 11, 1993, the State issued a Land Use License. The License referred to the federally approved Environmental Impact Statement. The amount of hazardous waste permitted to be disposed of annually was 36,500 tons.

193. This capacity limitation was never changed.

Municipal Permits

194. The municipality twice received applications for construction permits for the project. It denied the first application, made when COTERIN was wholly Mexican-owned on September 21, 1991. It denied COTERIN's second application on December 5, 1995.

State-Municipal Legal Relationships

195. Mr. Leonel Serrato has testified that under State law, municipalities can request in support of the State government to provide them with, for example, legal advice. Other instances where the State support may be requested and provided is police force. Although seldomly used in both cases of State's support to municipalities is understandable as a matter of fact in a municipality that does not have Síndico lawyer and has a police force comprised of two policeman.

B. EVENTS LEADING UP TO THE NAFTA'S ENTRY INTO FORCE ON JANUARY 1, 1994

The Hazardous Waste Situation in San Luis Potosí Prior to Metalclad's Acquisition of COTERIN

196. By 1989, the first hazardous waste landfill in Mexico, situated at Mexquitic de Carmona, San Luis Potosí, had reached its capacity. By letter dated October 20, 1989, the regional office of SEDUE in San Luis Potosí (SEDUE-SLP) informed the Municipal

President of the Municipality of Mexquitic de Carmona that the landfill would be closing. Between October 1989 and October 1990 the facility closed the containment cells, undertook reforestation, and established the required maintenance infrastructure[119].

197. On December 5, 1989, *Confinamiento Técnico de Residuos Industriales, S.A. de C.V.* (COTERIN) was incorporated in San Luis Potosí pursuant to federal law[120]. COTERIN was incorporated for the purpose of establishing a hazardous waste disposal facility. All of its shareholders were Mexican nationals —indeed it was incorporated with a "foreigners exclusion clause"[121]. Its controlling shareholder, Mr. Salvador Aldrett León, had been the owner and operator of the landfill in Mexquitic de Carmona.

198. In 1990, COTERIN began the permitting procedure to establish a landfill in a 814 hectare parcel of vacant land located within the Municipality of Guadalcázar, in an area locally known as "La Pedrera". La Pedrera is located between the town of El Huizache, a town of 401inhabitants, and the *ejido* of Los Amoles[122], less than 10 kilometers from the section of highway 57 (one of the principal highways in Mexico, connecting Mexico City with the Laredo/Nuevo Laredo border) that runs from San Luis Potosí City to Matehuala. La Pedrera is 35 kilometers from the town of Guadalcázar, the seat of the Municipal Government and the most populated town in the Municipality with 1,146 people. The overall population of the Municipality is approximately 27,000 people.

199. Guadalcázar is a municipality situated in a relatively poor part of the nation. Although the municipality has electricity, there is no running watter in much of it, nor are there other infrastructure services such as sewage lines. Telephone communications are few. For example, the municipal government shares a telephone line with a public telephone booth. Not surprisingly, the municipality does not have a well-developed administrative infrastructure. It is run by the "*Ayuntamiento*". Members of the council are elected every three years. There is a small municipal office which employs around 40 people.

200. Guadalcázar is not industrially developed. The next largest commercial facility in the municipality is a gasoline station.

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119. Exhibit 23.

120. Exhibit 24. COTERIN Deed of Incorporation

121. Article 6 of its corporate by-laws prevented foreigners from becoming shareholders. This Article was amended in 1993, prior to Metalclad entering into the Option Contract.

122. An ejido is an agrarian social organization regulated by Mexican law as a moral person, whereby a small local community holds common ownership or a combination of common and private ownership of lands for agricultural or livestock production.

201. On August 24, 1990, after being satisfied that the general conditions of the site and subsoil of La Pedrera in principle were suitable for a hazardous waste landfill, SEDUE authorized COTERIN to prepare a proposal for the establishment of a hazardous waste landfill. SEDUE did not authorize COTERIN to commence construction of a landfill. Rather, it confirmed that geo-hydrologically the site complied in principle with federally-prescribed technical requirements and authorized COTERIN to prepare and submit a *proyecto ejecutivo*. A *proyecto ejecutivo* is a technical proposal describing what is planned to be built.

202. The evidence of the senior federal official responsible for permitting, Mr. René Altamirano, is that Mr. Salvador Aldrett approached SEDUE to request approval to construct a temporary storehouse to store waste from his existing clients, pending the time-consuming process of obtaining the permits for the landfill[123]. On October 29, 1990, COTERIN advised SEDUE that its *proyecto ejecutivo* was 80% complete and requested permission to establish on the same site the "temporary transfer station", pending completion and approval of the *proyecto ejecutivo* and the granting of the federal construction permit[124].

203. Two days later, SEDUE granted the authorization, taking into consideration the fact that the Mexquitic de Carmona landfill had by then been closed and that Mr. Aldrett's former clients, already used to sending their waste to that landfill, continued to produce waste[125]. The permit stated that construction of the transfer station had to be completed within 120 days[126].

204. COTERIN simultaneously continued the permitting procedure for a landfill. Less than a month later, on November 21, 1990, COTERIN submitted its environmental impact statement and *proyecto ejecutivo* to SEDUE and requested federal authorization to construct the hazardous waste facility. However, COTERIN'S environmental impact statement lacked important basic information.[127].

205. On January 9, 1991, SEDUE wrote to COTERIN referring to the deficiencies in the *proyecto ejecutivo* and instructing it to complete it in accordance with the applicable standards.

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123. Witness statement of Rene Altamirano at paragraph 6.

124. Exhibit 25. Letter from COTERIN to SEDUE, October 29, 1990.

125. Ibid.

126. Exhibit 26. SEDUE Authorization, October 31, 1990

127. Exhibit 27. SEDUE internal correspondence, received January 6, 1992.

206. By this time, COTERIN had been accepting waste at La Pedrera for some time, notwithstanding that the appropriate facilities had not been built. Unclassified waste was being deposited on the ground, unprotected from the elements. This gave rise to public concerns. The decision to evaluate the possibility of siting a hazardous waste landfill at La Pedrera was, therefore, not welcomed by the residents of the "*altiplano*" area, (an area of San Luis Potosí that includes Guadalcázar and twelve other municipalities). By letter dated February 9, 1991, twelve Municipal Presidents of the *altiplano* area joined the Municipal President of Guadalcázar in expressing opposition to the establishment of a hazardous waste landfill at La Pedrera[128].

207. By letter of the same date, certain *autoridades ejidales, autoridades comunales y educativas*[129] informed the State Congress of their opposition to the proposed project. Their letter stated:

> "We hereby address you, conscious that you have demonstrated to have acted responsibly in solving our State's problems.
>
> As you know, the Municipality of Guadalcázar, because of its geographical circumstances, has infinite deficiencies, and we continue to hope that the different levels of Governments will grant their support to find solutions to our most immediate needs.
>
> Further to these problems, others are added such as the intention to turn the Municipality of Guadalcázar into an industrial landfill; with the well known environmental harm, all of which has been originated by the Federal SEDUE representative, Eng. in Physics Humberto Rodarte Ramón, who with a very arrogant attitude tried to mislead the community in order to reduce the importance of the petition to close the landfill, in disregard of the municipal authorities.
>
> The community of Guadalcázar desires to express the following: That the sovereignty of each municipality be respected, and that any actions in each of them be taken pursuant to our Magna Carta.

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128. Municipal Presidents Virgilio Castillo A. of Matehuala, Fidel Segovia Morales of Cedral, Antonio Hernández of Villa de Guadalupe, Concepción Montiel Year of Vanegas, Raymundo Gaytán Moreno of Soledad, Joaquín Casillo Mares of Villa de Arista, Robustiano Hernández of Tamasopo, Porfirio Navarrete of Armadillo de los Ingantes, Bardomino Guardad of Villa de Ramos, Humberto Páez Galván of Salinas, Genaro Pérez Vázquez of Villa Hidalgo, Bonifacio Martínez Martínez of Moctezuma. February 9, 1991. See Exhibit 28.

129. Ejido, community and educational authorities.

> On the other hand, that every town, municipality, city and country be the one that pays the price of development, and that industrial waste be deposited in strategic places, seeking to cause the least damage, and that any consequences arising therefrom be faced by those who originate them; and not as in this case, in which our extremely needy conditions are not consistent with the intention to make us pay for that landfill.
>
> We hope that your significant intervention will be favorable to our problem, so that it may contribute to the well being of the *campesinos* and the development of Mexico."[130]

208. The local authorities and community leaders of Guadalcázar expressed their opposition to the landfill consistently from this time forward through numerous letters (annex 29 contains a number of such letters). For example, by letter dated April 29, 1991, the then President of the Municipality of Guadalcázar, Salomón Ávila Pérez, requested SEDUE to conduct an environmental impact statement of the La Pedrera site. He advised that the residents were categorically opposed to the hazardous waste landfill and added that any measure should first consider the health of their families[131].

209. Further evidence of local opposition is found in the witness statement of Mr. Hermilo Méndez. His testimony is that the local opposition was widespread and unabated since well before Metalclad acquired COTERIN and before Pro San Luis Ecológico and Greenpeace intervened. He testifies further that the local opposition was deeply rooted, and that during the 1991-96 period was formally expressed through the unchanging position of four consecutive *Ayuntamientos*[132], all of whom opposed the opening of the landfill[133].

210. The Tribunal should take note of the fact that members of the *Ayuntamientos* are elected by a direct vote and a system of proportional representation and therefore include

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130. Exhibit 29, Letter from Guiadalcázar Community leader to SLP Congress, February 9, 1992.

131. Exhibit 31.

132. The Ayuntamiento or Cabildo (municipal council) is a public corporation in charge of the administration of a Municipality. It is comprised of a Municipal President and several regidores and síndicos (municipal representatives and commissioners). The Constitution of San Luis Potosí (Articles 87 and 88) provides that municipal officials are elected by a direct vote and a system of proportional representation. The Ayuntamiento may have up to fifteen regidores: eleven are elected by a majority vote; the remaining four are appointed by a system of proportional representation from the minority political parties, according to the number of votes each received (provided that they obtained at least 1.5 per cent of the total number of votes).

133. Witness statement of Hermilo Mendez.

representatives of minority political parties[134]. This is a significant fact because the Tribunal will see that many decisions taken by the *Ayunamiento* regarding the project were unanimous, reflecting the views of all political parties represented on the council.

211. On March 12, 1991, SEDUE-SLP conducted an inspection of the site. Its report described in detail the progress of construction and noted that the offices were about 30% complete. However, it also recorded that about 9,000 tons of hazardous waste in drums had been stored on the ground and covered only with plastic or thin steel sheets (*lámina*). Mr. Aldrett signed the verification report, thus acknowledging its contents.[135] At this time, COTERIN had not sought or obtained a State land use permit or a municipal construction permit.

212. On April 29, 1991, the SEDUE-SLP office informed SEDUE of a verification visit conducted four days before by several local and federal officials, professors from the Autonomous University of San Luis Potosí, and the General Manager of COTERIN. It advised that:

a) they found that the works were being constructed according to the plan;

b) however, they also found that nearly 40,000 drums of waste had not been confined in containment cells;

c) on their way back they spoke with local *Ejidatarios* who voiced their concerns regarding the site;

d) when they arrived in the City of San Luis Potosí they were informed that the *Ejidatarios* had blocked the road to the transfer station and that the trucks were not being permitted to enter the property; and

e) they tried to talk with the Governor who agreed to discuss the issue with local *Ejidatarios* at a meeting scheduled for May 6-10, 1991[136].

213. By letter dated May 6, 1991, Municipal President Ávila Pérez asked Sergio Alemán González to prepare geological and geo-hydrological studies to determine the harmful effects of the hazardous waste which had been dumped at La Pedrera[137].

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134. Article 88 of the Constitution of San Luis Potosí provides that: "Political parties entitled to participate in the Entity, that did not achieve a majority in the municipal elections, may appoint regidores in proportion to the votes that they received, provided that they achieved at least one and one half per cent of the total votes..."

135. Exhibit 30, SEDUE-SLP Verification Report, March 12, 1991.

136. Exhibit 31, SEDUE-SLP Memorandum to SEDUE, April 29, 1991.

214. Five days later, the Faculty of Medicine of the UASLP issued a study entitled *Estación de Transferencia para Residuos Industriales "La Pedrera", Evaluación Preliminar de los Riesgos para la Salud*[138]. The covering letter submitting the study stated there was a potential health risk to the community and recommended that further studies be undertaken. Based on the data, the Faculty recommended that:

a) the reception of hazardous waste be temporarily suspended;

b) immediate steps be taken to isolate the confinement cells and the facility to prevent waste escaping during rainy periods;

c) that SEDUE order the company to protect the drums that had not been placed in the cells;

d) the federal Health Secretariat should coordinate a health impact study, with the participation of the UASLP and UNAM [the National Autonomous University of Mexico];

e) SEDUE should, in addition to its own review, allow another institution to review the environmental impact statement submitted by the company; and

f) authorization to operate the site should be granted on the basis of the health impact study, the environmental impact statement, and the measures required to remedy the site[139].

215. On July 11th, SEDUE sent a technician to La Pedrera to conduct a verification. The inspection revealed that COTERIN had now stored 55,000 barrels of toxic waste (approximately 20,500 tons) on the land in completely unprotected conditions[140].

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137. Exhibit 32. In view of the Claimant's repeated reference to the "fraudulent Alemán report", it warrants noting that Mr. Alemán was a member of the State University's Faculty of Engineering who had just completed a metallurgical geography of the whole of the State of San Luis Potosí. The report was requested by the local authorities in view of the continued concerns regarding risks to the environment and health, given the large amounts of toxic waste that were being disposed of at the site in completely uncontrolled conditions. The Respondent considers that although federal officials may not have agreed with Mr. Alemán's conclusions, his report cannot be described as "fraud". Moreover, the Claimant has tried to imply that the report was somehow contrived to impede Metalclad from constructing and operating the landfill. However, it should be kept in mind that the report was written in 1991, more than three years before Metalclad acquired COTERIN.

138. Exhibit 33, "La Pedrera" Temporary Transfer Station for Industrial Waste, Preliminary Evaluation of Health Hazards, by Fernando Díaz Barriga and Miguel Ángel Santos.

139. Ibid. at p. 2.

140. Exhibit 34, Letter from SEDUE to Office of the President of Mexico.

216. In July, Mr. Alemán submitted to the Municipality a 46 page report entitled, Aspectos Fundamentales para la Óptima Ubicación de Confinamientos de Residuos Industriales y Dictamen Geológico, Geohidrológico y Geofisico del Área que Comprende el Instalado en el Huizache, Municipio de Guadalcázar, S.L.P[141]. In his view, the site was not appropriate for a hazardous waste landfill. As the Claimant itself has acknowledged in its pleadings, the Alemán report was widely publicized and was cited as evidence of the site's unsuitability.

217. The strength of local concern about what COTERIN had done at La Pedrera began to attract the attention of senior federal officials in Mexico City. In the summer of 1991, the Office of the President of the Republic requested information on the problem[142].

218. In view of growing concern about the unprotected waste being stored on the site, by letter dated August 19, 1991, SEDUE ordered COTERIN to:

a) construct the transfer station in accordance with certain stipulated requirements within two weeks;

b) complete the construction of cell 4 by installing a polyethylene lining;

c) submit an inventory of the waste that had been received;

d) place lids on the open drums containing hazardous waste;

e) prepare a comprehensive plan to treat and confine the waste that had been received to date; and

f) comply with the applicable laws and regulations[143].

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141. "Substantive Aspects for the Optimal Location of Industrial Waste Landfills, and Geological, Geo-hydrological and Geophysical Report of the the Area where the One in El Huizuache, Municipality of Guadalcázar, S.L.P., is Established". Its relevant conclusions and recommendations were, inter alia:

that the site was located in an area comprised of great calcareous rocks that were highly permeable and likely to contain large deposits of water; there was evidence of large underground streams throughout the studied area that very possibly merged with tributaries of the Gulf of Mexico stream and underground rivers that pass beneath several Municipalities of La Huasteca. Thus, plume effect contamination could already be occurring; based on all the data obtained, the La Pedrera site was not suitable for the establishment of a hazardous waste landfill, particularly in view of the risks it presented for the future;

other sites elsewhere in the country that are more suitable for the establishment of a hazardous waste landfill should be considered; and care should be taken to protect existing natural resources for the benefit of the community. (Claimant's Memorial, Exhibit 12).

142. Exhibit 34, Letter from SEDUE to the Office of the President of Mexico, August 5, 1991.

143. Exhibit 35, Letter from SEDUE to COTERIN, August 19, 1991.

219. The next day, SEDUE conducted a verification inspection of the site and found, *inter alia*:

a) three cells were almost full and had not been covered (however, this could not be done until authorized by SEDUE);

b) approximately 16 drums of waste had not been placed in a cell;

c) COTERIN lacked SEDUE's authorization for final disposal of hazardous waste;

d) COTERIN did not produce an environmental impact statement and appropriate risk analysis;

e) COTERIN did not produce the semestral report of transportation and reception of hazardous waste; and

f) four cells measuring approximately 60X40X5 meters had been constructed[144].

220. COTERIN was given 48 hours to file a schedule and a plan to remedy the environmental violations found in this verification visit[145].

COTERIN Applies for a Municipal Construction License

221. On or about September 11, 1991, COTERIN and Ing. Salvador Aldrett in his own right submitted an application for a municipal construction license. The application cited, as the basis for requesting a construction license precisely the same provisions of state law that the Respondent says constitute the legal requirement for a municipal construction license in this case[146]

La Pedrera is Shut Down by Federal Order

222. By September of 1991, it had become clear that while authorized to construct a transfer station, all that COTERIN had done was to store a large volume of hazardous waste on the site without fully constructing the transfer station or taking all of the

144. Exhibit 36, SEDUE Verification Report, August 20, 1991.

145. Ibid. at p. 7.

146. Exhibit 37, COTERIN/Aldrett application for Municipal Construction License, dated August 15, 1991.

necessary precautions in handling and storing the waste. In the space of less than a year it had created a major environmental problem for the authorities.

223. By letter dated September 18, 1991, Municipal President Ávila Pérez wrote to then President of the Republic, Carlos Salinas de Gortari, "to share the profound concern that the people and authorities of the Municipality have with respect to the arbitrary establishment of a hazardous waste landfill at La Pedrera"[147].

224. On September 19th, SEDUE-SLP conducted another verification inspection of the site in response to a complaint from Municipal President Ávila Pérez to Governor Ortiz Santos that a large load of hazardous waste had been received at the site on September 19th[148]. On September 20, two SEDUE-SLP officers were dispatched to conduct a further verification inspection. After completing the inspection they were stopped and detained by local residents who were obstructing the access road to the landfill site. The inspectors contacted their superior, Humerto Rodarte Ramon, who spoke with the protesters by telephone to hear their demand for closure of the site. The inspectors were detained for a

147. Exhibit 38, Letter from Municipal President Ávila Perez to President Salinas de Gortari, September 18, 1991. His letter stated further:

- the owners of La Pedrera had a landfill in Carmona that was closed, for which was the reason they came to Guadalcázar, but they promised they were exploring for water to make the region a prosperous area;
- although 56,000 drums of waste had been received, the State government had only granted permits for preliminary studies;
- the facility would not alleviate the problem of clandestine dumps as 99% of the waste it received originated from outside of the State;
- the Alemán study, commissioned by the Municipality, showed the risk that the hazardous waste facility represented for the community's health and the environment; and
- many people were using drums discarded by the operators of the facility to store water, which was very scarce in the region, after being emptied of waste.

148. Exhibit 41. The verification report stated that:

- company officials confirmed that 20 trucks, each carrying 40 tons of waste, unloaded approximately 800 tons of boxes containing medical waste from the Instituto Mexicano del Seguro Social [Mexican Social Security Institute] (IMSS) on September 19th;
- trucks were unloading boxes of medical waste when the SEDUE official arrived;
- the SEDUE official ordered the company to return the waste to its place of origin;
- the receipt of medical waste breached the accord reached by the parties before the State Congress in June.

further five hours (until 2 a.m.) when a municipal official arrived and negotiated their release.[149]

225. The following day, the Auditor General of SEDUE asked the Director General of Prevention and Control of Environmental Pollution, René Altamirano, to apply sanctions to COTERIN on the basis of the violations found in the verification inspection of September 19th and 20th, and having regard, in particular, to the terms of the authorization to operate the transfer station that was issued to COTERIN[150].

226. On September 25, 1991, pursuant to Mr. Altamirano's instructions, SEDUE conducted a further verification visit and ordered the complete closure of the site[151]. COTERIN was ordered to remove and return, within 3 days, 170 tons of medical waste that it had just received, and to refrain from accepting delivery of any further waste. It was permitted to continue maintenance work at the site. The order stated:

> "...pursuant to Article 170 of the 1988 Environmental Law, it is hereby ordered the temporary and total closure of the company from this date on, and until a further resolution is taken according to the provisions of law... [the order] prohibits the company from introducing any kind of waste or material and from continuing the construction of the works it has been doing, until the competent office of the Secretariat issues a further resolution [on this matter]..."

227. In addition, the verification report stated:

a) the company did not show the monthly report of transportation and receipt of hazardous waste that it claimed to have submitted;

b) the company did not show the operating license; and

c) the company did not provide the environmental impact statement and risk assessment study and their governmental approval.

228. On September 30, 1991, COTERIN wrote to SEDUE requesting that the closure order be rescinded. COTERIN advised that the medical waste had been removed and sent

149. See witness statement for Enrique Hernández.

150. Exhibit 40 Letter from Auditor General of SEDUE to Arq. Altamirano, Sepember 23, 1991.

151. Exhibit 41, SEDUE Verification Report and Closure Order, September 25, 1991.

to the RIMSA facility in Mina, Nuevo León (further requests to SEDUE to reopen the site were made on October 21 and December 2, 1991. They were refused)[152].

The Municipality Denies the Construction Permit

229. On October 1, 1991, the *Ayuntamiento* of Guadalcázar unanimously denied COTERIN's application for a construction permit. By letter dated October 1, 1991 Municipal President Ávila Pérez informed COTERIN that the application had been denied because the company did not have:

a) an environmental impact statement requested by SEDUE;

b) a State Land Use permit requested by the State Government; and

c) control for the high risks inherent in this project.

230. Mr. Ávila Pérez's letter also noted that the Alemán study had determined that the site was unsuitable for a hazardous waste landfill[153].

231. On October 3rd, SEDUE conducted another verification inspection at the site to determine if the September 25th shut-down order was being observed. Inspectors found that the medical waste had been removed. SEDUE ordered that no further work be performed at the site except for maintenance of the existing cells. Official closure seals were placed on the entrance to the site. SEDUE stated that:

> "This visit is a follow up of the inspection visit report number 240170319 of September 25, 1991...thus we seal the main door of the company noting that security personnel may gain access to the facility as the company is obliged to maintain the existing trenches and to keep the premises under surveillance, in the understanding that the management of the company will not accept any further delivery of any kind of waste, nor it will continue to construct works whatsoever in accordance with the warnings of the aforementioned report, and until the competent office of the Secretariat issues a further resolution on the matter"[154].

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152. Exhibit 42, Letters from COTERIN to SEDUE, September 30, October 1, and December 2, 1991.

153. Exhibit 43, Letter from Guadalcázar Ayuntamiento to COTERIN, October 1, 1991.

154. Exhibit 44, SEDUE Verification Report, October 3, 1991.

232. Although the site was closed, COTERIN continued to seek the necessary approvals. On October 18, 1991, SEDUE notified the company that it had received the company's environmental impact statement and would review it. The evidence of Mr. Altamirano is that SEDUE had a legal obligation to consider all properly documented applications and eventually COTERIN's was so documented[155]. SEDUE instructed COTERIN not to initiate any work until the statement was approved.

Further Expressions of Local Opposition

233. On January 20, 1992, the newly-elected *Ayuntamiento* confirmed the earlier denial of the construction permit[156]. The Ayuntamiento's ratification of the previous denial of the permit was significant because a new municipal administration had just assumed office on January 1, 1992[157].

234. The *Ayuntamiento* stated that after hearing from the people of Guadalcázar, it had decided to deny any permit that would help COTERIN to continue operating in the Municipality. It also agreed to meet with the then-Governor of the State to request his support[158].

235. In February 1992, the Municipal Presidents of Villa de Guadalupe (February 12, 1992), Potosí Matehuala (February 12, 1992), La Paz (February 12, 1992), Cedral (February 27, 1992), Villa de Arista (February 14, 1992), Villa Juárez (undated), Villa

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155. Witness statement.

156. Exhibit 45, Resolution of the Guadalcázar *Ayuntamiento*, January 20, 1992. The *Ayuntamiento* considered that:

- the landfill was secretly built, while the people were told the excavations were done to open wells to provide water to the region (according to Joaquín Cortés, the comisariado ejidal of Los Amoles);
- Governor Ortiz-Santos had confirmed the State had not issued a land use permit and gave the Municipality a copy of a federal authorization issued to COTERIN to submit a "study";
- meanwhile, thousands of tons of hazardous waste had been stored in La Pedrera;
- the elected Governor had declared he would shut down the facility;
- all the comisariados ejidales of the Municipality opposed the operation of the landfill; and
- in September 1991, the site was shut down by SEDUE authorities in Mexico City.

157. See Witness statement of Leonel Ramos.

158. See Exhibit 45.

Hidalgo (undated), and Cerritos (undated) requested Governor Gonzalo Martínez Corbalá to order the permanent closure of the site. The Municipal Presidents expressed their complete support for the Municipal President and the people of Guadalcázar.

236. Similarly, by letter dated February 15, 1992, Ciudad del Maíz's Municipal President, Rosendo Mireles, expressed his support for the decision of the Municipal President and the people of Guadalcázar in opposing the opening of the landfill and to deny any permit for that purpose.

237. On April 29, 1992, during a presidential visit to Nunez, in the Municipality of Guadalcázar, President Salinas publicly declared his political decision to permanently close the La Pedrera transfer station. [evidence?]

238. By letter dated May 7, 1992, SEDUE again advised COTERIN that it was prohibited from conducting any further construction work until its environmental impact statement was approved[159].

239. On May 22, 1992 the Faculty of Medicine of the Autonomous University of San Luis Potosí (UASLP) provided the Chief of Coordinated Health Services for San Luis Potosí with a report on the alleged presence of radioactive contamination in the transfer station zone. The report was instigated by Mr. Miguel Martínez Castro's allegations, reported in a local newspaper, *El Sol de San Luis*, that certain health conditions experienced by members of the community could be linked to radioactive waste deposited at the transfer station[160]. The Faculty of Medicine found no radioactivity at the transfer station or in the confinement cells containing waste from the transfer station.

240. By letters dated May 26 and May 28, 1992, COTERIN informed the Secretary General of San Luis Potosí and SEDUE-SLP, respectively, of its response to allegations concerning the relationship between community health problems and the alleged presence of radioactive contamination at the site. The letters attached a report by the Faculty of Medicine which COTERIN stated was undertaken at its request. COTERIN also attached evidence of precautions taken to protect workers at the facility from possible contamination.[161]

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159. Exhibit 46, Letter from SEDUE to COTERIN, May 7, 1992.

160. On May 16, 1992, a newspaper article appearing in El Sol, a daily newspaper published in San Luis Potosíi City, reported on a statement issued by Miguel Martínez Castro, the President of the Consejo Técnico Consultivo de la Liga de Comunidades Agrarias y Sindicatos Campesinos en el Estado San Luis Potosí (Technical Advisory Council of the Agrarian Communities and Peasant Unions League of the State of San Luis Potosí) stating that: "People have complained about loss of hair, serious skin irritation, illness and vomiting according to those living in the region." Exhibit 47, "Hazardous Waste in la Pedrera Is Hurting People—Cattle Are Dying".

161. Exhibit 48, Letters from COTERIN to SEDUE-SLP, May 26 & 28, 1992.

The Environmental Impact Statement is Approved

241. On January 27, 1993, INE authorized COTERIN's Environmental Impact Statement, allowing it to carry out the tasks in order to proceed with the construction and operation of an industrial waste landfill[162]. INE's authorization was not a construction permit; rather, it approved the environmental impact that the construction of the landfill would have, as meeting federal regulations, and thus allowed COTERIN to proceed with the necessary tasks for the construction and operation of the landfill[163].

242. Moreover, contrary to the Claimant's allegations that federal jurisdiction over the site was exclusive and exhaustive, INE's authorization of January 27, 1993 was expressly stated to be without prejudice to the requirement to obtain any other federal, state or municipal authorizations, concessions, permits or licenses required by law. The authorization stated:

> "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."[164] [Emphasis added]

243. Mr. Altamirano testifies that the language of the January 27th order was clear on this point. He takes issue with the translation of the order that the Claimant has provided to the Tribunal (he also notes that the subsequent permit granted on August 10, 1993, incorporated the language of the January permit by reference)[165].

244. The Tribunal should note that the environmental impact statement authorization was granted for a hazardous waste landfill, although the closure order of September 25, 1991, remained in place. COTERIN was, therefore, allowed to proceed with the necessary tasks for the construction and operation of the landfill, but was unable to continue operating the transfer station, i.e. to receive further waste at the transfer station.

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162. Claimant's Exhibit 6.

163. Exhibit 145. Expert report prepared by INE.

164. Witness statement of Rene Altamirano.

165. Ibid.

Mr. Kesler Assumes Control of Metalclad

245. Mr. Grant Kesler became a director of Metalclad on February 18, 1991 and became its President and Chief Executive Officer (CEO) in June 1991. He purchased 1,000,000 shares in Metalclad (directly from the company) at a price of 1.42 dollars per share which he financed with a 2 million dollar non-recourse loan from a trade union pension fund (his shares were pledged as security for the loan)[166]. Mr. Kesler also persuaded Metalclad to pay a commission of 17 cents per share to one of two companies that he controlled at the time (either Paradigm Securities or Merchant House Financial Corporation; the press releases differ as to who was the actual recipient of the commission)[167].

246. Shares belonging to Metalclad's former CEO (Leland Sweetser) were deposited in a voting trust, giving Mr. Kesler control of the company. Mr. Kesler also received options to acquire 125,000 additional shares at 1.50 dollars per share and 125,000 shares at 2.00 dollars per share, exercisable within five years (i.e. by February 1996)[168].

247. At the time that Mr. Kesler joined Metalclad, the company's business was stagnant. Metalclad was breaking even in its commercial insulation services, sales of insulation products, and asbestos removal services. During the next six years it would make a loss in its business (by August 31, 1995, Metalclad's auditor, Grant Thornton,[169] would conclude that "the Company has had substantial recurring losses from its operations and has been dependent upon external financing to sustain its operations". These factors, among others, according to the auditor "... raise substantial doubt about the Company's ability to continue as a going concern"[170]. Grant Thornton was then dismissed as the company's auditor).

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166. Mr. Kesler borrowed the funds to purchase his shares from the Southern California & Arizona Glaziers Architectural Metal & Glass Workers Pension Plan. See Schedule 13D filed with the SEC on May 16, 1994 at page 3. Exhibit 10G.

167. Exhibit 49, Metalclad Press Release, "Metalclad Corp. Sells Common Stock Shares to Grant S. Kesler", March 4, 1991.

168. See "Option to Purchase Common Stock of Metalclad Corporation, dated February 26, 1991, void after 5:00 p.m. California time, on February 28, 1996". It appears that Mr. Kesler exercised these options in February 1996 when he and two other directors exercised their stock options and on-sold their shares pursuant to a "private placement" at $4.00 per share, having failed to disclose that the Municipality had denied Metalclad's application for a construction permit and had obtained an injunction against re-opening the site pending resolution of its challenge of the INE-PROFEPA-COTERIN Convenio de Concertación. Exhibit 142.

169. Grant Thornton was appointed as auditor in 1993 after KPMG Peat Marwick resigned as the company's auditor.

170. Exhibit 10[N], Report of Independent Certified Public Accountants, annexed to Metalclad's 10-

248. Throughout its history, the company had not paid dividends to its shareholders (this continued throughout the 1990-96 period). Investors had to look to capital appreciation of Metalclad stock for a return on their investment. Mr. Kesler initially successfully tripled the price of the company's stock from about 1.50 to 5.00 dollars in his first two years as CEO without increasing profits or acquiring any revenue-producing assets. As the Respondent's expert, Mr. Kevin Dages has testified, this was done by the regular issuance of project announcements. With the exception of the acquisition of Química-Omega, none of the projects announced during the 1992-94 period came to fruition. In fact, projects which were predicted to have construction commence imminently, never broke ground.

249. Prior to joining Metalclad, Mr. Kesler, another Metalclad director, Mr. Ronald Robertson, and two other individuals were shareholders in a privately held company called Environ Technologies Inc. (ETI). On July 21, 1991, ETI, together with Mr. Kesler and another shareholder, Reed T. Warnick, entered into a contract with a group of Mexican investors to form a company called Eco-Administracion S.A. de C.V. The Mexican investors had been applying for the necessary federal permits for a hazardous waste treatment facility including an incinerator, to be located in Santa María del Río, SLP. They had also applied for the local and municipal permits for the facility[171]. Eco-Administracion was duly incorporated on August 14, 1991[172].

250. Thus, contrary to Mr. Kesler's implication that Metalclad invested in Mexico after Mexican officials invited it to do so in 1992-93, ETI and Mr. Kesler personally had already invested in Mexico as of July 1991. Mr. Kesler then arranged to sell his and ETI's interest in ECO-Administracion to Metalclad four months later.

251. ETI changed its name to ECO-Metalclad upon being acquired by Metalclad on November 20, 1991. Its shareholders received 1,180,000 shares in Metalclad in exchange for their shares in ETI. Mr. Kesler received 840,000 shares, giving him a total of more than 1.8 million shares in Metalclad[173].

K, for the fiscal year ended May 31, 1995 at p. F-1.

171. Exhibit 50, Joint Venture Agreement, July 25, 1991. See Clause II a) and b) for the recitals.

172. Exhibit 51. Extract from Deed of Incorporation of Eco Administracion S.A. de C.V., August 14, 1991. The American Directors of the company were Grant Kesler, Ronald Robertson, Reed Warnick and Terry Douglas.

173. The auditor's report says the assets and liabilities of ETI were "insignificant". Exhibit 10[A] Page F9.

The Santa María del Río Project

252. ECO-Administración acquired a 227 acre property at Santa María del Río, SLP, that it intended to use as a hazardous waste treatment facility (incorporating a modest landfill as part of the operation) that was to include an incinerator[174]. The Santa María del Río site assumes importance because Metalclad's actions and statements respecting that site became intertwined with those respecting the La Pedrera site[175].

253. When Metalclad acquired Eco-Metalclad, it entered into a management services contract for the supervision of the design, construction and management of the Santa María del Río facility with a consulting firm owned by the former shareholders of Eco-Metalclad, including Messrs. Kesler, Neveau and Robinson. The consulting company was to receive 4% of the project cost, 5% of the gross revenues, and 25% of the net operating profits of the facility[176].

254. In April 1992, Metalclad entered into an agreement with two unaffiliated individuals who were former shareholders of ETI. They received 100,000 shares in Metalclad and $250,000 dollars each in consideration for surrendering their interest in the consulting contract. Later in August 1992, Metalclad agreed to pay Messrs. Kesler, Neveau and Robinson $250,000 dollars each in consideration for a waiver of their interests in the consulting contract: $60,000 dollars were conditional upon Metalclad obtaining the "Final Construction Permit" for the San Luis Potosí facility (at Santa María del Río) and the balance was conditioned upon commencement of construction of the Santa María del Río facility)[177].

255. In May 1992, the Claimant reached an agreement in principle to acquire 100% of the shares in the Mexican corporations owning the proposed project in Santa María del Río and two other projects at Veracruz and Tamaulipas. Ageements were later made and

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174. Exhibit 10[A].

175. In addition, as the Chicago Partners' expert report points out during the 1991-94 period, the Claimant made many representations to investors about its Mexican operations. During 1991-92, the Claimant staged a series of announcements to the market about the operations.

176. See Exhibit 10[A], page 9.

177. Exhibit 10[C], 1992 10K, page 21. Although Metalclad's SEC filings are unclear on this point, it appears that its management later switched the site of the facilities. That is, the officers in question became entitled to these bonus payments when certain events were claimed to have taken place at La Pedrera rather than Santa María del Río. Construction of the Santa María del Río facility never took place but the interested directors took the bonuses originally contemplated for that site when construction at La Pedrera started.

the price was set at US$1,480,000 and the issuance of 1,480,000 shares of the Claimant's common stock subject to achievement of certain benchmarks[178].

256. In July 1992, Metalclad announced that ECO-Administración "will break ground for the San Luis Potosí facility in September, 1992 and begin providing waste management services in late 1992"[179]. The operational plan for this facility was described by the company as having three phases:

a) the operation of a waste handling facility having 60,000 tons per year capacity for metals recycling and chemical reprocessing, with a secure landfill for deposit of residual waste;

b) the addition of enhanced waste segregation and a rotary kiln incinerator, expanding both the type of waste that could be processed and the facility's annual capacity; and

c) the introduction of newly developed non-burn technologies such as the "catalytic extraction process", enabling the facility to increase the recovery of metals and chemicals while reducing operating costs and emissions[180].

257. Metalclad reported that construction would commence as soon as financing for the estimated 10 million dollar cost of *phase one* was secured[181]. Financing for Santa María del Río was never obtained and the facility has never been built[182].

258. Metalclad's representations to the investing public concerning the Santa María del Río site are telling. The Respondent will submit in argument that they show a pattern of conduct that was repeated in relation to the COTERIN project. In January of 1992, for

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178. Exhibit 10[C], 1992 10K, pages 6 & 7. The $2 million was payable $500,000 at the closing of the stock acquisition, $500,000 at the time construction of the Santa Maria del Rio plant was commenced, $500,000 upon the commence ment of commercial operations at the Veracruz plant. One million of the two million shares would be placed in escrow with 500,000 to be released upon commencement of commercial operations at Santa Maria del Rio and the balance upon commencement of commercial operations at Veracruz.

179. Exhibit 10[B], SEC Form 8, Amendment to Application or Report, dated July 8, 1992 at p. 8.

180. The Claimant made much of its "Exclusivity Agreement" with Molten Metal Technology, Inc. which was to give it an exclusive 15-year license of MMT's technology for Mexico. The license would be granted upon the Claimant's paying $2 million before January 7, 1994. This fee was never paid and the Claimant stopped emphasizing that its operations would use the "catalytic extraction process."

181. Exhibit 10[C], 1992 10K, pages 8-10.)

182. Exhibit 10[C] Page 8.

example, Mr. Kesler held a press conference to announce that the company had nearly secured the 250 million dollar financing for the first of its 10 planned plants in Mexico. According to the Orange County Register, on January 10, 1992, Metalclad announced that it "nearly had the financing to build an enormous hazardous-waste-recycling plant in central Mexico"[183].

259. The press report went on to note that:

> "Amy Sudol, a spokeswoman for Chase Manhattan in New York, refused to comment on the Mexico deal. But [Anthony] Cappello, chief executive of Beverly Hills-based Euro American Financial Corp., confirmed that the $250 million proposal is in its final stages.
>
> 'People like us and the bank do not invest a great deal of our time unless we're serious,' Cappello said. 'We know the people over there (at Chase Manhattan) very well, and we're optimistic we'll be able to pull this together.'"

260. The February 1st Dow Jones News/Retrieval Service repeated the report that in January Mr. Kesler had announced "that Eco-Administración has received a proposal from Chase Manhattan to provide $250 million in financing to build 10 other... waste processing facilities in Mexico"[184] [Emphasis added]

261. The financing was never obtained. (In the argument, the Respondent will elaborate upon the Claimant's announcement practices).

The Acquisition of COTERIN

262. With respect to the acquisition of COTERIN, the then-owners of COTERIN evidently met Metalclad representatives through Dr. Humberto Rodarte Ramón, a SEDESOL official, in early 1993.

263. The Tribunal should take note Dr. Rodarte Ramón's role in the affair. In 1991 he had been the SEDUE-SLP representative and in fact was the official who issued the temporary closure order at La Pedrera on September 25, 1991. He was obviously well aware of the local opposition.

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183. Exhibit 16.

184. Exhibit 52, "Metalclad Corp" Mexico Business Monthly, February 1, 1992.

264. Dr Rodarte Ramón apparently played a key role in facilitating Metalclad's acquisition of COTERIN. The evidence is that by May of 1993, Dr. Rodarte-Ramón was planning to leave the federal government to join Metalclad. Although his witness statement describes his position with Metalclad as being that of an "external environmental consultant", in fact, he had a much more substantial role[185]. On June 16th, 1993, Metalclad issued a press release on PR Newswire announcing the "recent opening" of its environmental management consulting group, Consultoría Ambiental Total, S.A. de C.V. (CATSA) and that "Dr. Humberto C. Rodarte has been appointed the director general of CATSA". It went on to describe Dr. Rodarte-Ramón's vision of CATSA's mission[186]. At the time of this announcement Dr. Rodarte Ramón was still an employee of SEDESOL.

265. Dr. Rodarte Ramón became the Managing Director of CATSA by June at least, although, as his witness statement observes, he did not leave SEDESOL until September. The business plan that was prepared for CATSA suggests that he began working with Metalclad well before the mid-June announcement. The terms of his employment included salary and car allowance of US$126,000.00 per year, a substantial increase over the value of his official emoluments as a federal civil servant[187].

266. In argument, the Respondent will submit that the evidence of this witness —a man who was holding two different positions during the summer of 1993 and who appears to have had a financial interest in the consummation of the COTERIN transaction— is not credible and the evidence of the relevant federal and State officials is to be preferred.

267. COTERIN's corporate records show that on February 23, 1993, the Secretariat of Foreign Affairs approved the company's application to amend its by-laws to eliminate the foreigners-exclusion clause and thereby allow foreign investment in the company.

The First Santa María del Río Payments to Interested Directors

268. In February, two months before it entered into the option to purchase COTERIN and the La Pedrera site, Messrs. Kesler, Neveau and a third person were each paid 60,000 dollars by Metalclad for the claimed issuance of the final permit to commence construction of a facility in San Luis Potosí. This was the February 23, 1993, INE permit issued in respect of the Santa María del Río project.

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185. See Dr. Rodarte-Ramón's witness statement at the last paragraph.

186. Exhibit 13 "Metalclad Announces Opening of Environmental consulting Group", PRNewswire, June 16, 1993.

187. See Exhibit 53, CATSA Business Plan, July 1993 and memorandum dated August 4, 1994.

269. Metalclad had agreed to pay the officers of what became ECO-Metalclad certain fees upon the issuance of permits and commencement of construction of the Santa María del Río site in which ETI had a 49% interest at the time that it was acquired by Metalclad. Although the Santa María del Río project was never built, Metalclad's 10-K later reported:

> "In August 1992, a disinterested majority of the Board of Directors of the Company approved the payment to the three related parties of $250,000 each conditioned upon the commencement of construction of the facility at San Luis Potosi in consideration of their waiver of their interests in the Consulting Contract. Of this amount, $180,000 ($60,000 each) was to be paid upon the receipt by the Company of the notification of issuance of the final permit to construct the San Luis Potosi facility. The Company received this notification in February 1993 and paid the related parties $60,000 each."[188]

The Option to Purchase Agreement

270. On April 23, 1993, Metalclad acquired an option to purchase 94% of the share capital of COTERIN. The "Promise Agreement", signed by Mr. Salvador Aldrett León (the majority shareholder of COTERIN), on his own behalf and on behalf of COTERIN, three other minority shareholders, and Ronald Robertson, Senior Vice President of Metalclad, provided that in consideration for the payment of 50,000 dollars:

a) the existing shareholders would sell to Metalclad or to Eco-Metalclad, Inc. the shares of the capital stock that they owned;

b) Mr. Salvador Aldrett would contribute the ownership of the La Pedrera site;

c) if it exercised the option, Metalclad would pay 1.95 million dollars, subject to the vendors' election that part of that sum be paid in common shares of the capital stock of Metalclad;

d) Metalclad would pay to the vendors an amount equal to 5% of the defined gross revenue of the confinement; and

e) if Metalclad exercised the option, it would pay 450,000 dollars on the date of closing, 500,000 dollars thirty days thereafter, 500,000 dollars sixty days thereafter,

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188. Exhibit 10[N], 10-K for the year ending May 31, 1995 at page F-16.

and a final payment of 500,000 dollars ninety days thereafter.[189]

271. The Promise Agreement's term commenced as of the date of its execution (April 23, 1993) and expired 20 working days after:

> "... COTERIN has obtained all the local permits and all other permits required pursuant to applicable law, which allows it to operate forthwith and without any further proceeding or authorization (hereinafter referred to collectively with the federal permits as the "PERMITS")."[190]

272. Thus, the Claimant—even at the time that it entered into the Promise Agreement—was aware that federal permits were not the only permits that would be required of COTERIN. Moreover, it appears that Metalclad's intention was to protect itself by keeping the option open for as long as it took to obtain the "PERMITS". This put the onus on the existing owners to take the necessary steps to expedite the sale because it would not close until all the permits were obtained.

273. Having executed the Promise Agreement, the existing owners of COTERIN pursued the State permit. On May 11, 1993 (days before Governor Torres-Corzo left office), the State issued a Land Use license to COTERIN[191].

274. The Land Use license stated that the actual use of the land was rural "with the exception of a surface area of 80 hectares, on which there has been in operation a temporary transfer station of industrial wastes, as an antecedent to the technical landfill requested."[192] The license established further that COTERIN shall reserve 780 hectares to establish a reforestation area.

275. The Land Use license is expressly conditioned upon compliance with the provisions of the environmental impact authorization issued by INE on January 27, 1993, which authorized COTERIN to pursue the development of a hazardous waste landfill having a capacity of 100 tonnes per day, or 36,500 tons per year.[193]

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189. Exhibit 8, Promise Agreement, April 23, 1993.

190. Ibid., clause 5, page 6. [Emphasis added]

191. Claimant's Exhibit 7. Mr. Sánchez Unzueta observes that during this time the Claimant retained the former Governor's law firm to act on its behalf. Witness statement of Mr. Sánchez Unzueta.

192. Ibid, Land Use Permit at Clause 4.

193. Ibid., Clause 4.

276. To ensure that the license adhered to the quantity limits, it was required periodically to report to the San Luis Potosí Ecology Secretariat as to the volume, type and source of the waste received.

277. By its express terms the licence did not authorize works, construction or operations at the site and that "[n]on-compliance with any of the points indicated above invalidates this License"[194].

278. The Tribunal should note that although the Claimant later convinced federal authorities to increase tenfold the annual capacity of the facility (to 360,000 tons per annum), the State Land Use permit, which was tied to the original environmental impact statement authorization, was never amended to increase the permissible capacity of the landfill.

The Election of Governor Sanchez Unzueta

279. On May 18, 1993, Governor Torres-Corzo concluded his term as interim governor and Governor Horacio Sánchez Unzueta took office[195]. During the course of his election campaign, Mr. Sánchez Unzueta had toured the Municipality of Guadalcázar and learned that there was widespread concern that the La Pedrera landfill could be a serious environmental hazard. On January 29, 1993, in a meeting held at the town of Guadalcázar, he had promised that although he was not totally familiar with the La Pedrera situation, if it was the will of the people of Guadalcázar that the landfill remain closed, his government would respect their wishes[196]. At that time, neither Mr. Sánchez Unzueta nor the residents of Guadalcázar were aware of Metalclad or its interest in establishing hazardous waste disposal facilities in Mexico. The problem that concerned the community was attributed entirely to a locally-owned enterprise.

280. During the election campaign Mr. Sánchez Unzueta was advised by Drs. Fernando Díaz Barriga and Pedro Medellín Milán on the need to have a proper waste management program for local industry. Hazardous waste management was not, however, a key election platform as Metalclad alleges. After being elected, the Governor prepared the "State Development Plan" which contained a chapter entitled, "Ecology and the Environment". Its stated objective was "to establish the regulatory and operative means to achieve a rational exploitation in the four state regions, preserving the ecosystems and guaranteeing the foundation of a sustainable development". The Plan did not contain a commitment to establish a toxic waste landfill. It did, however, propose "to study and

194. Ibid., General Provisions.

195. Witness statement of Mr. Sánchez Unzueta.

196. Ibid.

solve the situation of the industrial hazardous waste landfills located in the Municipalities of Mexquitic and Guadalcázar, to determine whether they are convenient, operationally viable and their real environmental impact"[197].

Metalclad Corporate Developments

281. On May 28, 1993, Metalclad engaged Grant Thornton as its new auditor to replace KPMG Marwick[198].

282. Metalclad's "10-K" (annual report) for the period January 1, 1993 to May 30, 1993 (the "1993 10-K")[199] filed with SEC later disclosed that in November 1992 and January and February 1993, Metalclad entered into agreements with the Mexican shareholders of ECO-Administración to acquire an additional 26 percent of the shares in each of the subsidiaries (i.e., for a total of 75 percent) in consideration of payment of 1,480,000 dollars and the issuance of 1,480,000 shares in Metalclad. The monies payable and shares issuable were conditioned upon achieving certain "benchmarks", namely, the commencement of construction and operation of the treatment facilities at Santa María del Río, as well as facilities in the states of Veracruz and Tamaulipas. One of the shareholders, José Rodríguez, a director of Metalclad, was to receive an aggregate of 320,000 dollars and 320,000 shares in Metalclad in the event that all three plants obtained final construction permits and the San Luis Potosí (the Santa María del Río) facility commenced operations[200].

283. The 1993 10-K also stated that the San Luis Potosí facility (the Santa María del Río site) would proceed (as described above) and that the company "anticipates that ECO Administración will break ground for the San Luis Potosí facility as soon as joint venture or other project financing is arranged", the cost of phase one being estimated at $10 million dollars.

284. The Santa María del Río site was not developed.

285. The narrative section of the 1993 10-K said nothing about the acquisition of COTERIN. However, the notes to the consolidated financial statements stated, under "contingent liabilities", that in April 1993 the company had entered into an agreement in principle to acquire 94% of COTERIN for 2 million dollars and that:

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197. Ibid.

198. Exhibit 10[D] Page 22.

199. Ibid.

200. Ibid.

- COTERIN owned a permitted hazardous waste landfill in Guadalcázar San Luis Potosí and had received the construction permit from SEDUE;

- COTERIN anticipated obtaining the state and municipal land-use authorizations by September, 1993; and

- Metalclad expected to complete its due-diligence and finalize the acquisition of COTERIN during the third or fourth quarter of 1993[201] [Emphasis added].

Metalclad's Initial Contacts With State Officials

286. Dr. Pedro Medellín testifies that in April or early May, 1993, while he was still at the local university (UASLP), Mr. Antonio Soto Díaz, a resident of the United States of Mexican origin, visited San Luis Potosí on behalf of Metalclad, and asked to speak with Roberto Leyva, Fernando Díaz Barriga, and himself. Mr. Soto wanted their opinion on the Santa María del Río project. Drs. Díaz Barriga, Leyva and Medellín were critical, noting that the site was in the midst of some of the only arable land in the high plains of the state and was in a densely populated area. They also noted that the Mexican joint venture partners, Messrs. Hermosillo and de la Fuente, had done a poor job in terms of public relations and that there was stiff local opposition to the project. They recommended that the Santa María del Río project be abandoned[202].

287. On or about June 11, 1993, Metalclad representatives met with Governor Sánchez Unzueta, who had just assumed office. They provided the Governor with a letter from Mr. Kesler indicating Metalclad's interest in the hazardous waste business in the State[203]. (Metalclad did not provide a copy of Mr. Kesler's letter with its Memorial).

288. The evidence of former Governor Sánchez Unzueta is that the discussion at the June 11th meeting was general in nature and centered on the need to establish proper hazardous waste disposal facilities to eliminate the problem of clandestine dumps. He recollects that during the meeting, which lasted no more than 30 minutes, the Metalclad representatives told him that their company was one of the leading industrial waste management companies in the United States. He told them that his government was planning to promote an industrial park for companies that generate hazardous waste and a program to minimize or incinerate such waste. He also stated that if the NAFTA were approved, Mexican industry would have to comply with international environmental

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201. Ibid.

202. Witness statement of Pedro Medellín.

203. Witness statement of Mr. Kesler.

standards and that his government was willing to take the first steps to make industrial development in the State more competitive [204].

289. Mr. Sánchez Unzueta denies that Metalclad showed him "its maps, engineering plans, renderings and studies pertaining to its hazardous waste landfill investment in La Pedrera"[205]. Metalclad did not indicate that it had plans to acquire COTERIN or to install a hazardous waste facility at La Pedrera. The Governor made it clear that any hazardous waste project they wished to pursue would have to comply with the law and decision-making authority of the three levels of government and respect the interests of the community[206].

290. Metalclad's allegation that it showed maps, drawings, etc. pertaining to La Pedrera is contradicted by an advertisement that it later published on January 11, 1994. In that document, Metalclad stated that on June 11, 1993, it "presented the investment project for the installation of an incinerator in the Municipality of Santa María del Río" and "the possibility of acquiring and operating" La Pedrera[207]. The former Governor's evidence is that it did not do even that.

291. At the end of the meeting, Metalclad representatives asked Governor Sánchez Unzueta to express in writing that the government was sympathetic to foreign investment in the State's environmental program. He told them they were welcome as investors and expressed in writing what he told them orally: that he would support their projects if they complied with the law at the federal, state and municipal levels, and respected the interests of the communities in which they proposed to carry on business[208].

292. In his letter of June 11, 1993, Governor Sánchez -Unzueta replied to Mr. Kesler that:

> "I would like to inform you that The State Executive Power under my responsibility has considered, as part of the State development plan for 1993-1997, implementing measures to control and protect the environment, in order to secure a clean environment for the residents of the Federal Entity and to prevent risks that may

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204. Witness statement of Horacio Sánchez Unzueta.

205. As asserted at page 67, paragraph 49 of Claimant's Memorial. Witness statement of Governor Sanchez Unzueta.

206. Ibid.

207. See Exhibit 1. Metalclad Advertisement, "Enormous Misinformation", paragraph 3.

208. Witness statement of Governor Sánchez Unzueta.

threaten their health. In order to achieve this purpose, we will soon implement an aggressive comprehensive industrial waste management program.

The program will emphasize preventative aspects, however, we acknowledge our State's need to have a hazardous waste landfill and thermal treatment facility to eliminate the most hazardous wastes.

We thank Metalclad Corporation for its interest in actively participating in the [implementation] of this program. I would like to note also that the proposals submitted to my consideration, that comply with the environment regulations of the different levels of government, and that show due respect to the genuine interests of the community, will benefit from the necessary support to carry them through successfully." [Emphasis added]

293. Contrary to Metalclad's present claim that this amounted to unqualified support by the Governor, the letter expressly contained two provisos. It also did not expressly refer to the La Pedrera site nor declare support for it. (The Tribunal will see from the Claimant's SEC filings that at the time of the June 11th meeting, Metalclad was promoting the Santa María del Río site and considerable promotional material for that project had been prepared by the company).

294. The Respondent submits that this letter is indicative of two points central to this dispute: (1) the law established requirements at the federal, state and municipal levels, and (2) social concerns also had to be addressed. Notwithstanding that Metalclad was well aware of these two issues, as reflected by the promise agreement, it was expressly put on notice thereof by the State Governor himself, well before it exercised its option.

295. Dr. Rodarte Ramón's testimony is that he and the late Secretary Colosis attended the meeting between Metalclad and the Governor, claiming that SEDESOL sent him to the meeting[209]. Mr. Sanchez Unzueta rejects this account. Moreover, the Tribunal will recall that, as of at least June, Dr. Rodarte Ramón had been working for Metalclad's Mexican subsidiary.

296. In argument, the Respondent will submit that Dr. Rodarte Ramón's evidence is not credible on this point.

209. Rodarte Ramón witness statement at page 6, second paragraph.

The "Cornerstone" Announcement

297. One month later, on July 16th, Metalclad issued a press release entitled, "Metalclad is Cornerstone of Industrial Plan Announced by Mexican Governor", declaring that its Mexican subsidiary "has agreed to participate with governor Horacio Sánchez Unzueta... in a program that he created to insure the enforcement of environmental regulations and attract new industry to San Luis Potosí"[210]. The press release stated that "the program of Governor Sánchez Unzueta includes a waste minimization program complemented by a waste recycling facility, a controlled hazardous waste landfill, and a plant for the thermal treatment of industrial wastes, all of which will be developed by Metalclad"[211].

298. This press release was issued at the "U.S.-Mexico Border Infrastructure Financing Conference" at San Antonio, an event organized by the U.S. and Mexican governments. According to the press release:

> "The primary objectives of the San Antonio conference was to introduce private sector financial representatives with investment opportunities in Mexico's infrastructure projects. Environmental projects such as Metalclad's facility in San Luis Potosí are considered to be of great importance to sustain the economic growth of the nation. Metalclad was invited to participate in the conference because of the importance of its project to the Mexican environment and its contribution to the implementation of the North American Free Trade Agreement (NAFTA)..."
>
> [The press release continued:] "Mr. Kesler commented that it would be hard to overstate the value of today's announcement in furthering the company's development plans. 'We'll now be able to go forward with the operational portion of our plan. Because of the Government/private sector partnership that we have created with Governor Sánchez-Unzueta and the federal officials at SEDESOL, we will be the first company in Mexico to create such a commercial hazardous waste facility. Three years of patience and hard work by our staff and our Mexican partners will now pay off as we move to create an organization for the management of all forms of hazardous wastes. We expect to be fully operational with two technologies this year and with a third beginning the first quarter of next year. We expect to be able to announce the acquisition of an existing and operational hazardous waste landfill in the near future.

210. Exhibit 12, "Metalclad Is Cornerstone," July 16, 1993.

211. Ibid. [Emphasis added].

Also, we expect to be able to announce the results of ongoing negotiations with our potential European partner with attendant financing'." [Emphasis added]

299. This press release implied that (1) the Governor had requested Metalclad to participate in his program, (2) that Metalclad had acceded to that request, and (3) that there was an agreement between the parties. Mr. Sánchez Unzueta has testified that none of this is true.

300. It should also be noted that the Claimant's press release related mainly to the planned Santa María del Río site (which contemplated thermal treatment). This is clear from the last paragraph's reference to the company's expected additional announcement of the acquisition of "an existing and operational hazardous waste landfill", an apparent (and misleading) reference to the La Pedrera site (the claim that such a landfill actually existed and was operational was untrue; as the Tribunal will recall, the site had received some of the federal permits and the State Land Use permit, but at the time of the announcement, it was bare land with an environmental liability, no facilities had been constructed, and, furthermore, it was still shut down).

301. The evidence of Mr. Sánchez Unzueta is that the Claimant's announcement that it was the "cornerstone" of his development plan was disturbing to him as it did not reflect the discussion in the 30-minute meeting that he had had with its representatives[212].

302. On July 21, 1993, the National Foreign Investment Commission approved Metalclad's request to purchase 94% of COTERIN's shares. A condition of the approval was that the acquisition had to be exercised within the following four months.

303. Dr. Pedro Medellín's testimony is that in July or early August, 1993, he met with representatives of Metalclad. Dr. Medellín believed at the time that they were beginning talks with the objective of developing a project that would take some time to realize[213]. They reviewed a study that had been prepared by Professors Joel Milán Navarro, David Atisha Castillo and Francisco Puente Muñiz of the UASLP. The study, completed in March 1993 (one month before Metalclad even entered into the Promise Agreement), identified more than 30 potentially viable sites for the establishment of a hazardous waste landfill. Metalclad was made privy to information which had not yet been made available to other companies or the public.

212. Witness statement of Governor Sánchez Unzueta.

213. Witness statement of Dr. Pedro Medellín.

The August INE Permit

304. By letter dated August 10, 1993, INE issued the federal environmental impact statement authorization to COTERIN for the establishment and operation of a hazardous waste landfill at the site, upon compliance with the certain conditions *inter alia*: the company was authorized to receive 3,043 tonnes of waste per month (36,516 tonnes per annum with quotas allocated for each of the ten types of waste authorized[214].

The Acquisition of COTERIN

305. Dr. Medellín testifies that he met with Mr. Neveau and Dr. Rodarte Ramón two or three weeks after INE issued the August 10, 1993 authorization and that they told him they had until September 10th to exercise their option to purchase COTERIN. Dr. Medellín's testimony is that this was the first time they had told him of their plans to attempt to open La Pedrera. Dr. Medellín's evidence is that he told them it was not a good idea because of the strong public opposition to that project, and because the site had not been included in the UASLP draft study as a potentially suitable site and that they would be putting their money at risk if they proceeded[215].

306. In a prospectus filed with the SEC on August 31, 1993, Metalclad did not refer to the proposed COTERIN acquisition. It did, however, describe its intention to develop, own and operate hazardous waste treatment facilities in San Luis Potosí. It stated that its plans to establish similar facilities in Veracruz and Tamaulipas would not actively be pursued until the facility in San Luis Potosí (i.e., Santa María del Río) was under construction[216].

307. On September 9th, Metalclad exercised its option to acquire COTERIN. On that date, the parties executed an "amendment agreement" to the Promise Agreement. The amendment agreement noted that rather than contributing the La Pedrera site directly to the purchaser, Mr. Aldrett had sold it to COTERIN for 1 million *nuevos pesos*[217].

308. The payment schedule was also amended. As previously agreed, Metalclad would pay 450,000 dollars on the date of closing. However, the agreement provided that the next payment of 500,000 dollars was not due until:

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214. Claimant's Exhibit 8.

215. Witness statement of Dr. Pedro Medellín.

216. Exhibit 10[E], prospectus issued August 31, 1993.

217. Exhibit 3, Clause II(a).

"twenty days following the day in which the government of San Luis Potosi, through its current Governor, has authorized to proceed with the construction needed for the operation of a controlled confinement of hazardous wastes located in the lot of land...known as La Pedrera... and that 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 to legally proceed with the building of such confinement."[218]

309. The September 9th Agreement was signed by Mr. Kesler.

310. The Claimant's Board of Directors approved the acquisition of COTERIN on September 17, 1993. The one independent member of the Board with hazardous waste experience voted against the motion to approve the acquisition.[219]

311. The Tribunal will see that the amendment made very specific what had been expressed in more general terms before. First, unlike the April 23rd agreement, it now included an express reference to the need for the Governor's authorization. Secondly, while the earlier agreement spoke more generally of "all the local permits and other permits required pursuant to applicable law", the amended version spoke specifically of (i) the municipal construction permit or (ii) a definitive court ruling that would constrain the Municipality to issue the permit, thereby allowing construction to proceed.

312. It is evident, therefore that, contrary to the Claimant's pleadings and Mr. Kesler's testimony, by September 9, 1993 when it exercised its option, the Claimant clearly recognized that:

a) notwithstanding its current characterization of the Governor's June 11th letter in its Memorial and Mr. Kesler's witness statement, at the time that it exercised the option to purchase COTERIN, it did not have the Governor's support to proceed with the construction of La Pedrera;

b) notwithstanding its current claim in its Memorial and Mr. Kesler's witness statement that it was led to believe that the federal government had exclusive jurisdiction and pre-emptive power, its contract was amended specifically to require the approvals from the other two levels of government as a condition precedent for the payment of the balance of the purchase price;

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218. Ibid. page 7.

219. Exhibit 54, Partial Minutes of Metalclad Directors Meeting, September 17, 1993. This is document 1A as produced by Mr. Kesler.

c) the municipality had asserted its permitting authority; and

d) there was a need to obtain a municipal construction permit or to challenge the municipality in court proceedings and obtain a "definitive judgment in a writ of amparo".

313. The amended agreement also contained a "violence" clause that allowed Metalclad to postpone the schedule of payments in the event of violence or protests at the site.

314. The Tribunal will recall that Metalclad alleges that the opposition was contrived by Governor Sánchez Unzueta and Dr. Medellín. The Respondent will submit in argument that the "violence" clause shows that, far from being fomented by the Governor —who had assumed office just four months earlier— Metalclad was well aware of the existence of local opposition. At the time that it decided to exercise the option, Metalclad recognized that there was a possibility that local civil disobedience would prevent it from operating the site, even if it got all the permits. As it did for the local approvals, it contractually provided for the excuse not to pay the remaining three-quarters of the purchase price if violence occurred[220].

Metalclad Corporate Developments

315. Shortly after it exercised the option to purchase COTERIN but before it closed the deal, on September 27th, Metalclad obtained a loan of 2.5 million dollars from CVD Financial Corporation pursuant to the terms of a promissory note due on September 1, 1995. The note bore interest at the rate of prime plus 7% and was secured by all of the assets of the company[221]. The company also was obliged to pledge all of its shares in Metalclad Insulation Corporation, Metalclad Environmental Contractors, and ECO-Metalclad as security for the note. The company also issued CVD a 5-year warrant to purchase 375,000 shares of common stock at a price of 4.50 dollars[222].

316. The company's 10-K for the period ending May 31, 1994 filed later claimed that the proceeds of the loan and other financing (the issuance of more common stock and debentures) "were used for working capital and construction of the landfill in Mexico". The Respondent will question how this representation could be made because throughout this period there was no construction at the La Pedrera site.

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220. Exhibit 3, page 8.

221. See Exhibit 10[J] 10-Q for the quarterly period ended August 31, 1994, at page 6.

222. Ibid.

317. An "8-K" (current report) filed on October 19, 1993, stated that on October 7, 1993[223], Metalclad completed the acquisition of 94% of COTERIN which "owns a permitted hazardous waste treatment landfill near Guadalcázar..." and that the consideration for the acquisition was agreement to pay a total of $2 million and 5% of the gross revenues from the landfill operations for a 10-year period. Of this sum, 500,000 dollars had been paid, with the balance payable in three installments of 500,000 dollars, "with the first installment due over a 90-day period with the next installment on or about December 1, 1993"[224].

318. The Tribunal should take note of the payment schedule as Metalclad's subsequent statements in its SEC filings shed light on the relationship between the financing of the project and the permits issue.

The Federal-State Meeting

319. On or about October 7, 1993, Governor Sánchez Unzueta, Dr. Sergio Reyes Luján (the federal Under-Secretary of Ecology), Dr. Pedro Medellín and Arg. René Altamirano met in San Luis Potosí[225].

320. Former Governor Sánchez Unzueta testifies that he knew Dr. Reyes Luján well because they had both worked at SEDUE as senior officials under Secretary Patricio Chirinos. He testifies that during the meeting they discussed the Guadalcázar landfill project and that Dr. Reyes Luján informed him that the company had acquired La Pedrera and obtained the federal permits, and that it would be advisable to support the project. The Governor testifies that he told Dr. Reyes Luján about the delicate political and social problem the landfill faced in Guadalcázar. The local authorities and the community had consistently rejected the project and continued to do so. He informed Dr. Reyes Luján that, in his opinion, the case should be handled with care and suggested that they analyze any alternatives to solve both the problem of the 20,000 tons of toxic waste deposited there, and the selection of an adequate site for its final disposal[226].

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223. This is the same date that, according to Metalclad's memorial, the Governor had imposed two additional requirements, namely, that Metalclad have the project approved by experts of the UASLP and that Metalclad work to generate community support for the project. Query whether this information was sought and obtained prior to closing.

224. In fact, there was no certainty that the first installment would be payable on or about December 1, 1993, because it depended on the Governor's support and the municipal permit issue. COTERIN did not apply for the latter until November 15, 1994.

225. See Witness Statements of Governor Sanchez Unzueta, Dr. Pedro Medellin and Mr. Rene Altamirano.

226. Witness Statement of Governor Sanchez Unzueta.

321. The Claimant asserts that, after the meeting, Dr. Reyes Luján said that the Governor had requested Metalclad to comply with two additional requirements, namely: (1) to present the proposed project for consideration by experts at the UASLP; and (2) to work with the local community to explain and generate support for the proposed project. Metalclad claims that these were "additional requirements". It further states that "The Governor agreed to grant his active public support (beyond his letter of June 11, 1993) upon Claimant's accomplishment of those two tasks"[227]. Governor Sánchez Unzueta's remarks, however, can hardly be characterized as expressing support "beyond" that of the June 1993 letter. In fact, they were consistent with his earlier statements to Metalclad.

322. Mr. Altamirano has testified that he recalls that he and Dr. Reyes Luján met with Dr. Rodarte Ramón after the meeting with the Governor. He says that Dr. Reyes Luján told Dr. Rodarte Ramón that he had explained the federal position and that the Governor had said that the issue was very delicate, but that Dr. Reyes Luján thought some progress had been made[228].

323. Governor Sánchez Unzueta has testified that one week later, Dr. Medellín showed him a copy of an advertisement in which the Claimant was already announcing Mexican landfill services in the United States[229]. Governor Sánchez Unzueta called Dr. Reyes Luján immediately to share his concern that the company was already promoting its services, claiming that it was fully permitted, when this was not so (additionally, although Metalclad had obtained the federal authorizations, these did not allow for the importation of foreign waste). The Governor underscored his position that the company had to comply with the law, and that they had to be aware that the local community opposed the landfill. He thought that the company was irresponsibly pushing ahead and lying[230].

324. Mr. Altamirano recalls that he and Dr. Reyes Luján were angered when they heard that Metalclad was announcing that the project was opening.

325. On October 16, 1993, the public first became aware of Metalclad's plans as a result of an article published in *Pulso*. Reporters had learned that Metalclad was advertising in the United States that it would soon be providing hazardous waste landfill services at a plant in El Huizache. They correctly concluded that it was the closed La

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227. Paragraph 52, at page 68 (English) / 25 (Spanish) of the Memorial, and witness statement of Grant Kesler, at page 4 (E) / 5 (S).

228. Witness statement of Rene Altamirano.

229. Exhibit 55. Eco Metalclad Advertisement in *PC*, September 1993.

230. Witness Statement of Horacio Sanchez Unzueta.

Pedrera site. The content of the article indicates that the reporter was surprised to learn that a permit to operate at La pedrera had been issued by SEDESOL[231]

326. On October 25, 1993, an article published in the U.S. publication "Chemical Marketing Reporter" declared that Metalclad was opening the landfill in San Luis Potosí[232]. The Article stated that:

> "Metalclad Corporation is opening a hazardous waste landfill in San Luis Potosi, Mexico. The facility will cost $6.2 million and be able to process over 10,000 tons of hazardous waste per month. The Company is also launching a community awareness program to teach the public about the project.
>
> Metalclad plans to handle all types of hazardous wastes..."
>
> It further stated, "Metalclad is also negotiating with a potential joint-venture partner. Its consulting subsidiary, Consultoria Ambiental S.A. de C.V., has opened an office in Mexico City and begun generating revenues."

327. The basis for the Governor's concern was obvious. On the same date as the Chemical Marketing Reporter article was published, the *Ayuntamiento* of Guadalcázar in official session discussed a letter sent by the municipal *ejido* authorities to the President of Mexico requesting that the federal authorities act consistently with a statement made by President Salinas on April 29, 1992, which in their view definitively closed the hazardous waste landfill. The *Ayuntamiento* issued the following resolution:

> "... this *Cabildo* urges Hermilo Méndez Aguilar, *Regidor* of Ecology, to take all necessary measures to assure the people of Guadalcázar, that this industrial landfill will never re-open and, in contrast, that the corresponding process to remove the waste that is stored in such cemetery be also initiated. In order to protect the Municipality's environment and its surroundings, which, as the subsoil, are already damaged by this highly dangerous toxic waste."[233]

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231. Exhibit 56, "Offering to Confine Hazardous Waste," *El Pulso*, October 16, 1993.

232. Exhibit 57, "Mexican Landfill Started," *Chemical Marketing Reporter*, October 25, 1993.

233. Exhibit 58, Resolution of Guadalcázar, *Ayuntamiento*, October 25, 1993.

328. The *Ayuntamiento* ordered that a copy of this decision be sent to the State Congress and to Governor Sánchez Unzueta, with their appreciation for the actions taken for the well-being of the ecology of the Municipality and the State of San Luis Potosí[234].

The Claimant's Community Awareness Programme

329. The Tribunal should also take note of the Claimant's contention that it did not pursue a program of engaging the local people in a dialogue on the benefits of siting a hazardous waste landfill in their community because it was instructed not to do so by federal and state officials. However, on October 13, 1993, less than a week after it acquired COTERIN, it issued a press release on the acquisition stating:

> "The company has implemented a community awareness program which is designed to communicate the high degree of safety and environmental standards being employed. Metalclad's program identifies the close and open relationship intended with the community, the economic benefits relevant to its operation and the positive environmental impacts."[235] [Emphasis added]

330. These actions would have been consistent with the directions given by the Governor as early as June 11, 1993 if they had been carried out. However, as can be seen upon reading the article that appeared in *El Pulso* on October 16, 1993, and the Resolution of the Guadalcázar *Ayuntamiento* on October 25, 1993, Metalclad had not implemented a community awareness program of any kind, let alone one which emphasized a "close and open relationship ... with the community".

331. By letter dated November 9, 1993, COTERIN informed PROFEPA of conservation work being carried out at the La Pedrera site. COTERIN advised that:

- it had seven employees at the site engaged in various activities, including maintenance and surveillance (COTERIN asked PROFEPA to keep the names of its employees confidential in order to protect them from retaliation by complainants.);

- the treatment of the industrial waste was one of the most important operations; that many of the wastes were dangerous, but others were not. However the general belief was that everything was poisonous and highly concentrated so that a few grams would be lethal;

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234. Ibid.

235. Exhibit 59, "A Mexican Hazardous Waste Landfill", PRNewswire, October 13, 1993.

- the trucks and machinery entering the site did not carry any waste. One truck was a water-tank that was used to fill drums in order to water the trees and twice a month it delivered water to the nearby towns;

- the landfill was not operating at the time, but that did not mean that maintenance work could not be performed. Although operations had been suspended, the site was not abandoned;

- three cells had been covered two years ago and remained in the same state; and

- the volume [of waste] was 13,500 tons[236].

Continued Community Concern

332. On November 11, 1993, officials of the *ejidos* La Ventana, Núñez, Santa Rita del Rocio, El Terrero de Posadas, San Juan Sin Agua, San Agustín, San Isidro, La Negrita, La Polvora, and the Municipal Presidents of Villa de Guadalupe, Ciudad del Maíz, Cerritos, Matehuala, Villa Juárez, La Paz and Cedral, in support of other affected claimant *ejidos* filed an environmental claim with the Guadalcázar Municipal President regarding the La Pedrera site. Their statement of facts alleged that:

a) In 1989 a hazardous waste landfill was established by Salvador Aldrett, who hired nine residents of the community without providing them with appropriate equipment and protection;

b) As a result of the contamination of lands and water, cattle was poisoned, and a claim was filed with the criminal prosecutor, who had done nothing up to that date;

c) On April 29, 1992, the President of Mexico visited Guadalcázar and after hearing the peoples' complaint, and after consulting with Governor Martínez Corvalá, closed the landfill. In addition, they claimed that the company deposited hazardous waste generated from advertisements that Metalclad-Eco Administración had published in foreign publications. Thus, they requested that the permit to deposit hazardous waste be denied permanently, and that, in view of the fact that the company's federal authorization had expired, no renewal be granted[237].

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236. Exhibit 60, Letter from COTERIN to PROFEPA SLP.

237. Exhibit 61, Environmental Complaint from *ejido* leaders to Municipal President of Guadalcázar, November 11, 1993.

333. By letter dated November 30, 1993, Dr. Medellín wrote to Dr. Reyes Luján, including the State's comments on the geo-hydrologic studies done at the La Pedrera site. The comments also considered the documents that had been provided to the State by INE, and the discussions held with Messrs. Sergio Riva Palacio and Jesús Barragán of INE on November 22, 1993. Dr. Medellín expressed the view that the site was not suitable and there was not sufficient evidence to determine that the soil was favorable, while there were other places in the State with an adequate geo-hydrologic composition for the establishment of a hazardous waste landfill (in this respect, he referred to the studies by the Engineering Faculty and Geology Institute)[238].

334. In light of the Claimant's allegations against Dr. Medellín that he later sponsored a competing landfill site (Memorial at pages 86-87), the Respondent will point out in argument that Dr. Medellín's November 30th letter to Dr. Reyes Luján is entirely consistent with his testimony. He testifies of the study done in March of 1993 on the potential sites in the State. His testimony is that when he became a State official, he informed Metalclad and the Federal officials from the beginning that he considered the Guadalcázar site to be a bad idea. His letter to Dr. Reyes Luján and his later meeting with the head of INE, Gabriel Quadri, is consistent with that evidence. From the beginning, Dr. Medellín took the position that reopening La Pedrera was not advisable for both social and technical reasons and that all the parties would be better off looking at a new site that did not have pre-existing social opposition[239].

335. Dr. Medellín concluded his letter to Dr. Reyes Luján by stating that he did not find a single reason to approve the Guadalcázar site, but rather found that, given that the site was not suitable, there were significant risks in relying too heavily on technology and administration[240].

336. Dr. Medellín explains in his testimony that, in his view, three basic issues should be considered regarding hazardous waste landfill projects: (i) the technology to be used; (ii) the administration of the facility; and (iii) the geographical location of the site. Dr. Medellín believes that the technology and administration of the facility are considerations for the short or medium terms only. The technology may eventually fail and administration will cease. However, waste buried in landfills is intended to be remain there forever. Thus, in order to ensure continued safety and health of future generations, the most important consideration is the geography of the site[241].

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238. Exhibit 62, Letter from Dr. Medellín to Dr. Reyes-Luján, November 30, 1993.

239. See Dr. Pedro Medellin Witness statement.

240. Ibid.

241. Ibid.

337. On December 11, 1993 PROFEPA conducted a verification visit of the site and found that:

a) containment cells 1, 2 and 3 were full and covered but cell 4 was empty as it was still under construction; and

b) there was no moisture in the wells which, according to COTERIN, were checked several times a month[242].

338. On December 17, 1993, PROFEPA conducted a further verification visit of the La Pedrera site in response to a complaint by Eng. Alemán and Municipal President Carrera that drums of waste had been delivered to the landfill and were simply buried. PROFEPA's inspection report states:

a) the wells on the property were checked and no water was found;

b) the south part of the property where the drums of waste were reported to be buried was searched but nothing was found;

c) the complainants did not attend but Municipal *Regidor*, Hermilo Méndez, was present to witness the inspection;

d) there was no evidence that the landfill had been operated since the issuance of the closure order on September 25, 1992;

e) the inspectors found no fissure in the land other than one 500 meters away from the property; and

f) the existing containment cells occupied only two hectares of the 814 hectare site[243].

339. On December 16 and 17, 1993, federal, state and municipal officials met with residents of the Municipality to discuss COTERIN's proposed project and to attend the La Pedrera site[244]. The minutes of the December 16th meeting recorded that:

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242. Exhibit 63, PROFEPA Verification Report, December 11, 1993. PROFEPA officials later met with Juan Carrera Mendoza, President of the Municipality, and COTERIN officials in the city of San Luis Potosí and were planning to meet with Dr. Núñez , the head of Frente Ecologista Pro-San Luis Ecológico and Eng. Alemán, who acted as an advisor to the Municipality.

243. Exhibit 64, PROFEPA Verification Report, December 17, 1993.

244. Exhibit 65. In attendance on December 16 were: Juan Carrera-Mendoza, Municipal President of Guadalcázar; Pedro Medellín, San Luis Potosí Director of Ecology; Sergio Alemán; Advisor to the

a) on December 13th, Sergio Alemán and Municipal President Carrera Mendoza visited PROFEPA in Mexico City to complain about COTERIN drums containing waste that had been buried outside of the containment cells;

b) the meeting was being held to discuss the technical evidence and written and verbal complaints regarding the landfill and to visit the area around the landfill to verify the alleged damage;

c) during their visit to the area of *dolinas* and caves, Mr. Alemán referred to his study and repeated several times the difficulties the area represented for drainage of liquids and advised that this area provided water to the region;

d) during their visit to the *Realejo* area, Ms. Dominga Castilleja stated that in July and August she could see colored vapor clouds and bubbles falling and killing the grass;

e) during their visit to the *ejido El Huizache*, Mr. Eligio Martínez, an owner of land in the area, stated that in July and August of 1991, his property was flooded with greenish, smelly waters and that Mr. Aldrett of COTERIN promised to send fertilizer, which he never did, and thus his *magueyes* and *mezquites* died and he lost his crop. They observed that only a few of them had completely dried;

f) during their visit to the *El Huizache tanque*[245], Mr. Valentin Tinoco, on behalf of the ecology NGO of Guadalcázar stated that there was a hole in which they used to throw dead animals and toxic substances from the hazardous waste landfill, causing it to dry, and now it was covered with dirt. Mr. Hermilo Mendez had pictures of this; and

g) during their visit to the stream at La Pedrera, UASLP Researcher and Eng. Joel Milán stated the conditions were more favorable than required by the technical standards with regard to rain[246].

Municipality; Joel Milán, geologistfrom the UASLP; Maria Catalina Alfaro; chemical engineer from the UASLP; Hermilo Méndez, Municipal Regidor; Edith Posadas, representing the Guadalcázar community; Manuel Caso, Municipal Síndico; Rafael de la Rosa, President of the Ejido; Dominga Castilleja, a Guadalcázar resident; José Luis Ramírez, María Eugenia Quezada and Angelina Núñez of Pro-San Luis Ecológico; Luis Quezada Camacho, Miguel Ángel Irabién, Héctor Muñoz Gallo of PROFEPA, Mexico City; and David León Calvo of PROFEPA, San Luis Potosí.

245. Water pond.

246. Exhibit 65, page 3.

340. On December 17, 1993 the meeting was reconvened at the site but counsel for COTERIN allowed only two people to enter and search for the drums described by Eng. Alemán and Municipal President Carreras in their December 13, 1993 complaint[247].

Summary Of Matters As They Stood On December 31, 1993, Prior To NAFTA's Entry Into Force

341. The evidence shows that prior to the NAFTA's entry into force:

a) The La Pedrera site had been a local controversy since 1991;

b) In September of 1992 the transfer station was closed by federal order;

c) While wholly-owned by Mexican nationals, COTERIN applied for and was denied a municipal construction permit;

d) Metalclad decided to enter into a new business, one in which it had no experience;

e) Although Metalclad claims to have been induced to exercise its option by strong and repeated assurances by federal and state officials as to federal primacy in the area and state interest in the project:

i) The January 1993 federal permit was expressly without prejudice to local permits and the August 1993 permit expressly incorporated its terms;

ii) The evidence of the key federal official who issued the permit is that neither he nor his superior stated that the federal government had exclusive jurisdiction in the area or that it had primacy such that it could force the site to be opened;

iii) The Governor did not express unqualified support for La Pedrera; on the contrary, once he was informed of Metalclad's plan, he advised against it;

iv) Dr. Medellín similarly advised against it;

247. Ibid. at page 4.

v) Metalclad's claims of a joint partnership with the State and that it was the "cornerstone" of the Governor's development plan were false;

f) The September 9, 1993 amendment to the Promise Agreement shows that Metalclad recognized it did not yet have the Governor's support;

g) The amendment also showed that Metalclad was aware of the Municipal construction permit issue; and

h) The September 9th agreement also showed that Metalclad was aware of the local opposition.

C. THE LEGALLY RELEVANT PERIOD

The January Public Exchanges

342. On January 1, 1994, NAFTA entered into force.

343. Metalclad alleges that on January 9, 1994, Governor Sánchez Unzueta was quoted in the press as having made a public announcement rejecting the landfill because it was unsafe, it did not meet the international standards and because the people had not been consulted.[248] The Governor said that this was the final word and that word was "No"[249].

344. Governor Sánchez Unzueta testifies that the reason he spoke out in January 1994 was because Metalclad had become a matter of public controversy in the local media after the company advertised in the United States, first in September 1993, and then in the October edition of Chemical Marketing Reporter, the operation of a hazardous waste landfill facility in San Luis Potosí.

345. For example, on January 8, 1994, the local newspapers *El Sol de San Luis* and *El Pulso* reported that:

> "... according to the latest issue of the American journal 'Chemical Marketing Reporter' the North American company Metalclad Corporation obtained a permit to reopen the Guadalcázar landfill

248. Claimant's Chronology at page 4.

249. Memorial, paragraph 61, at page 71.

and to process up to 10,000 tons of hazardous waste each month since August 10 [1993].

The Article published last December, entitled "Mexican Landfill is Authorized", states that:

> Metalclad Corporation is in the process of opening a hazardous waste landfill in San Luis Potosí, Mexico. The facilities will cost 6.2 million dollars and will be capable of processing more than 10 thousand tons of hazardous waste per month. At the same time, the company has begun an education campaign for the people to know (the advantages) of the project.
>
> Metalclad plans to process all types of hazardous waste. The National Institute of Ecology, the Mexican environmental office, issued a permit to the company to construct an incinerator for hazardous waste. The company acquired in April an option in a 89 hectare facility in La Pedrera, and obtained the permit to operate it..."[250]

346. In light of the fact that the local media were reporting the reopening of La Pedrera, the Governor felt it was necessary to declare that Metalclad's advertising of landfill services was irresponsible. As reported in *El Pulso*, the Governor stated that the landfill would not be reopened for two reasons: (1) technically, it did not guarantee safety, and (2) politically, the community had not been consulted, and a decision could not be made without the social approval. The Governor also stated that it was urgent to find adequate alternative sites, and said that an investigation that certain UASLP professors had prepared was useful in that regard. He said that it was preferable to have a safe landfill and one that was properly constructed, rather than have over 37 illegal landfills as the State then had.[251]

347. After the Governor's comments were reported in the press, on January 11, 1994, Metalclad took out an advertisement in a local newspaper challenging what the Governor had said. The advertisement, entitled "Enormous Misinformation," and directed to Governor Sánchez Unzueta, stated:

> "...METALCLAD CORPORATION, a company dedicated to the preservation of the environment, and interested in operating in San

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250. Exhibit 66, Articles in *El Sol* and *El Pulso*, January 8, 1994.

251. Witness statement of Mr. Sánchez Unzueta at paragraph 19, and Exhibit 1, *El Pulso*, January 9, 1994.

Luis Potosí, believes that it is imperative to clarify various points raised in the publications in the *Pulso* on Saturday, January 8th and Sunday, January 9th, 1994, and *El Sol de San Luis* on Sunday, January 9th, publishing firstly (Saturday, January 8th, 1994 in *Pulso*) on eight columns in the local section "Authorized Dumping in Guadalcázar," without an author and with the American magazine "Chemical Marketing Reporter" as the only source. On Sunday, January 9th, *El Sol de San Luis* and *El Pulso* in the same section, published an article authored by reporter José B. Mora entitled "No Dump in Guadalcázar". The text contains statements from the Governor in which he accuses METALCLAD CORPORATION of irresponsible conduct for having advertised the services of the facility, when, in fact, the last word on the reopening of the hazardous waste facility was his, as Governor. The Governor notes that he is in possession of a very credible scientific study in which it is shown that the waste facility located in La Pedrera, Municipality of Guadalcázar does not meet the International Safety Standards, that the public was not consulted regarding its establishment, that they are in contact with American companies that have the capital and technology to establish hazardous and toxic waste incinerators; and that San Luis Potosí will not be anyone's dumping ground.

In our opinion, these statements are the result of misinformation of their advisors on environmental matters, and thus we will clarify the following.

1. To begin with, METALCLAD CORPORATION never authorized a statement and nor is it responsible for the newspaper article in *Pulso* last Saturday, January 8...

2. It is important to note that the authorization for the reopening of the facility was issued by SEDESOL on August 10, 1993 and it is not for the reopening the Guadalcázar dump, as stated in the January 8 article in *Pulso*. METALCLAD CORPORATION owns the La Pedrera facilities in the municipality of Guadalcázar since September of 1993 and is not responsible for the previous management of the transfer station. Moreover, we recognize that a serious danger exists in the event that the facility, approved by the Federal Government, cannot be operated given that the number of containers existing on the site may reach up to 120,000 in number representing close to 30,000 tons of dangerous and toxic waste deposited only in ditches which do not meet the construction standards and are only covered with dirt, without complying with the minimum safety conditions and standards and which may pose a great danger to the health of the inhabitants of

the communities. Given this grave danger, METALCLAD CORPORATION is ready to treat and confine their wastes investing the amount of $5,000,000 to meet these ends, thereby avoiding further damage that, at this moment, is already posed to the detriment of the environment....

METALCLAD CORPORATION of Newport Beach, California, which is interested in operating a controlled facility and incinerator in the State of San Luis Potosí had a meeting, last June, with the President of the Instituto Nacional de Ecologia (SEDESOL) in which they were informed of the project's level of progress. In this meeting, the Institute recommended that there be an extensive co-ordination with the State Government of San Luis Potosí, in order to be able to proceed with the strict procedures required by the Mexican environmental standards.

Following the instructions of the same institute and of the Federal Attorney General for the Environment (PROFEPA), on June 10, 1993, METALCLAD CORPORATION met with Lic. Horacio Sánchez Unzueta and with two of his advisors in San Luis Potosí. On this occasion, the company presented the investment project for the installation of an incinerator in the Municipality of Santa Maria del Río and the possibility of acquiring and operating the controlled Facility already approved by SEDESOL located in the Municipality of Guadalcázar, SLP. As well, the Governor was informed that this company planned to invest in the State of San Luis Potosí approximately $250 million.

As a result of this meeting, METALCLAD CORPORATION received from Lic. Horacio Sánchez Unzeta document No. 0014/93 dated June 11, 1993 in which Mr. Grant Kesler, President of the Company, was informed that the projects presented would be supported by his Government in order to bring them to good terms and in compliance with the environmental standards of the different levels of government and respectful of the genuine interests of the community.

10. The State of San Luis Potosí has a serious ecological problem due to the monthly 3,500 tons of hazardous waste which are clandestinely dumped into the Entity. This type of environmental problem was one of the serious objections of the opponents to the signing of the Trilateral Free Trade Agreement. METALCLAD CORPORATION seeks to transform San Luis Potosí, alongside the State Government, into a leader in the management of industrial waste in Mexico. In accordance with our

experience, we are prepared to construct and establish ourselves in La Pedrera in only 15 weeks with an investment of $6 million in order to finally resolve the problem of industrial waste in San Luis Potosí."[252]

348. Two days later, on January 13, 1994, Metalclad took another advertisement to publish a second letter to the Potosinian public and Governor Horacio Sánchez Unzueta. The letter stated:

"WHAT IS REALLY HAPPENING IN GUADALCÁZAR WITH THE LANDFILL?

"In light of the rumors initiated by the local press and other sources to create confusion in the public's opinion to the effect that there is a general rejection by the community regarding "reopening the landfill" because there is a great risk to the inhabitants, flora, and fauna of the area. In Metalclad Corporation, we wish to clarify that, in accordance with the commitments made to the Potosinian community:

1. The concept of reopening the facility does not exist, what was mentioned in "La Pedrera", municipality of Guadalcázar, was a "Transfer Station", as established by the federal authorization, by a company we acquired last year. We have had the authorization by SEDESOL to construct and operate the facility since August of 1993 and these documents could be shown at any moment. However, we have not started to construct nor operate the facility because we do not have the consent of the State Government...

2. The real and only risk that may exist at "La Pedrera" are some 120,000 containers with close to 30,000 tonnes of HAZARDOUS WASTE which cannot be neutralized while we are not permitted to carry out the necessary works.

3. METALCLAD CORPORATION operates under the most rigorous measures for the protection of public and environmental health in the world through experts that periodically monitor the water, air, ground, fauna and flora. Our recycling process, confinement and incineration are controlled. Even though we have not commenced operations, we have already undertaken works for reforestation in the "La Pedrera" area...

252. Exhibit 1, "Enormous Misinformation", January 11, 1994.

4. We deny that there is a general sentiment against our construction and operation of the Controlled Facility. What we have discovered through a public opinion poll and a socio-economic study of the area, which we will make public in a few more days, is that there is a lack of information, misinformation as well as a manipulation of information. The majority of the population within this municipality is not involved in this sense. The socio-economic information that we have reveals that there exists great poverty in the region, a high degree of emigration, a high level of unemployment, a weak infrastructure (telephone, roads, drainage, drinking water, etc.), an absence of cultural attractions, recreation, sports and zero economic growth.

5. METALCLAD CORPORATION is prepared to start an information campaign in Guadalcázar with the goal that the public will feel safe with the project, understand the benefits that it will bring and become involved in its development.

6. METALCLAD CORPORATION is prepared to sponsor a "Foundation for Community Development" in Guadalcázar, directed and coordinated by a committee of local leaders in Guadalcázar.

7. METALCLAD CORPORATION is prepared to discuss the technological details of its environmental project in "La Pedrera" with any person that so requests."[253]

349. On the same day (January 13th) Governor Sánchez Unzueta wrote a letter to the newspaper responding to the Claimant's first advertisement. The Governor also wrote to René Altamirano asking for copies of various documents in INE's possession and enclosing the newspaper articles and Metalclad's press statements[254].

350. The Governor's response was published on the following day (January 14th) in *El Pulso*:

"The Guadalcázar hazardous waste landfill, as the public is already aware, has an unfortunate history. First, large amounts of hazardous waste were inadequately deposited there, and were later hastily contained. All of this, carried out by COTERIN under the

253. Exhibit I, "What Is Really Happening in Guadalcázar", January 11, 1994.

254. See Witness Statement of Governor Sanchez Unzueta.

supposed federal authorizations, through the Instituto Nacional Ecologico (INE).

Mr. Sergio Reyes Luján, a scientist, and then president of INE, verbally informed us that the facility had been shut down because of incorrect management by the company COTERIN.

The same Reyes Luján also told us, later on, that INE had authorized the "reopening of the landfill" in Guadalcázar, and the company Metalclad verbally informed us it had acquired the company COTERIN. To date, the State Government has not been, nor has been formally notified of either the precise terms and conditions under which these actions were taken. The public position of both the Federal and State authorities are in agreement that the authorization of the State Government is necessary to operate such a facility. The State Government also warned that it is absolutely necessary to have the consent of the people of Guadalcázar who have repeatedly expressed their opposition publicly and to the mass media.

Thereafter, as a result of a hasty promotional campaign where the company Metalclad advertised services which supposedly were already being provided at the Guadalcázar facility, we informed Mr. Reyes Luján of our concern that Metalclad was advertising services without having the approval of the State Government, and that we had not received the necessary technical information to test, if this was the case, whether the site was suitable. The physicist, Sergio Reyes Luján assured us that the site would not be reopened and that we would receive the studies upon which INE's authorization was issued, as well as the conditions under which the landfill would operate.

To date, the National Institute of Ecology has not sent us the authorization documents, the subsequent closure documents, or the new operating authorization for the site, that are said to exist. The company Metalclad has not submitted one single document pertaining to the permit application, acquisition of the company, legal status, or other documents requested which would be necessary to initiate a formal relationship. Neither has it given us the technical studies mentioned in its press release, such as: environmental impact study, geological, geo-hydrological, climatic, topographical, basic engineering, and detailed engineering studies, *proyecto ejecutivo*, etc. upon which their claims are based.

The State Government acknowledges the imperative and urgent need to have an industrial waste disposal system which protects the environment. This requires: (1) having a site which meets a number of technical and environmental requirements; (2) having the best processing technology available in the world; and (3) guaranteeing impeccable management. This should be carried out: (a) In accordance with the development plans of the State of San Luis Potosí; (b) With the consent of the people living in the area where the facilities are placed, or in other areas that could be affected; and (c) with great benefit for them, and without harming them in any way. They must also comply with all the requirements and authorizations of law, and the concurrent Federal, State, and Municipal agreement.

All of this is possible, it will be so carried out, as the inadequate disposal of industrial waste is extremely harmful. The law already sets out clear industrial requirements for the disposal of their wastes. The State Government is obliged to facilitate this and assure itself that it will occur.

Recently, the Federal Attorney General for Environmental Protection (PROFEPA) visited the landfill in response to a formal complaint presented by the community of Guadalcázar. PROFEPA has not yet issued a report.

We will exhaustively review the Guadalcázar landfill facility's current technical and legal situation, and if appropriate, we will enforce any liabilities. On this basis, we will order the remediation of said facility in order to guarantee the safety of the residents of the affected region and the health of the soil and subsoil of the State.

Finally, on the basis of these criteria and on information we will obtain, it is necessary to clarify that the company Metalclad may, or may not, be selected to operate in the State of San Luis Potosí."[255]

The Claimant's Change of Position

351. On the same day as the Governor's response was published, Metalclad was contacted by its local legal counsel, Bufete de la Garza, S.C.

255. Exhibit 4, "To the Public", January 13, 1994. [Emphasis added]

352. The Claimant alleges that in January 1994, it received an unsolicited letter from José Mario de la Garza Mendizabal, a local attorney who had assisted Metalclad in an unrelated matter[256]. Mr. de la Garza testifies that Metalclad had been a client of his law firm since November 1993. Through a chance encounter with Eng. Antonio Soto Ravizé (a former Metalclad representative whom Mr. de la Garza had known for a long time) Mr. de la Garza learned about Metalclad's business in San Luis Potosí. He offered the Company his legal services through Eng. Soto Ravizé, but was turned down since Metalclad was already being advised by the law firm of Teófilo Torres Corzo (the law firm of the former governor, from whose administration Metalclad obtained the state land use permit). In October 1993, Mr. Soto Ravizé advised Mr. de la Garza that Metalclad was no longer satisfied with Torres Corzo's firm, and was looking for a new firm to represent it. In November, Metalclad retained Bufete de la Garza to take care of its legal matters in San Luis Potosí[257].

353. As counsel to Metalclad, Mr. de la Garza saw fit to contact his client and advise it that debating the issue publicly with the State authorities was a serious mistake. Mr. de la Garza testifies that he did not act out of altruism. He hoped that Metalclad would entrust this matter to his firm, since the landfill project seemed to be of the utmost importance, and they could expect to charge substantial fees[258].

354. In his letter to Messrs. Kesler and Neveau, Mr. de la Garza observed that "matters seems [sic] to be escalating so steeply that make us believe that your chances to start operations in spite of your good will and intentions, are getting quite deteriorated [sic]"[259].

355. Mr. de la Garza believed, he testifies, that the company had made a serious error by confronting the State authorities. When he so advised, Mr. Kesler agreed[260]. As a result, the Claimant met with Mr. de la Garza to develop a strategy, and decided to change course. On January 14, one day after the State Governor had written his response to Metalclad's previous public letters, Metalclad published another advertisement.

356. The Claimant addressed several issues:

a) it responded to the Governor's statement that the State Government had not received any information regarding the suitability of the

256. Memorial, paragraph 93 at page 84 and witness statement of Grant Kesler, at page 6.

257. Witness statement of Mr. de la Garza at paragraph 8, ii).

258. Ibid.

259. Ibid.

260. Ibid.

site, pertaining to the permit application, the acquisition of the company, its legal status, or other documents:

> "The copies of the legal documents which show the acquisition carried out by METALCLAD CORPORATION regarding the "La Pedrera" facility; the copies of the corresponding authorizations from SEDUE, INE and SEDESOL to construct and operate the La Pedrera facility; the request to the Government of San Luis Potosí to construct and operate the facility in "La Pedrera" Municipality of Guadalcázar; a document that shows our legal status/personality; the respective technical studies regarding the matters of environmental impact and risk assessment; the geological, geo-hydrological, climatic, topographical, basic engineering and detailed engineering studies; as well as our operation and management manuals and plans for public health, and a safe and secure environment, will all be submitted to your office next week."[261]

b) More importantly, Metalclad publicly expressed its agreement with the Governor's position on the need for local approval:

> "We agree with you that the consensus of the population of Guadalcázar is required in order to be able to construct and operate such a facility. We know that misinformation exists, which an educational campaign in co-ordination with the State Government would provide for an appropriate remedy. We are against any attempts to manipulate the public." [Emphasis added]

c) Finally, Metalclad publicly acknowledged the role of the State and Municipality, by touching on two concepts that have particular significance in Mexican constitutional law and politics:

> "We recognize the sovereignty of the State of San Luis Potosí and the autonomy of the Municipality of Guadalcázar."

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261. Exhibit 2, Metalclad public letter of January 14, 1994, published in El Pulso. [Emphasis added]

The January 28th Meeting With the Governor

357. Metalclad has alleged that at the June 1993 meeting, "the Company presented to the Governor its maps, engineering plans, renderings and studies pertaining to its hazardous waste landfill investment in La Pedrera"[262], and that, at least by January 9, 1994, all the "complete and comprehensive studies that were submitted to the federal government in applying for the federal permit [had]... been given to the state"[263]. Therefore, "Knowing that the Governor had been provided with the copies of all the studies, tests and analyses submitted to the federal government in the process of obtaining construction and operating permits, as well as the Humara report [which sought to refute the Aléman report], Company officials sought another meeting with the Governor for the clarification of his position"[264], as had been reported in the local media.

358. The implication is that the Governor had carefully analyzed all such information, and would therefore be convinced of the soundness of the project. However, these allegations are contrasted by its own paid advertisement in *El Pulso*, where it responded to the Governor's statement that the State Government had not received any such documentation, including the technical information to test the suitability of the site. The Claimant publicly committed to provide the documents within the week of January 17, 1994, only two weeks before they actually met.

359. The meeting was arranged by José Mario de la Garza through Luis Manuel Abella, a local industrialist, since neither Mr. de la Garza nor anyone else at his firm had ever met the Governor or had any way of personally contacting him. Mr. Abella was a long-time friend of both Mr. de la Garza and the Governor.[265]

360. On January 28, 1994, Metalclad representatives, including Mr. Kesler, met with Governor Sánchez Unzueta and Dr. Medellín. The meeting took place at the *Casa de Gobierno* (the Governor's Residence) and was attended by Governor Sánchez Unzueta, Dr. Pedro Medellín, Messrs. Grant Kesler, Dan Neveau, and Humberto Rodarte Ramón, Mr. José Mario de la Garza, one of his partners, Héctor Raúl García Leos, and Mr. Luis Manuel Abella. The La Pedrera site was the subject of the discussion. The evidence of the former Governor is that he reiterated the opposition of the local community and the municipal authorities to the landfill, and that the Municipality would therefore not support issuing a construction permit. He said that it was a serious problem and that this was not

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262. Memorial, paragraph 49 at page 67.

263. Memorial, Chronology, at page 4.

264. Memorial: paragraph 62 at page 71.

265. Witness statement of Governor Sánchez Unzueta and witness statement of Mr. de la Garza.

a new position as it dated back to 1991[266]. Mr. de la Garza's evidence corroborates this. He testifies that the Governor never instructed Metalclad officials to satisfy technical concerns raised by certain UASLP professors, and that he would support the project if they did; nor did he say that he and Dr. Medellín would take care of any local problems.

361. Dr. Medellín's evidence is to the same effect.[267]

362. Governor Sánchez Unzueta testifies further that Metalclad's representatives asked him whether the site could ever be opened. He responded that in his judgment the opposition of the municipal authorities and the community would impede their developing the project "due to a long chain of lies to the community for more than three years." He added that this would be very difficult to overcome and the only opportunity to open a landfill was not La Pedrera itself, but to find another location.[268]

363. The evidence of Governor Sánchez Unzueta is that Mr. Kesler responded that the most important thing was not La Pedrera itself, but the fact that the site already had all the federal permits. He said that it would take the company more than three years to obtain the permits for a new site, and they would rather risk resources to finance studies in order to demonstrate that it was a safe site[269].

364. Governor Sánchez Unzueta also testifies that he told Metalclad that even if the additional studies the company proposed showed that the site was safe, that would not necessarily solve the opposition of the municipality authorities and the community. For that reason, he offered to commit the State's support to assist in selecting another site[270].

365. Governor Sánchez Unzueta testifies further that, because of Metalclad's insistence on La Pedrera, he suggested, as he had publicly advised before, that they engage the assistance of the most competent investigators of the UASLP, who had information gathered throughout the years, in order to locate new sites.[271] Mr. de la Garza has also testifies that the Governor had serious doubts about the site because it represented a social and political problem, so he suggested that a new site be located in coordination with UASLP investigators.[272]

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266. Ibid.

267. Witness statement of Dr. Medellín.

268. Sánchez Unzueta statement.

269. Ibid.

270. Ibid.

271. Ibid.

272. Ibid.

366. Governor Sánchez Unzueta, Dr. Medellín and Mr. de la Garza all testify that the Governor said that if a new site were located, he would commit the State's full support and assist Metalclad in obtaining new permits from the federal authorities[273].

367. The Claimant alleges that the Governor set up the "University Commission" to which three UASLP professors, Roberto Leyva, Joel Milán and David Atisha were appointed. The Commission would be in charge of conducting and supervising various tests and studies.[274]

368. Governor Sánchez Unzueta testifies that he suggested engaging university investigators to assist in locating a new site. He advised against conducting further studies at La Pedrera because "even if La Pedrera were confirmed as a safe site, this would not solve the opposition of the municipal authorities and the community *per se*"[275]. Both Governor Sánchez Unzueta and Dr. Medellín testify that no "Commission" was ever established. The establishment of a University State Government Commission would have required a formal agreement with the university authorities, and this did not occur[276].

369. In fact, the Claimant's pleadings are contradicted by letters dated May 31, 1995 sent by Mr. Kesler to U.S. Senator Bill Bradley and Representative Brian P. Bilbray (a copy of the latter was also forwarded to Representative Christopher Cox on June 6, 1995)[277]. Mr. Kesler attached to those letters a draft of a "Confidential Summary of Events", dated June 1, 1995. This latter document asserts:

> "The geophysical and geohydrological studies prepared by Metalclad at the site showed, after consulting several experts in the matter both at the national and state levels, that the results presented in the study of Eng. Alemán were completely fraudulent. Metalclad's studies were required by a commission formed by the Dean of the UASLP..."[278]

370. Similarly, a June 2, 1995 letter from Eng. Francisco Guerrero Alcocha to Former Ambassador of Mexico to the United States, Jesús Silva Herzog, requesting his assistance

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273. Ibid.

274. Memorial: Chronology, page 5; 64, at page 71.

275. See Witness Statement of Governor Sanchez Unzueta.

276. Witness statement of Governor. Sánchez Unzueta and Dr. Medellín.

277. Exhibit 67, Letter from Metalclad to Representative Bilbray, May 31, 1995, attaching confidential Summary of Events.

278. Exhibit 67 at page 3. [Emphasis added]

on this matter adds that the UASLP Dean had appointed the Chemical Sciences Faculty Director to head the group of investigators interested in expressing their opinion on the Metalclad project[279].

371. Governor Sánchez Unzueta says further that, consequently, there was no agreement to produce a report, nor to make anything public. Roberto Leyva did not resign in protest, because he had not been appointed to anything as claimed by Metalclad[280]. (With respect to the alleged protest of Mr. Leyva, the Tribunal should take note of the fact that Metalclad described him as a member of the Board of Directors of its wholly-owned subsidiary, ECOPSA[281]. The Respondent will point out in argument that this was not the only time that Metalclad apparently tried to co-opt an independent party.)

372. Mr. Joel Milán has testified that, since the Metalclad was trying to establish a landfill at La Pedrera, it visited some UASLP specialists in order to show them its executive project. Among such specialists, it visited investigators of the Faculty of Engineering's Earth Sciences Department. This resulted in disputed opinions. The Dean of the UASLP established a technical committee under the direction of Dr. Roberto Leyva, then the Director of the Chemical Sciences Department, who invited Mr. Milán at the Dean's suggestion. David Atisha, Guillermo Labarthe and Fernando Díaz Barriga also formed part of the committee. The only spokesperson was Dr. Leyva[282].

373. The committee's objective was to render an opinion on whether the technical studies presented by Metalclad were sufficient to ensure that the landfill complied with existing national and international environmental regulations, and that there would be no impact on the environment[283].

374. The committee suggested that Metalclad perform several studies in order to determine the geologic and geo-hydrologic conditions of the site. Metalclad never did so. The committee, therefore, was unable to render a final opinion. Metalclad intended that the committee reached a conclusion on the feasibility of its project. However, the UASLP never committed nor did it have authority to do so. This was for the competent authorities to decide[284].

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279. Exhibit 68, Letter from Eng. Guerrero Alcocha to Ambassador Silva Herzog, June 2, 1995.

280. Witness statements of Govr. Sánchez Unzueta and Dr. Medellín.

281. Exhibit 14.

282. Witness statement of Joel Milán.

283. Ibid.

284. Ibid.

375. The evidence shows that the Governor was also unsure of the Claimant's credentials. Shortly after the January 28th meeting, on February 2nd, Mr. Kesler sent a letter to the Governor providing additional information on Metalclad. In the letter, Mr. Kesler represented that Metalclad was:

> "...one of the largest and most respected contractors in the area of asbestos removal and separation in the Western United States and have successfully carried out more than one billion dollars in such work..."[285]

376. As noted in the Introduction to this Counter-memorial, this was a misrepresentation. According to its own statements, the company had found the asbestos abatement business to be unprofitable and had abandoned it.

377. Mr. Kesler went on to attempt to outline the company's credentials in the hazardous waste area and concluded:

> "In sum, Mister Governor, while it is true that we are not the largest company in the area of waste management, we are clearly capable of making this project successful in San Luis Potosí."[286]

378. This claim was also dubious given that the company had no prior experience in the business.

The Decision to Conduct an Audit

379. In early 1994, it was decided to conduct an environmental audit at La Pedrera, so that PROFEPA would obtain better information regarding primarily two issues: (1) the situation of the hazardous waste that COTERIN had stored without prior authorization, and what remedial work COTERIN would have to undertake; and (2) the geological and hydro-geological characteristics of the site, in light of the NOMs[287]. COTERIN sought authorization from PROFEPA to conduct an independent environmental audit.

380. Environmental Federal Attorney, Antonio Azuela, testifies that during this period, such audits were conducted as follows: The company to be audited would nominate an

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285. Exhibit 15.

286. Ibid.

287. Witness statement of Antonio Azuela

auditor acceptable to PROFEPA. As a matter of law and policy the auditor's client was PROFEPA; however, the expense of the audit would be borne by the company[288].

381. Both Secretary Carabias and Mr. Azuela testify that, as in the case of financial audits, the credibility of the environmental audit was crucial and the auditor's independence was of utmost importance, especially since the Guadalcázar site had gained such notoriety.[289] This is an important point of testimony as shall be seen in subsequent events).

382. Thus, after discussions with PROFEPA, by letter dated March 17, 1994, COTERIN sought authorization to conduct an audit of the confinement cells containing the 55,000 drums of hazardous waste[290].

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288. Witness statement of Secretary Carabias.

289. Ibid.

290. Exhibit 69, Letter from Metalclad to PROFEPA, March 17, 1994. The letter stated:

- that Metalclad was a U.S. corporation which in September 1993 acquired 94% of the shares in COTERIN and that, prior to that date, had met with federal (SEDESOL, SECOFI, SRE, SHyCP, etc) and State authorities in order to determine (as objectively as possible) what the legal, economic, social and political situation of the project was. As a result of the market studies Metalclad conducted and its advisors' recommendations, Metalclad had decided to buy COTERIN;''
- provided a background of the La Pedrera site:
- on August 24, 1990, SEDUE authorized COTERIN to prepare a proyecto ejecutivo;
- on October 30, 1990, COTERIN obtained authorization to establish a temporary transfer station;
- on February 18, 1991, SEDUE informs that there are no restrictions regarding the location of the site;
- in May 1991, for several reasons, the local delegation of SEDUE shut the transfer station down, after 7 months of activities whereby approximately 55,000 drums of waste were stored, but no further waste had been received since the site was shut-down [this is a mistake, the site was shut-down on September 25, 1991, and closure seals were placed on October 3, 1991];
- nonetheless, COTERIN continued the process of obtaining the necessary permits and authorizations from the federal and state authorities, in order to operate a hazardous waste landfill;
- on February 10, 1992, the San Luis Potosí Congress issued COTERIN a favorable report which pointed out there had to be a hazardous waste disposal landfill and the La Pedrera site was an appropriate one;

The Idea of a New Site

383. On April 8th, Mr. Kesler sent another letter to Governor Sánchez Unzueta. He stated that:

- on January 27, 1993, COTERIN obtained the construction permit from INE;
- on May 11, 1993, the State SEDUE issued the State land use license; and
- on August 10, 1993, COTERIN obtained the operating permit from INE. referred to the current status of the landfill as follows:
- on June 11, 1993, Metalclad officials had met with Governor ánchez and his ecology officials, following the recommendation and prior intervention of INE;
- Metalclad informed the Governor of the industrial waste treatment plant that it was thinking of acquiring and operating in the immediate future, and, as a result, Governor Sánchez had issued a letter of intention to Metalclad expressing that he was sympathetic to the project;
- since June 1993, it had been negotiating with the San Luis Potosí Government and its advisors (inter alia, the UASLP) and the San Luis Potosí Government had requested to conduct a number of complementary studies in addition to those required by the Mexican environmental standards and the conditions established in the authorization to operate the hazardous waste landfill of August 10, 1993; Metalclad had agreed in order to ratify its greatest commitment with the Potosínian society and it State and Municipal autorities;
- in February 1994, Metalclad had submitted to the Governor a draft agreement containing all the recommendations of the commission set up by the Governor in January 1994 for that purpose, recommendations that Metalclad had agreed to observe and implement once the authorization to initiate activities was granted; and
- Metalclad had promised the Governor to undertake an environmental impact statement of the 14,000 tons of hazardous waste that was deposited in three (60x40x5 metres) cells to prevent theft and protect the health of the community after the May 1991 closure.
- requested authorization to conduct an environmental audit of La Pedrera —especially of the 3 cells that contain te 55,000 thousand drums of hazardous waste, in order to detect any potential risk to the environment an take all the corrective and preventive measures, found to be necessary as a resulto of the final environmental audit report;
- proposed to hire Corporación Radian S.A. de C.V. (Radian), a widely recognized enterprise, both domestically and internationally, for its technical capacity and seriousness to conduct the audit;\
- COTERIN confirmed its desire to work in coordination with PROFEPA and suggested signing an audit agreement if PROFEPA considered it appropriate to do so.

"In accordance with your requests and as we have interpreted your wishes, we have carried out the various recommendations which you brought to our attention, as follows:

> 1. We submitted to you additional information with respect to the history of our company which we hope has been sufficient and adequate so that you may form an opinion of our capacity to be in charge of the project.
>
> As you will be able to see from the material provided, Metalclad has been involved at the international level in projects of greater magnitude than those which are proposed in this case and they have been carried out with great success.
>
> 2. Under the direction of Licenciado Luis Manuel Abella Armella a commission was formed to study the "La Pedrera" site and to determine if it was both secure and suitable."[291]

384. After discussing the composition of the commission formed by the company, Metalclad continued:

> 1. We provide you with a written commitment between our company and the State Governor, the same one which was submitted to Dr. Pedro Medellín M. who, in the beginning told us that he was in agreement with the terms of the proposal but has not returned the document nor has he made any formal written commentary on the same. The commitment as well as our agreement with the University mentions that a different site will be located jointly. Upon carrying out the additional sampling, we will also include this new site in the subsoil sampling.
>
> 2. We have received proposals to carry out the subsoil studies by acceptable geologists for the Universidad Autonoma de San Luis Potosí and we are initiating the implementation of these samples. The cost of this is in the order of US$300,000.
>
> 3. We completed an exhaustive study of the opinion of the residents of Guadalcázar and we are using it as a basis

291. Exhibit 70. Letter from Grant Kesler to Governor Sánchez Unzueta, April 6, 1994.

and foundation for an educational program in the local communities. We have found that the project, in principle, has the support of part of the community.

4. Much as been said to the public by the State Ecological Director through the media. Our position has been to avoid a response and, instead, we await a meeting with you." [292]

385. The Tribunal should note that Mr. Kesler's letter mentions that "a different site [from La Pedrera] will be located jointly." The Respondent will submit in argument that this is important evidence supporting the testimony of Messrs. Sánchez Unzueta and Medellín that by the end of the first quarter of 1994, the parties had agreed that an alternative site should be found due to the problems of local opposition and the State's concerns that there were technical problems with La Pedrera.

386. Mr. Kesler's letter concluded:

"The hearings subsequent to the signing of the Free Trade Agreement are about to commence in the United States Congress. We will be providing testimony at these hearings with respect to our positive experience in San Luis Potosí and we are truly anxious to relay this most important experience following the Free Trade Agreement."[293]

387. By letter dated April 12, 1994, COTERIN requested an extension of the authorization granted by the INE on January 27, 1993 to construct the proposed hazardous waste landfill. On April 22, 1994, INE granted COTERIN an eighteen month extension of the Environmental Impact Statement Authorization to finish the construction work.

388. On April 25th, Mr. Kesler wrote to Dr. Medellín. In his letter he stated:

"As a result of our various interviews related to the transfer station located in La Pedrera, Municipality of Guadalcázar, S.L.P., and with a view to the agreement being considered, it is a pleasure to submit for your review the following schedule of activities:

1. Beginning with our position that we should avoid at all costs any situation which may signal a public problem, all matters which

292. Ibid. [Emphasis added]

293. Ibid.

involve political or social questions will be handled through mutual agreement, under your coordination, with the commitment on our part to provide you with our support and cooperation.

2. We are well aware that the actual transfer station established in the site mentioned should be remedied, Ecosistemas del Potosí S.A. de C.V., 100% subsidiary of Metalclad Corporation, will initiate at the very latest by May 16, 1994 the works related to the remediation of the site, including the construction of the controlled confinement and the related works.

3. Given the circumstances which entail the remediation of the site, this will be carried out "in situ" and, in time, a thermal treatment system will be installed which will allow for the destruction of the dangerous, non-confinable wastes.

4. Once the complementary works are concluded, which it is estimated will be in the month of September of 1994, based on the authorization granted by the Federal Government, we will be carrying out the confinement of wastes, so that Metalclad may be compensated for the remediation.

5. In order to fulfil paragraph 2, noted above, our company will contract approximately 250 workers which will preferably be selected from the local population and the selected bordering areas, so that the inhabitants of the region may benefit from the endeavours.

6. In accordance with the suggestion put forth by this Coordination, and based on the studies carried out by the UASLP with regards to the location of an alternative site for a controlled confinement, Metalclad will immediately initiate the studies in order to negotiate the respective authorizations. As such, the support and collaboration offered by the State Governor with regards to the offer to expedite these procedures to the State and Federal level is very much appreciated.

Awaiting your response so that we may initiate the corresponding works, we again send to you our highest regards."[294]

389. The Tribunal should note the following key points proposed by the company:

294. Exhibit 71. [Emphasis added]

(1) The site would first be remediated through landfilling in a new confinement cell and perhaps by the incineration of dangerous, non-confineable wastes.

(2) After remediation, the company then proposed to receive new waste immediately.

(3) The company would immediately begin to look for an alternative site with State support.

390. Mr. Kesler's letter enclosed a response that he proposed that Dr. Medellín send to him. Dr. Medellín did not sign and send his response in the form suggested[295].

391. However, Mr. Kesler's letter eventually led to the conclusion of an oral agreement on May 27th (this is described below).

392. During May 1994, members of UASLP faculty visited Metalclad's headquarters in California, a landfill at Orange County, California and a landfill in Texas (both landfills are municipal waste landfills, not hazardous waste landfills[296]).

393. Metalclad/COTERIN claims that it began work at the proposed site on May 16, 1994. It was the State and federal authorities' understanding that this work was directed at maintenance or preparing for remediation[297].

The Agreement Between the State and the Company

394. By letter dated May 26, 1994, to Metalclad counsel José Mario de la Garza, Dr. Medellín reviewed the agreements reached in order to promote the State's goal of having an integral system of hazardous waste management, in which Metalclad, the State government believed, would play a relevant role. Dr. Medellín's letter states that:

"The concrete agreements include:

1) Remediation of the final confinement cells of the site officially known as Transfer Station at La Pedrera, Municipality of Guadalcázar, probably requiring *in situ* re-confinement and

295. Witness statement of Dr. Medellín.

296. Expert Report of Marcia Williams.

297. Witness statement of Dr. Medellín.

incineration, pursuant to the highest technical standards, paid for and done by Metalclad.

2) Thus, Metalclad will firstly prepare a study of the site, a remediation plan, and geo-technical studies to learn about the subsoil, in order to guarantee the works will be carried with maximum security. These studies shall comply with standards agreed by the State Government, the company Metalclad, and the UASLP academic group.

3) The establishment and operation of a hazardous waste landfill in an area of the State to be determined by common agreement, where Metalclad will again prepare the local studies required by law, and to guarantee, in the view of Federal, State, and municipal authorities, safe operations. In such a case, the State Government will fully support Metalclad and provide technical information as available (in particular geological maps and geo-hydrological studies), and will facilitate local technical assistance, especially through agreement with the local university and other institutions with which the Government maintains assistance relations. The State Government will also support the company Metalclad in its permitting procedure. The participation of the company in the new Government's risk-controlled-industrial-zone plan will also certainly be required.

4) The decision of approving a landfill in La Pedrera to receive hazardous waste in addition to the existing waste will be subject to:

a) Convincing state and municipal authorities that the facility could operate with high safety standards.

b) The community accepting its operation, such acceptance being assessed jointly by state and municipal authorities and the company, following a truthful and clear proposal to the community of the conditions and implications of operation."[298]

395. The agreement concluded that "in every action, Metalclad would observe all technical and legal requirements and the State Government would grant its support"[299].

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298. Exhibit 72, Letter from Dr. Medellín to Lic. de la Garza, May 26, 1994. [Emphasis added]

299. Ibid, page 2.

396. According to Dr. Medellín, the Claimant did not formally acknowledge agreement to his letter. However, representatives of the company participated in the press conference held the following day at the Governor's Palace. Dr. Medellín believed, therefore, that in light of Mr. Kesler's earlier letter and the comments at the press conference that there was a clear agreement between the parties.

397. The Claimant has characterized Dr. Medellín's letter as expressing the State's full support. In the Respondent's view, it clearly contains qualifications, the most important ones relating to the La Pedrera project's approval by the local community and the relocation of the landfill to another site. The latter point is key. It is consistent with the evidence of the former State officials that the landfill at La Pedrera would no be able to operate without the consent of the local authorities and community. They therefore sought to persuade Metalclad to relocate the site. The Respondent will submit in argument that due to the representations that Metalclad made to its investors, it could not agree to do so; it had to be able to say that it was operating at La Pedrera because it told its investors that it had all the necessary approvals and the support of all levels of government in Mexico[300].

398. On May 27, 1994, the San Luis Potosí State Government and the Claimant jointly announced that an agreement had been reached to promote the establishment of a new hazardous waste landfill while Metalclad cleaned up La Pedrera site. The announcement, which was reported on May 28, 1994, in *El Sol de San Luis*, stated that:

a) in the next days, national and foreign experts will begin preparing a number of studies to determine suitable sites in the State to open a different hazardous waste landfill from the one existing in La Pedrera. The studies will take approximately nine months. The sites will be presented to Governor Sánchez Unzueta;

b) the studies will be paid for by Metalclad, and once concluded, will be submitted to the Federal authorities for approval and initiation of operations within 12 months; and

c) for the project, the company Química Omega will substitute for COTERIN[301].

399. The local press attended the press conference. The next day *El Pulso* reported in an article entitled "Metalclad will Clean La Pedrera and Open a New Facility":

> "The State Government and Metalclad yesterday announced the agreement reached to remedy the situation at La Pedrera, a site in

300. Ibid.

301. Exhibit 73, "An Industrial Waste Facility will Be Established in SLP", *El Sol*, May 28, 1994. [Emphasis added].

which 55 thousand containers of industrial waste lie, as well as the authorization allowing Metalclad to establish a controlled facility, at a site yet to be determined."[302]

400. Similarly, *Momento* published an article entitled "Metalclad Will Install a Waste Facility: But it will not be at La Pedrera; that one will be cleaned":

> "Metalclad will install in San Luis Potosí a hazardous waste facility using the highest technology available, investing between some 4 to 6 million dollars. In addition, they have committed themselves to clean up La Pedrera, where a transfer station exists. To date a site for the facility has not been determined."[303]

401. The Respondent will submit in argument that the plain terms of the agreement as confirmed by three newspaper accounts of the press conference are to be preferred over the Claimant's version of the facts. The Memorial and Mr. Kesler's witness statement portray the May 27th announcement as aimed solely at the opening of La Pedrera for commercial operation; in fact, the site was to be opened for remediation and only then, if the State and the local community agreed, would COTERIN be permitted to receive new hazardous waste. Moreover, both parties agreed to find an alternative site to La Pedrera[304].

402. The Claimant denounces a later letter from Professor Joel Milán to Metalclad as "an apparent further effort to divert Metalclad from realizing the fruition of its investment and in a bold attempt of self-aggrandizement"[305].

403. Professor Milan's letter, however, was entirely consistent the State government's suggestion (made by the Governor as early as January 1994) and with the company's later agreement of May 27, 1994 to use local university professors to find the alternate site[306]. In fact, professor Milan's letter states:

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302. Exhibit 73, "Metalclad Will Clean up Pedrera and Open a New Facility", *El Pulso*, May 28, 1994. [Emphasis added]

303. Exhibit 73. [Emphasis added]

304. The Tribunal should note how Mr. Kesler describes that in the joint announcement: "... [Medellín's] public comments gave emphasis to the fact that we would be remediating the old Aldrett transfer station site and not that we would be building and operating the first hazardous waste treatment facility in Mexico"(Declaration of Grant S. Kesler, at page 8). As the independent evidence shows, Mr. Kesler's characterization of the agreement is not supportable.

305. Memorial at paragraph 65.

306. Claimant's Exhibit 15. The Claimant has characterized Joel Milán as a colleague and relative of Dr. Pedro Medellín (Memorial, paragraph 64, at page 72). Dr. Medellín has testified that, although he

"Recently, Metalclad Corporation intends to establish a controlled landfill in this State... Metalclad obtained the construction permit of a Mexican company, that had received it for a site named "La Pedrera", in which 50,000 tons of waste had already been deposited, under conditions that do not guarantee the safety of the environment. And, further, the site is located within a region that servers as a part of an overcharge zone for a probable aquifer region, along with other characteristics that do not make it better than any other site[307]. For this reason, the company has accepted, as part of a general strategy, that all the necessary studies be conducted to locate another, more adequate site within the State, and with these studies carry out the necessary process to obtain the correspondent permits for the establishment of a landfill at this new site, in the understanding that the state government would support this measure to the extent of it capabilities. And during this process, the foreign company committed itself to do more detailed studies in La Pedrera, to be able to design and construct cells, and facilities that will serve to confine the products for the remediation program that will be implemented at the site."[308]

404. The object of the studies was to select the two best sites, from the sites previously identified in a study of the University (the March 1993 study) in order to build the hazardous industrial waste landfill in one of them. Mr. Milán testifies that the UASLP committee was aware that Metalclad and the State government had reached an agreement to find alternate sites to establish a landfill. The members of the committee had been told by the Metalclad and the State government that the former had committed to study alternate sites and to conduct further studies at La Pedrera in order to develop a remediation plan. The Faculty of Engineering of the UASLP would only perform the first of such studies. Thus, Mr. Milán submitted a proposal to Metalclad[309].

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knew and had worked with Joel Milán, they are not related.

307. It should be noted that this conclusion of professor Milán is consistent with the findings of Eng. Sergio Alemán. The Tribunal will recall that professor Milán was purportedly a member of the "University Commission" that the Governor allegedly established, that contradicted the "Aleman Report" (see Memorial, paragraph 58 at page 70).

308. Ibid.

309. Witness statement of Joel Milán.

How Metalclad Represented the May 27th Agreement

405. The Respondent will submit in argument that the Claimant misrepresented the May 27th agreement to the public markets. On May 31, 1994, Metalclad announced, through Mr. Kesler, an agreement with the State officials of San Luis Potosí. According to the press release, Governor Sánchez Unzueta called a press conference at his office on Friday, May 27, 1994, "to announce an agreement had been reached with Metalclad Corporation insures that Metalclad will be the dominant waste management company in San Luis Potosí". The Metalclad press release went on to state:

> "Dr. Pedro Medellín, coordinator of ecology for the state, announced that, after many months of work and discussion, an agreement had been reached with the following salient terms:
>
> - Metalclad would characterize and remediate the prior Aldrett transfer station that operated for a brief period of time several years ago;
>
> - Metalclad will receive full state support, as well as local encouragement, for using the technologies for recycling, landfilling, incineration and waste minimization for all forms of hazardous waste;
>
> - The state will cooperate with Metalclad in locating additional sites for facilities in San Luis Potosí for future use, in accordance with the governor's economic development plan, thus creating an environment for expansion of economic development in a way that fully protects the environment.
>
> - Metalclad subsidiary, Química Omega, will immediately establish a waste oil and liquid waste collection facility in San Luis Potosí, providing a solution for the problem of hazardous materials that find their way into the public sewers."[310]

406. Metalclad's Chairman, Mr. Neveau, was quoted in the press release as stating:

> "...The facilities now under construction by Metalclad will be state-of-the-art, meaning Mexico will be leap-frogging 20 years worth of

310. Exhibit 74, "Metalclad Reaches Public Agreement with Government of Mexican States", PR Newswire, May 31, 1994. [Emphasis added]

technological environmental development in the United States. Metalclad's facilities, the first of their kind in Mexico, are expected to create an example to be emulated by other industrialized Mexican states, providing further expansion opportunities for Metalclad."[311]

407. Dr. Humberto Rodarte Ramón also stated that the Governor was an educated economist who understood the relation between economic growth and environmental protection. "The governor's environmental policies have now received broad-based public support", he added"[312].

408. The Respondent will submit in argument that this press release was misleading. It omitted to disclose the fact that full approval had not been given to La Pedrera, and that it had expressly been conditioned on the acceptance of both the local community and the authorities. Yet it stated that state-of-the-art facilities were under construction. It implied that La Pedrera was being opened and that the agreement was to find additional sites when in fact it was to find an alternative to La Pedrera. La Pedrera would be allowed to open only if the local community approved. The press release does not mention this crucial fact.

The Second Santa María del Río Payment

409. The Tribunal will recall that in February 1993 Metalclad paid $180,000 to Messrs. Kesler, Neveau and a third person for the claimed issuance of the "final permit" to commence construction of the San Luis Potosí facility. The company's 10-K for 1995 later reported that during fiscal year 1994, "one individual received the balance due him of $190,000 and the two other individuals each received $150,000, the balance owing of $80,000 ($40,000 each) was paid in fiscal year 1995"[313]. These latter payments were based on developments at La Pedrera, not Santa María del Río.

The Municipality Rejects the Claimant's Proposal

410. On or about June 6, 1994, company representatives met with Municipal officials and community leaders. Metalclad made various offers to the local community, all of which were rejected.

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311. Ibid.

312. Ibid.

313. Exhibit 10[N], 1995 10K, page 16. See F-16.

411. For example, on June 13, 1994, Mr. Neveau wrote to Municipal President Juan Carrera Mendoza, observing:

a) that a hazardous waste landfill was an engineering work to dispose of hazardous waste that, treated with the most developed technology used in countries like the United States, Canada, the Netherlands, and Switzerland, could be deposited without risk in cells covered with impermeable and indestructible materials;

b) that the proper construction of a hazardous waste landfill took into consideration the geologic and environmental conditions of the area in order to apply the best technology to the site. (Mr. Neveau referred as examples, to a landfill located near the Mass River in the Netherlands next to a tulip field, and to Orange County, California, where within 3 kilometers of a landfill, one could find orange groves and strawberry fields and a residential area of 2.5 million people)[314];

c) that a professionally designed and constructed hazardous waste landfill required a huge investment that will promote the development of an area not fit for agriculture or industry. A hazardous waste landfill could be operated without risks; and

d) that the hazardous waste in La Pedrera had to be classified, treated, incinerated and deposited back in the drums[315].

412. Metalclad therefore proposed:

a) to clean the site with the proper infrastructure. This represented a large investment in time (two to three years) and money, and thus, it could only be done if the company was able to operate during and after the remedial work;

b) to invest whatever amount of money was required to clean the site insofar it was able to operate;

c) to clean the site meeting all the requirements of the Mexican authorities and environmental standards;

d) that the Municipality directly supervise the activities in the site;

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314. There is no hazardous waste landfill in Orange County, California. The landfill to which Mr. Neveau referred is a municipal landfill.

315. Exhibit 75. Letter from Metalclad to Municipal President Carrera, June 13, 1994.

e) to use the best technology as applicable to the site;

f) to preferentially hire residents of the nearby communities;

g) to invite a professional institution like UASLP to help in supervising the site, in the event that the Municipality lacked qualified personnel;

h) to actively participate with the Municipality in developing education and social community programs; and

i) to train their personnel and thus improve their living standards[316].

413. Mr. Neveau concluded by requesting that Metalclad be given an opportunity to demonstrate that it was possible to professionally operate a hazardous waste landfill without risks to the health or the environment of the community and with benefits for the people. He offered to provide information showing how developed countries had done it and invited the Municipal official to jointly elaborate a working plan that would satisfy the community, and to leave distrust, miscommunication and other type of errors behind in order to promote regional development in compliance with Municipal, State and Federal laws[317].

414. The Tribunal should note that one of Metalclad's claims to the local municipality was that it would generate significant employment in an area of chronic unemployment. Mr. Neveau, for example, later wrote to federal authorities claiming that the company would hire up to 400 employees at peak production and remediation.

415. The company's internal documents actually contemplated much lower levels of employment for the landfill's operation. A Project Status Report dated October 1993 stated:

> "This same work force and prior employees of COTERIN located near the La Pedrera landfill will provide experience in operations of the landfill[318]. Past operation of the landfill included as many as 90 personnel, which is several times the anticipated size of the EMI [Eco-Metalclad] staff required for operations.

316. Ibid.

317. Ibid.

318. The landfill had never engaged in "past operation". It was an unlawfully operated transfer station.

> By applying current operating techniques from the U.S. for both material handling and cell construction, a smaller work force is expected to be sufficient. With the availability of experienced landfill personnel in the immediate area, a smooth ownership transition is expected which should minimize start-up time."[319]

416. Similarly, an internal Eco-Administración Operating Plan organization chart dated March 1993, listed only 33 employees for La Pedrera[320].

417. The company's proposals did not assuage local concerns. Its brief attempt to negotiate an agreement with the Municipality failed to win any support.

Preparations for the Audit

418. By letter dated July 4, 1994, Radian sought instructions from PROFEPA on the steps to be taken for the forthcoming environmental audit.

419. Three days later, in response to Radian's letter, PROFEPA informed Metalclad that the policies and formal steps for the audit would be as follows:

a) the audit would be conducted by the consulting firm chosen by Metalclad (Radian) and would be supervised by a third independent firm;

b) all expenses associated with the audit would be borne by Metalclad;

c) once the audit was over, and a plan of action drafted, PROFEPA and Metalclad would enter into an accord for the implementation of the plan by Metalclad, which would secure its compliance with a bond for 20% of the required investment;

d) Metalclad would inform PROFEPA of any other agreement between the company and federal or state authorities. For the protection on environment. Non-compliance with any such agreements could result in PROFEPA invalidating the audit[321].

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319. Exhibit 6, Eco-Administración Operating Plan March 1993, 4th chart after page 31. Exhibit 21 as identified by Mr. Kesler. [Emphasis added]

320. Exhibit 7, Metalclad Corporation Project Status Report, October 1993 at page 15. Exhibit 2H as identified by Mr. Kesler.

321. Exhibit 76 Letter from PROFEPA to Metalclad, July 7, 1994.

420. The letter further advised that PROFEPA was studying the document submitted by Radian entitled Especificaciones Complementarias a los Términos de Referencia para Auditoría Ambiental de Confinamientos Controlados[322].

Further Local Opposition

421. By letter dated July 12, 1994, the Democratic Peasants Union of San Luis Potosí sought a meeting with Governor Sánchez Unzueta to inform him of the contamination of the *ejido el Huizache* in Guadalcázar, that they believed was caused by the hazardous waste landfill at La Pedrera. The letter contended that contamination had affected *el Huizache* and another kind of trees, and their crops, and resulted in consequential harm to the health of their families[323].

The Importance of the Audit to the Claimant

422. By letter dated July 14, 1994, to the San Luis Potosí office of PROFEPA Metalclad's subsidiary Eco-Administración requested that the shut down order of the site be lifted[324].

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322. Supplemental Directives to the Terms of Reference for Environmental Audits of Controlled Landfills.

323. Exhibit 77, Letter from Democratic Peasants Union to Governor Sanchez Unzueta, July 12, 1994.

324. Exhibit 78, Letter from Eco Administracion to PROFEPA-SLP, July 14, 1994. The letter stated:

- Metalclad acquired COTERIN on September 9, 1993, and owned Eco-Administración as well.
- Eco-Administracion was in charge of the administrative and legal affairs of COTERIN (the letter attached documents demonstrating its authority to represent COTERIN).
- The letter reiterated the claims of the letter of March 17 with regards to the meetings that Metalclad had with federal and state officials prior to buying COTERIN.
- Metalclad had been negotiating with the San Luis Potosí Government, through Dr. Medellín, to win the support for the project.
- Metalclad had submitted to the UASLP, the local newspapers, San Luis Potosí businessmen and different social groups from the State and the Municipality its integrated proposal for the treatment of hazardous waste at La Pedrera and, in general, had received positive reactions.
- Metalclad had proposed an environmental audit and affirmed that it would comply with all recommendations and results of the audit.

423. The Respondent will submit that when viewed in light of subsequent events, it is evident that the Claimant saw the audit as a means for launching construction work at the site. COTERIN sought the removal of the closure seals ostensibly for the purpose of having the audit conducted (This explains why, as shall be seen, COTERIN received written admonitions from PROFEPA to the effect that it was conducting unauthorized activities at the site).

424. By letter dated July 18, 1994[325], Ariel Miranda of COTERIN advised PROFEPA that:

a) Since Metalclad acquired COTERIN on September 9, 1993, the only work that has been performed is:

b) installation of a water tank for irrigating the re-forestation area and sanitary cleaning;

c) remediation of a septic well;

d) strengthening of the *bordes*[326] protecting the containment cells from the rain;

e) remediation of a *vado*[327] crossing the La Pedrera stream

b) All such activities are part of the landfill's regular maintenance program.

425. The Tribunal should note that these works were characterized as being in the nature of maintenance.

Further Local Opposition

426. By letter received July 21, 1994, signed by the Municipal President and all of the members of the *Ayuntamiento* of Guadalcázar, PROFEPA was requested to remove the waste, clean up the site, and to refrain from authorizing COTERIN to reopen the proposed site or negotiating any other proposal with COTERIN[328].

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325. Exhibit 79, Letter from COTERIN to PROFEPA-SLP, July 18, 1994.

326. Borders - in this context, a lip or low barrier along the edges of the cells.

327. A small dam to cross a stream.

328. Exhibit 80, Letter from Guadalcázar *Ayuntamiento* to PROFEPA, July 21, 1994. The letter stated further:

- The COTERIN project was "serious problem, a hazardous waste dump... arbitrarily implemented possibly through negotiated permits";

Events LeadingUp To The August 30th Resolution

427. On August 16th, PROFEPA conducted a verification inspection and found that unauthorized leveling work was being carried out. The inspector suspended the work on the grounds that COTERIN was only authorized to perform maintenance work. Once again, Mr. Miranda Nieto said the company had only done "maintenance work that was ~~have~~ done since the landfill was acquired (September 1993) up to the month of July 1994"[329].

428. By letter dated August 17th, Lic. Héctor Raúl García Leos of Metalclad's local legal counsel advised Javier Guerra of Química Omega on the construction permits issue. He set out how the Claimant could apply for the license through Ecosistemas del Potosí (rather than COTERIN) "... chances are that being...[ECOPSA], the new applicant, the City Council will not refer to the previous denial and if this is so, the new denial will give us the opportunity to go to the Federal Court"[330].

429. By letter dated August 19th, COTERIN responded to the August 16th verification report by submitting that the construction of a bridge and a road to the site and the leveling of cell number two was "maintenance work" required by the federal environmental regulations[331].

430. On August 30, 1994, PROFEPA issued a resolution on its August 16th verification visit finding, *inter alia*:

- The President of Mexico, Carlos Salinas shut down the site on April 29, 1992 [the reference to this date was to a visit of the former President to the region; in fact, the transfer station was shut down on September 25, 1991 by SEDUE]. The letter continued, that although the site was shut down, "an American company, Metalclad, is trying to reopen it ignoring this decision and using all kinds of tricks";

- The community was opposed to the project as indicated in the Municipality's complaint submitted to PROFEPA on November 11, 1993, to which there had been no response; and

- All technical information was [provided to] the technicians sent by PROFEPA and [in a letter] from Dr. Medellín to INE advising that the site was not adequate [suitable] for a hazardous waste landfill.

329. Exhibit 81, PROFEPA Verification Report, August 16, 1994.

330. Witness Statement of Lic. Jose de la Garza. [Emphasis added].

331. Exhibit 82, Letter from COTERIN to PROFEPA-SLP, August 19, 1994.

a) COTERIN had been doing some work at the site but it was justified to prevent an environmental hazard;

b) the transfer station did not fully comply with the applicable technical requirements;

c) the shutdown stickers should be removed on a provisional basis, so that COTERIN can conduct further remedial work;

d) COTERIN must arrange for a comprehensive environmental audit by an independent expert to assess the situation at the site and prepare a detailed list of the origin, location and quantity of hazardous waste in the containment cells. COTERIN shall inform PROFEPA of the results of the audit and shall not operate at the proposed site or accept further deliveries of waste until the environmental audit and remedial work are completed[332].

431. On September 6, 1994, PROFEPA ordered the removal of the shutdown seals that had been placed on the gates at the proposed site. This was a *partial* removal of the shut down order, so as to conduct the audit. The transfer station otherwise remained closed.

Metalclad Corporate Developments and Statements to Investors

432. On September 7th, Metalclad returned to CVD Financial Corporation for further financing. It obtained a short-term loan in the amount of 525,000 dollars (due November 30, 1994) from CVD pursuant to a promissory note. The note bore interest at a rate of prime plus 7% and was secured by all of the assets of the company. The company also issued a five-year warrant to purchase 75,000 shares of common stock at a price of 2.625 dollars per share[333].

433. Metalclad's 10-K for the fiscal year ended May 31, 1994 (the "1994 10K") was filed with the SEC on September 14, 1994. The 10-K referred in detail to the COTERIN landfill now known as "El Confin". The report advised that its subsidiary ECOPSA (Eco. Sistemas del Potosí, S.A., de C.V., formally Eco. Administracion) was "completing construction of a permitted hazardous waste landfill on a 2,200 acre site" which was acquired by the company in October 1993 and would be operated by ECOPSA in accordance with the terms of an operating agreement and lease"[334].

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332. Exhibit 83, PROFEPA Resolution, August 30, 1994.

333. Exhibit 10[J], 10-Q for the period ending August 31, 1994 at page 6.

334. The claim that ECOPSA was "completing" construction was exaggerated. Construction only began in earnest in late 1994. Indeed, as Exhibits 81 and 83 show, through the summer of 1994, COTERIN was assuring PROFEPA that no construction was going on at the site, only maintenance work. [Emphasis added]

434. The Respondent will submit in argument that leaving aside the fact that the Governor's support and local approval had not been obtained, Metalclad's statement was completely unrealistic in terms of federal approvals. The same 10-K later mentions that an audit of the site had been agreed with the federal authorities but acknowledged that it had not yet even commenced (it would not formally commence until December). It was not possible that the site would be permitted to be opened —even at the federal level— without the audit having been completed. Given that on August 30th, just two weeks previously, PROFEPA had issued the audit resolution, this could not take place in calendar year 1994 because it did not commence until December.

435. The reason why the Claimant made these statements, the Respondent will submit, is obvious: In September, Messrs. Kesler and Guerra went to England to meet with the company's investment bank, Oakes Fitzwilliams & Co. (a small investment bank, run by an American, Mr. Herbert Oakes, Jr.). Through that bank, Metalclad was able to sell almost $7 million worth of common stock with UK and European investors by a private placement[335].

436. While containing the disclosure that units being offered were "subject to a high decree of risk," the Offering Memorandum for the private placement went on to represent that:

> "ECOPSA is completing construction of a permitted hazardous waste landfill on a 2,200 acre site in La Pedrera, in the Mexican state of San Luis Potosí ("El Confin"), which site has been approved for the development of a fully-integrated hazardous waste treatment facility. The La Pedrera site is owned by COTERIN, which was acquired by the Company in October 1993, and will be operated by ECOPSA in accordance with the terms of an operating agreement. ECOPSA has also been issued a construction permit for an integrated hazardous waste treatment facility, including a rotary slagging kiln, near Santa Maria del Rio, San Luis Potosí; however, San Luis Potosí governmental officials have encouraged the Company to incorporate the kiln into its plans for El Confin and have indicated that the permit could be transferred to El Confin. The Company intends to operate its facilities on standards consistent with those imposed on hazardous waste treatment facilities in the United States[336]".

437. The 1994 10-K went on to describe the terms of COTERIN's acquisition, stating that the agreement with the minority shareholders of COTERIN required the company to:

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335. Exhibit 10[H], Offering Memorandum, September 1994.

336. Ibid. [Emphasis added]

a) pay them 500,000.00 dollars at the execution of the agreement;

b) upon occurrence of "certain contingencies", to pay them an additional $1.5 million and 5% of gross revenues for a 10-year period and to employ two of the minority shareholders; and

c) to provide any required remediation services on the previously operated cells of the landfill, subject to an off-set of up to 500,000 dollars out of the minority shareholders' percentage of gross revenue[337].

438. It stated further, however, that:

> "...the company now believes that the contingencies upon which the additional payments are conditioned will not occur. Consequently, the company was negotiating an agreement with the minority shareholders of COTERIN to issue 100,000 shares of common stock of the company to them in consideration for the remaining 6% of the capital stock of COTERIN and their waiver of rights to the contingent payment and their employment agreements. The company will also perform any site remediation, if required by PROFEPA"[338].

439. The Tribunal will recall that the contingencies specified in the agreement of sale were the declaration of the Governor's support and the issuance of the municipal construction permit or a definitive court decision compelling the municipality to issue the permit. The company was therefore now telling investors that the contingencies would not occur. Yet it was telling prospective foreign investors that the landfill was expected to commence operations before the end of the year.

440. The 1994 10-K stated further:

> "...in accordance with an agreement being negotiated with PROFEPA and as part of the consideration for the amendment of the agreement being negotiated with the minority shareholders of COTERIN, the company expects to perform an environmental audit of the area previously utilized as a transfer station during the next 12 months to determine if any remediation needs to be accomplished"[339].

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337. Exhibit 10[H], 1994 10K.

338. Exhibit 10[H], 1994 10K.

339. Ibid. [Emphasis added]

441. The 10-K stated further:

> "If the study demonstrates that remedial work is required, the agreement being negotiated with PROFEPA will provide for site remediation over a period of several years..." The company believes that the new landfill being constructed adjacent to the closed transfer station will enable the company to handle the vast majority of any remedial work on site in the normal course of its operations over several years. It is anticipated that site remediation will consist primarily of moving drums of hazardous waste to an adjacent cell meeting current governmental regulations. Some organic materials may be treated at other facilities operated by the company. The company believes that the amounts involved will not be material."[340]

442. The Respondent will submit in argument that the suggestion that there was a possibility that remediation might not have to be performed on the 20,000 tons of buried waste was deceptive. This was the main objective of the PROFEPA audit and the problem of the buried waste was a notorious fact.

443. The Claimant itself had affirmed this in its January 11, 1994 public advertisement in *El Pulso*:

> "...we recognize that a serious danger exists in the event that the facility, approved by the Federal Government, cannot be operated given that the number of containers existing on the site may reach up to 120,000 in number representing close to 30,000 tons of dangerous and toxic waste deposited only in ditches which do not meet the construction standards and are only covered with dirt, without complying with the minimum safety conditions and standards and which may pose a great danger to the health of the inhabitants of the communities. Given this grave danger METALCLAD CORPORATION is ready to treat and confine these wastes investing the amount of $5,000,000.00 to meet these ends, thereby avoiding further damage that, at this moment, is already posed to the detriment of the environment."[341]

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340. The 10-K describes at length the design of the landfill (by Harding Lawson and Associates) and its plans to carry out "inorganic treatment operation" (treatment neutralization and processing of a broad range of inorganic waste) in conjunction with the landfill operation.

341. Exhibit 1, "Enormous Misinformation,".

444. Similarly, in the previous April, Mr. Kesler had written to Dr. Medellín clearly expressing the company's recognition of the need for remediation[342].

445. The 1994 10-K also discussed Metalclad's plan to establish the hazardous waste treatment facility at Santa María del Río, stating that the company had:

> "been working with a variety of consultants, potential joint-venture partners, and potential operators. The company has also investigated financing sources with the International Finance Corporation, an affiliate of the World Bank, to provide project financing.

446. The Respondent will submit in argument that this 10-K filing was typical of Metalclad's behavior throughout the relevant period. It downplayed the site's need for remediation. It made no reference to the fact that the landfill project was encountering stiff local opposition. The company, which by this time was criticizing the State and had had its proposal rejected by the *Ayuntamiento*, was describing to its investors the "encouragement it has received from the state" with respect to the idea of transferring the kiln from Santa María del Río to La Pedrera.

447. Like the private placement Offering Memorandum, the 1994 10-K claimed that the hazardous waste landfill and inorganic treatment facility was "scheduled to open in the last quarter of 1994"; that Metalclad "believes that the completion of El Confin will enable it to commence hazardous waste treatment and disposal in the fourth quarter of calendar 1994"[343].

The Attempt to Appoint the Auditor to the Claimant's Board of Directors

448. By this time, Metalclad had been discussing with PROFEPA for some months the conduct of an independent audit and as seen above, on August 30th PROFEPA resolved that an audit should be undertaken. Radian Corporacion had been identified as the auditor and its Managing Director, Dr. José Antonio Ortega Rivero, was to oversee the exercise (Dr. Ortega testifies that Radian started preliminary work on the audit in the spring).

449. In August, Metalclad's Daniel Neveau and Javier Guerra offered Dr. Ortega Rivero an appointment to Metalclad's Board of Directors[344].

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342. Exhibit 71, Letter from Grant Kesler to Dr. Medellín, April 25, 1994.

343. Exhibit 10[H], 1994 10K. This representation was also made in the Offering Memorandum at page 3. [Emphasis added]

344. Witness statement of Dr. Antonio Luis Ortega Rivera.

450. Dr. Ortega Rivero declined the offer. His letter to Metalclad dated September 30, 1994 stated:

> "In reference to your kind request of myself to be a member of the Board of Directors of Metalclad Corporation, I would like to thank you for such distinction, but due to the work that I am currently conducting, it is impossible for me to accept such a position; therefore, I have to decline the offer."[345]

451. Dr Ortega Rivero insisted that Mr. Neveau acknowledge receipt of the letter. His witness statement attests to his belief that the signature on the letter is Mr. Neveau's[346].

452. Although Dr. Ortega Rivero declined the offer of a Board appointment, Metalclad announced in its 10-K for the year-end 1994 filed on September 14, 1994, that Dr. Ortega Rivero had joined its Board in August 1994:

> "Jose Antonio Ortega Rivero has been a Director of the Company since August 1994. He has been a consultant with Corporacion Radian S.A. de C.V. , with a focus in the fields of air quality, environmental impact assessment, risk analysis, vehicle and stationary emissions, waste management and environmental services since 1990..."[347]

453. The first sentence of this statement was false[348].

454. The evidence of Federal Attorney Azuela is that Metalclad's attempt to appoint the head of the audit to its Board of Directors was an ill-conceived act. He testifies that the independence of the audit was crucial (the terms of the PROFEPA August 30th resolution expressly referred to the audit being done by an "independent expert") and that both he and Secretary Carabias later relied upon the audit's results when they took the step of negotiating the *convenio de concertación* with COTERIN. Had Dr. Ortega accepted the company's invitation, the entire audit process could have suffered a serious blow to its

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345. Exhibit 6 to Dr Ortega's witness statement.

346. Ibid.

347. Exhibit 10[H] 1994 10K.

348. The company did not correct this statement when it subsequently filed an amended to 10-K. Exhibit 10[L] 1994 10K-A.

credibility[349]. Secretary Carabias testifies that she considers this action to be highly unethical[350].

Further Payments to Interested Directors

455. The 1994 10-K does not indicate any change in corporate policy at the Board level or a decision to abandon the company's original efforts to establish three other waste treatment facilities in Santa María del Río, Veracruz, and Tamaulipas in favor of the COTERIN landfill. However, it is evident that a change in thinking must have occurred. For example, the notes to the consolidated financial statements revealed that the three individuals who were owed money for their consulting contract with ETI before it became ECO-Metalclad (Kesler, Neveau and Robertson) were each paid 60,000 dollars in February 1993 when the company received notification of issuance of the final permit to construct a hazardous waste facility in San Luis Potosí (i.e., the Santa María del Río facility). It went on to say that during the year ended May 31, 1994, one individual received a balance due him of 190,000 dollars and the other two individuals each received 150,000 dollars. The balance owing as at May 31, 1994 (40,000 dollars each) was payable upon completion of construction of the hazardous waste treatment facility. It will be recalled that the balance payable had been conditioned upon commencement of construction at Santa María del Río. Construction never commenced there. Thus Messrs. Kesler, Neveau and Robertson persuaded the company to pay them for commencement of construction at La Pedrera instead[351].

Audit-related Construction

456. By letter dated September 20, 1994, COTERIN informed PROFEPA-SLP that the environmental audit was underway and that it would be necessary to do some maintenance work, including engineering and other work on the evaporation pond, the solidification tank, the neutralization area, the temporary warehouse for solid waste, the laboratory and the cells and the necessary incidental services[352]. COTERIN indicated that it would commence these works shortly if there was no objection from PROFEPA.

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349. Dr Ortega's witness statement.

350. Ibid.

351. Another point of interest is a change in the arrangement concerning Jose Rodriguez. It will be recalled that he was to receive an aggregate of $320,000 and 320,000 shares in Metalclad upon achieving certain benchmarks, namely the commencement of construction and operations that the San Lui Potosí waste treatment facility (i.e., Santa María del Río) and at similar facilities in Veracruz and Tamaultipas. Notes to the financial statement indicated that in October 1993 the agreement was amended to reduce the required payment to $50,000 and 50,000 shares. It appears that this was not contingent upon meeting the benchmarks.

352. Exhibit 84, Letter from COTERIN to PROFEPA-SLP, September 20, 1994.

457. Ironically, there was no need to mislead the federal authorities on the reason for construction of the landfill because INE had in fact issued the necessary federal authorizations.

458. However, far from engaging in "maintenance work," COTERIN began substantial earth moving and building construction.

459. By letter dated October 4, 1994, Dr. Medellín informed federal authorities that he considered that the audit supported the determination of the San Luis Potosí Government that hazardous waste be handled in the best possible way. Dr. Medellín requested that the audit be extended to include places in respect of which there have been complaints of pollution due to products that had been swept away from the transfer station[353].

460. By letter dated October 7, 1994, COTERIN asked PROFEPA to clarify paragraph 6 of the Administrative Resolution issued on August 30, 1994[354].

461. With Metalclad/COTERIN having commenced construction over a month before (in the name of maintenance to the federal authorities, in the name of an environmental audit to the local people, and in the name of constructing and imminent completion of a landfill to its investors), the local residents became concerned that what was supposed to be a partial lifting of the closure order for the audit and the commencement of remediation had been taken by the company as an excuse to construct new works.

462. On October 26, 1994, municipal officials attempted to conduct a verification inspection of the La Pedrera site. The evidence of Mr. Méndez is that the security guards refused them access to the site. They therefore climbed a hill overlooking the site and observed the construction that was underway[355]. They then issued a hand-written order that the landfill site be shut-down on the basis that COTERIN had not obtained a construction permit as required by Articles 2(II), 3, 4, 47(31), 53(II) of the *Ley Organica del Municipio Libre*[356] and Article 115(IV) of the Constitution[357]. The Municipality ordered COTERIN to refrain from performing further construction until it obtained the requisite Municipal permits[358].

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353. Witness statement of Dr. Medellín.

354. Paragraph 6 states: "It is strictly forbidden to introduce any kind of hazardous waste into the facility until the studies are completed and the remedial work is undertaken as provided by the results of the environmental audit established in paragraph 2 of the Technical Measures of consideration III."

355. Witness statement of Hermilo Méndez.

356. Free Municipality Organic Act.

357. See Exhibit 85.

358. Ibid.

463. By the resolution of October 26, 1994, the Municipality also created a representative commission, the *Comisión Popular Ecológica*, to supervise the observance of the stop work order[359].

464. By letter dated October 31, 1994, Dr. Humberto Rodarte Ramón of Ecosistemas del Potosí wrote to Dr. Medellín commenting that, in view of the existing lack of information, and the concern showed by the Guadalcázar Municipal government about the environmental audit and other scientific studies being currently conducted, he urged Dr. Medellín to work together to establish the Oversight Committee that had been proposed before by both the State Government and the company. Dr. Rodarte Ramón believed the Committee should be established with the participation of the "authentic community leaders" of the six communities located within a 10 km. radius of La Pedrera, Municipal, State, and Federal officials, and workers' representatives[360].

The Municipal Permit Issue

465. On November 9, 1994, the PROFEPA-SLP delegate, Lic. Zaragosa Garcia, responded in writing to COTERIN's letter dated September 20, 1994. He wrote:

> "In relation to your letter (dated September 20, 1994) in which you mention the need to construct some works, for example, an evaporation lagoon, a solidification tank, a neutralization area, a temporary storehouse, a storehouse for solids, a laboratory as part of the conditions to conduct the environmental audit and the possible remediation of the site, as a result of the environmental audit, I wish to inform as follows:
>
> This State delegation under my responsibility does not oppose your company conducting construction of the works mentioned above, in 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[361]."

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359. The commission was comprised of the following persons: Cirilo Gerardo Méndez Aguilar, Perfecto Méndez Martínez, Carmen C. Posadas, Valentino Tinoco Martínez, Sergio Alemán González, Carlos Infante Romo, Tomás García Hernández, Fernando Hernández Villanueva, Engrasia Lourdes López, Onareto Cruz, Rafael Mendoza Villanueva, Jaime Leal Romo, Eligio Martínez Montolongo, Hermilo Méndez Aguilar, and Roberto Meta.

360. Witness Statement of Hermilo Mendez.

361. Exhibit 86, Letter from PROFEPA-SLP, November 9, 1994.

466. By letter dated November 14, 1994, in response to COTERIN's letter of October 7, 1994 (requesting clarification of Paragraph 6 of page 9 of PROFEPA-SLP's decision of August 30, 1994 and requesting authorization to operate the hazardous waste disposal landfill upon completion of the environmental audit) the local PROFEPA representative, Mr. Zaragoza, advised Mr. Ariel Miranda Nieto of COTERIN that PROFEPA-SLP had responded as follows:

a) the August 30th decision established that COTERIN shall not operate the landfill until the studies of the situation at the site were completed and the company carried out the remedial works recommended by those studies;

b) the required studies would form part of environmental audit;

c) after the audit, COTERIN and PROFEPA would enter into an accord describing the work to be undertaken for remediation of the site;

d) COTERIN was not entitled to operate or receive waste at the site until it completed the remedial work recommended by the audit and expressed in the accord[362].

467. Mr. Zaragoza concluded by stating:

> "I cannot omit mentioning that the company you represent shall obtain the permits and authorizations that the other State and Municipal authorities are responsible for, within their own jurisdictions."[363]

468. The next day, COTERIN applied to the Municipality for a construction permit, pursuant to Articles 1(IV), 3(IV), 13(XII), 31(XIV), 34, 57(V), 63(I, II) and 64 of the Ecology and Urban Code of San Luis Potosí. The application attached the previous federal and state authorizations and the proposed construction plans (the application also noted that COTERIN's first request for such a permit was made in September, 1991)[364].

Representations to Investors

469. In a prospectus filed with the SEC on November 30, 1994, the Claimant advised:

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362. Exhibit 87, Letter from PROFEPA-SLP to COTERIN, November 14, 1994.

363. Ibid.

364. Exhibit 88, Application for Municipal Construction License, November 15, 1994.

- "Although the company... expects to complete the construction of the hazardous waste landfill at El Confin in the fourth calendar quarter of 1994 and commence landfill operations in the first calendar quarter of 1995, there can be no assurance that the company will be successful in its landfill operations.

- The company believes that it has obtained the support of state and local governmental agencies to operate the facility and has conducted an extensive public awareness and social development plan; however, 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.

- Although the INE has granted unconditional permits to construct and operate El Confin, there can be no assurance that construction or operating permits will be granted for additional sites.

- Although the company has selected sites for El Confin and its other planned facilities in areas where governmental approvals can be obtained, where potential claims from surrounding land owners are anticipated to be minimal, and where public response to a hazardous waste treatment facility is not expected to be unreasonably adverse, there can be no assurance that negative public response would not result in delays, increase costs, or closure of any proposed facility. Because of the lack of facilities in Mexico similar to those proposed to be developed by the company, the company can not predict whether citizens' groups will actively challenge the grant of any license or permit the company may obtain."[365]

470. The Respondent will submit that the claim that the company had obtained the necessary "support of state and local governmental agencies to operate the facility" was unsupportable, given that five months earlier the *Ayuntamiento* had declined the company's offer, one month before the shut-down order had been issued by the municipality, and the State would not support the site unless the local community and authorities consented. The Respondent considers equally that the claim that the company had selected the La Pedrera site (and others) where potential claims from surrounding land

365. Exhibit 10[K] prospectus, November 30, 1994. [Emphasis added.]

owners were anticipated to be minimal and where the public response was "not expected to be unreasonably adverse" was equally unsupportable.

New Federal Officials Appointed

471. On December 1, 1994, Ernesto Zedillo Ponce de León became President of Mexico. In his first official act, the President announced the members of his Cabinet. Julia Carabias Lillo, who had been President of INE during 1994, was appointed Secretary of SEMARNAP. Antonio Azuela de la Cueva was appointed as PROFEPA's Federal Attorney. Gabriel Quadri was appointed President of INE. These officials became responsible for the formulation, administration, enforcement, and permitting of the federal government's environmental law and policy.

The Audit Commences

472. On December 14, 1994, PROFEPA gave its final approval to COTERIN's proposal for the conduct of an environmental audit. PROFEPA confirmed that Radian would be the auditor and that Consultores Técnicos en Impacto Ambiental S.A. de C.V. (Consultores Técnicos) would supervise Radian's work[366]. Preliminary work on the audit commenced immediately.

Financial Arrangements

473. On December 30, 1994, Metalclad consolidated its two loan agreements with CVD Financial Corporation. The modification set out a new payment schedule (which, as shall be seen, Metalclad was unable to meet)[367].

The Attempt to Force the Opening

474. On January 1, 1995, a new municipal government was sworn into office. The new Municipal President was Leonel Ramos Torres. Mr. Ramos testifies that one of the first issues that he confronted during his campaign was the hazardous waste landfill at La Pedrera: there was a very serious ecological problem caused by the hazardous waste that had been inadequately confined, which had spawned the very strong opposition since the early nineteen-nineties[368].

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366. Exhibit 89, Minutes of the meeting of PROFEPA, December 14, 1994.

367. Exhibit 10(L), Modified Loan Payment Agreement.

368. Witness statement of Leonel Ramos.

475. Mr. Ramos contested the presidency against María Concepción Pineda, from the opposing *Partido Auténtico de la Revolución Mexicana*. Ms. Pineda supported the reopening of the landfill[369]. Mr. Ramos testifies that this was an important reason for her defeat.

476. In its 10-Q form filed with the SEC on January 19, 1995 for the period ending November 30, 1994, Metalclad addressed the situation at La Pedrera. Although the audit had just gotten underway and the federal closure order and the municipal shut-down order were still in effect, and even at the federal level nothing would be done to authorize the operation until the audit was completed and an agreement was reached with COTERIN, the Claimant announced to the market that, "Management anticipates that this facility will open in Spring of 1995"[370].

477. One week later, by letter dated January 26, 1995, COTERIN informed PROFEPA-SLP that:

a) the construction of the hazardous waste disposal landfill had been speeded up and was almost 80% complete; and

b) the environmental audit of confinement cells 1, 2, and 3 being conducted by Radian Corporation was continuing as planned[371].

In addition, Mr. Miranda Nieto requested authorization from PROFEPA to commence operations at La Pedrera on March 6, 1995[372].

478. By letter dated January 31, 1995, INE authorized the construction of a cell (cell 4) for final disposal of hazardous waste in response to a request made by COTERIN, pursuant to paragraph 30 of the hazardous waste landfill authorization of 1993[373].

479. By official document dated February 13, 1995, the Secretary of the Municipality of Guadalcázar certified that in the Municipality's book of records at page 02-995, there was an *Ayuntamiento* decision that stated:

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369. Mr. Ramos states that it was a known fact the Ms. Pineda's electoral campaign was supported and financed by Metalclad.

370. Exhibit 10[M] 10-Q for the period ending November 31, 1994 at page 6.

371. Exhibit 90, Letter from COTERIN to PROFEPA-SLP, January 26, 1995.

372. Ibid.

373. Claimant's Exhibit 21.

- That the Municipal President had expressed his view that he was not able to make a decision regarding the hazardous waste landfill on his own, and that the *Ayuntamiento* had expressed its opposition to the opening of the landfill; and

- That the Municipal President proposed that negotiations with these people [Metalclad] would be conducted only in meetings with the *Ayuntamiento*. The proposal was approved[374].

480. The Claimant declares that Metalclad officials met with the State Governor on February 18, 1995[375]. Governor Sánchez Unzueta denies having met with any Metalclad officials on this date[376]. The meeting took place at the *Casa de Gobierno* with Dr. Medellín.

481. On February 28, 1995, Metalclad defaulted on its modified loan agreement with CVD Financial Corporation. It failed to make a principal payment of $100,000 on that date[377].

482. By letter dated March 6, 1995, COTERIN asked INE to authorize removal of the shut-down seals in order to complete the works authorized by the January 27, 1993 construction permit. COTERIN advised that based on the progress of the work completed to date the landfill could begin operating on March 20, 1995 but recognized that the seals would have to removed first. In making this request, COTERIN relied on paragraph III.7 of the authorization issued by INE on January 27, 1993 (i.e., INE approval of the environmental impact statement and authorization to construct and operate a hazardous waste landfill) which stated that the company should advise the federal agency of the date that it intended to commence operations[378].

The March 6th Letter to Shareholders

483. In a Letter to Shareholders on March 6th, the Claimant informed its shareholders of the progress made in the past year and provided a preview of things to come. Metalclad stated that:

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374. Exhibit 91, Resolution of Guadalcázar *Ayuntamiento*, February 13, 1995.

375. Memorial, Chronology at page 8 and paragraph 77 at page 77.

376. Witness statement Governor Horacio Sánchez Unzueta.

377. See Loan Modification Agreement contained as an attachment to the 10-K for the fiscal year ending May 31, 1995 at page 142.

378. Exhibit 92, Letter from COTERIN to INE, March 6, 1995.

"Without a doubt, the most significant event of this past year for Metalclad is the completion of the first state-of-the-art hazardous waste treatment facility and confinement ever built in Mexico. Construction began on May 16, 1994, and while completion was expected in September, several factors delayed the beginning of commercial operations, which began with the assassination of Presidential candidate Donaldo Colosio. After that time, we were asked to proceed slowly, use only local labor, and institute a social development campaign in the local communities surrounding the site in order to ensure rock solid local support. All of this (and more) has now been accomplished and I am happy to say that the project has full political support from President Ernesto Zedillo at the top, who was recently praised by the Mexican Investment Board in recognition of his support of our project, on down to the environmental enforcement agencies of Mexico, the Governor of the State of San Luis Potosí, Governor Horacio Sánchez Unzueta, to the community of Guadalcázar and the micro-communities that surround our site..."[379]

484. The Tribunal will recall that the environmental audit had not been completed. The State Governor had not expressed support and all official actions and statements of the municipality were consistently and resolutely against the site opening. The Respondent will submit that it was false to describe the landfill site as having the full support of the different levels of the Mexican government. Moreover, far from diminishing, while there were some in the local community who supported the project because of the prospect of employment, the overall level of municipal opposition and non-governmental organization opposition was growing. Further, as previously discussed, Metalclad was in the habit of grossly exagerating its relationships with the federal government officials.

485. The March 6th letter to shareholders went on to state that commercial opening of the facility "will be heralded simultaneously by the Governor of San Luis Potosí and several dignitaries in the state, by Federal environmental officials in Mexico City, including members of President Zedillo's cabinet, and by the office of the Mexican Ambassador to the United States in Washington, D.C." and that it was scheduled for March 10th. This was not possible, as the company well knew at the time[380].

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379. Exhibit 93, Metalclad letter to shareholders, March 6, 1995. It is difficult to see how Colosio's death could have affected Metalclad's plans in any way. Colosio was left SEDESOL, to become the PRI presidential candidate. He was assassinated on March 23, 1994, at least two months before Metalclad purportedly began construction. [Emphasis added.]

380. After describing why the facility was unique (i.e., the first facility capable of handling all hazardous waste except those needing incineration, NAFTA's success, that it met and exceeded Mexican environmental standards, etc.), Metalclad addressed other relevant events of last year, inter alia:

- the acquisition of Química Omega on May 1994 and its expansion into five new markets;

486. Earlier in 1995 Metalclad began to organize the "Grand Opening" of the facility. It is not clear when Metalclad first began to publicize this event, but printed invitations began to be circulated to Federal and State officials in February[381]. The invitation stated:

> "Metalclad Corporation and its subsidiaries in Mexico... announces the opening of El Confin, Industrial Confinement and Integrated Treatment of Hazardous Waste, at "La Pedrera", Municipality of Guadalcázar, in the State of San Luis Potosí."[382]

487. The Claimant alleges that the Grand Opening was scaled back to a "facilities tour" because of the opposition of Dr. Medellín[383]. It is true that Dr. Medellín was opposed to the ceremony because none of the concerns raised by the State Government had been resolved[384]. More importantly, when Metalclad began circulating invitations in Washington

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- a contract with Cruz Azul Cement Company to become its exclusive supplier of alternate fuels for burning (Cruz Azul pays up to 50% of normal fuel cost for waste oils);

- an agreement with Dillon, Read and Company of New York to aid them in the creation of a joint venture with a Mexican company to establish a hazardous waste incinerator; and

- the completion of a securities private placement with a group of institutional investors in Europe, with the assistance of Oakes, Fitzwilliams & Co., members of the London Stock Exchange.

For the following year, Metalclad predicted, inter alia:

- that the investment banking community would discover the Company and would recognize its achievements in Mexico;

- the selection of additional landfills;

- that it would improve its balance sheet through the conversion of debt to equity; and

- the predictability and reliability of their earning forecasts would attract the industry analysts' interest.

The letter closed with a note of appreciation to those who delay after delay had supported the company in the past years, as it has "worked itself through the Mexican political system. The basis for future growth will be the excellent Mexican personnel the company has attracted and its reputation for quality and integrity". The letter was signed by Grant S. Kesler, President.

381. Witness statement of Dr. Medellín.

382. Exhibit 94, Invitation to Grand Opening Ceremony.

383. Memorial: Chronology, at page 9; paragraph 28, at page 58; and Declaration of Grant Kesler at page 10.

384. Witness statement of Pedro Medellín.

D.C., Mr. Raúl Urteaga of the NAFTA Office at the Embassy of Mexico in Washington instructed it not to hold the ceremony. His letter of March 8, 1995 stated:

> "Dear Mr. Kesler,
>
> We have been informed today that the authorization to operate the Metalclad facility in San Luis Potosí is still pending of approval. We received notification of this from the Representative in Washington of the Secretary of Environment, Natural Resources and Fisheries of Mexico.
>
> Accordingly, it would be premature to make the public announcement of the Metalclad opening before this matter is resolved by the Attorney General Office for the Protection of the Environment (PROFEPA).
>
> Please contact me as soon as possible to discuss this matter further and to see what steps can be taken to resolve this issue."[385]

488. In light of Federal and State objections, therefore, Metalclad held its scaled-down "facilities tour" at the landfill site (the Mexican Embassy's letter also makes it clear that contrary to Mr. Neveau's earlier claim to the Governor, the Embassy was not pushing for a public relations exercise in connection with the landfill).

489. On March 9, 1995, the Metalclad subsidiary Ecosistemas del Potosí (ECOPSA) published an advertisement in the local newspaper *El Heraldo*, stating that :

- The prior conditions of La Pedrera did not represent safety. However, applying the most advanced technology existing in the world for the treatment and disposal of industrial waste, it now complied with the environmental rules and provisions established in the Mexican federal and state laws;
- The Guadalcázar landfill is the first in Latin America to use this advanced technology, and it will set a precedent so that Mexico and some other countries will have adequate sites for the disposal of industrial waste;
- The construction of the facilities incorporates the latest technological advances for the treatment of industrial waste, according to standards and guidelines that have been established worldwide applying U.S. technology.

490. It went on to provide a description of the facility's technology:

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385. Exhibit 95, Letter from Mr. Urteaga of the Mexican Embassy in the United States to Mr. Grant S. Kesler, March 8, 1995.

- el Confin will not receive industrial waste until it submits to the State Government the results of the audit that was supervised by PROFEPA, and that will guide the operation and remediation;

- both [the remediation and operation] have passed approval phases, and ECOPSA expects to comply with the last state requirements within the following weeks, and thus obtain the State Government's approval;

- the opening ceremony scheduled for next Friday [March 10, 1995] will basically consist of a guided tour in order to present the facilities and the new security and processing systems to the different sectors of the public opinion.

The Failed Grand Opening

491. The Claimant has alleged that:

> "... having substantially completed construction, and with the Governor's public statement of support [in reference to the May 27, 1994 agreement]... [t]he Company issued 300 invitations to an opening ceremony to be held on March 10, 1995. (The actual invitation was approved by Medellín Milan before any were sent, in keeping with the agreement between the Governor and the Company that anything "public" by the Company would be reviewed and approved.) Invitees included: major investors from Great Britain, Europe and the United States; Mexican Federal officials; United States Ambassador; the Governor of San Luis Potosí and members of his administration, including Medellín Milan; the President of the Municipality of Guadalcazar; and various local residents, workers and ejido leaders."[386]

492. The Tribunal will recall that the Dr. Medellín's letter of May 26, 1994 expressly provided that the decision to approve a landfill in La Pedrera was conditioned upon satisfying State and municipal authorities that the facility could operate with high safety standards and the community accepting its operation.

493. Dr. Medellín denies that he approved the invitations prior to their being sent. In fact, Dr. Medellín testifies that he was not aware of the "opening" (or that Metalclad was preparing invitations) until he received an invitation a few days prior to March 10, 1995. Moreover, contrary to the Claimant's contention, Governor Sánchez Unzueta and the Municipal President, Leonel Ramos, testifies that they did not receive an invitation. Governor Sánchez Unzueta learned of the "grand opening" through Dr. Medellín, after he informed the Governor that he had received an invitation. Mr. Ramos testifies that he

386. Memorial, paragraph 86, at page 81.

learned of the "opening" on the morning that it occurred, when he was informed that residents of the municipality were demonstrating against the landfill and had blocked the road leading to La Pedrera[387].

494. Metalclad's Chronology alleges that the event was attended by "dignitaries from England, Mexico, Europe, and the U.S., including a member of the U.S. Embassy in Mexico, Antonio Azuela de la Cueva of PROFEPA and others"[388]. The Respondent is unable to provide any independent proof as to who attended. However, as Mr. Azuela testified in his witness statement, contrary to the claim in the Memorial, he did *not* attend, and he instructed PROFEPA officials not to attend. In fact, Mr. Azuela has never been to La Pedrera or even to Guadalcázar[389]. Secretary Carabias did not attend either[390]. Mr. Azuela states that he was surprised by the invitation, because the site was still subject to a closure order (the Tribunal will recall that the closure had partially been lifted only to allow the audit to be conducted); there was not yet a plan for remediation; and federal authorities were well aware that the State and Municipal Governments continued to oppose the reopening of the site.

495. The Claimant characterizes the March 10, 1995 events as follows:

> "On March 10, after the Company's guests had participated in the day's festivities, more that 100 paid protestors from outside the local communities arrived at the landfill driven by San Luis Potosi state police in San Luis Potosi-owned vehicles. Most of the demonstrators were intoxicated, many had guns. The demonstrators intimidated those trying to leave the landfill shouting. "Out gringos!" and blocked the exit with vehicles and bodies, denying egress to the Company's guests. For more that three hours, dignitaries from England, Mexico, Europe and the United States and other guests were also held hostage in their buses. During this period, a pick-up with a San Luis Potosi ensignia on its doors arrived, its bed laden with beer and soda for the demonstrators. Company officials and others feared violence when local residents in attendence as Company guests, confronted the demonstrators. Company representatives avoided violence, however, when they persuaded the local residents to withdraw from the confrontation. Four uniformed

387. Witness Statement of Mr. Leonel Ramos.

388. Memorial at page 9 paragraph 29 at page 58 of the Memorial, the Claimants asserts that "other government officials [were] trapped in their buses for almost three and one-half hours".

389. Witness statement of Antonio Azuela.

390. Witness statement of Secretary Carabias.

state policemen stood at the outer perimeter of the mob, neither saying nor doing anything."[391]

496. Metalclad has alleged, without evidence, that Dr. Medellín and Mr. Leonel Ramos organized the protest using organized professional demonstrators[392]. Both Dr. Medellín and Mr. Ramos deny the allegation[393]. Moreover, the evidence of Leonel Ramos, Dr. Angelina Núñez and Hermilo Méndez directly contradicts this claim.

497. Their evidence is that the local residents did not know of the event until the morning of March 10th. Mr. Méndez testifies that the media arrived in Guadalcázar and began to interview citizens on their views about the landfill's opening. Word of the event spread quickly and, far from being organized from the City of San Luis Potosí, there was a spontaneous groundswell of opposition and people made their way to the site. Mr. Méndez was among the protestors. When they got to the site, some of the "guests" had already arrived. They blocked the road to La Pedrera, so that no vehicles or people could enter or exit. He has reviewed the videotape adduced by Metalclad and can identify many of the protesters by name and residence.

498. He categorically rejects the claim that the protestors were bused in from outside the municipality. The protestors made their way to the site on their own means of transportation. He testifies that they learned about the opening of the landfill through the newspaper; at that time, we organzied ourselves and notified other communities and continued with our organizing in order to prevent the opening. We stopped the traffic and, as a result, we denied trucks and busses carrying food, drinks, mariachis and guests entrance to the landfill site: "[W]e did not receive any support from the State or municipal government."

499. He also denies that some of the protestors were drunk[394]. He testifies that the only food and drink came in a vehicle headed for the site, but arrived after the protestors, and

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391. Memorial, paragraph 89 at page 83; also, paragraph 29, at page 58.

392. At page 58 of its Memorial, the Claimant asserts without evidence: "The day before [March 10, 1995], however, Medellín Milan met with municipal officials to whom he reportedly said, 'There will be no state officials present. Do what you have to do'. At Medellín Milan's urging, the municipal leaders organized a groupto demonstrate at the landfill site". At page 82 it further asserts, again withour evidence: "Claimant is informed and believes that Medellín Milan then met with the Municipal President of Guadalcázar, whom Medellín Milan informed that since no one from the state government would be there, the Municipal President should 'do what needs to be done.' What followed was the organizing of a demonstration at the landfill site on March 10, 1995."

393. Witness statement of Dr. Medellín and witness statement of Leonel Ramos.

394. Witness statement of Mr. Hermilo Méndez.

could not get through to the landfill. However, none of the protestors consumed any of the food and drink[395].

500. Mr. Méndez categorically rejects that any of the protestors were armed. In fact, many of them, and the most active, were women. The demonstration was conducted peacefully. The video presented by the Claimant as evidence corroborates this[396]. The people demanded to speak to Humberto Rodarte Ramón, who was on one of the buses, but Dr. Rodarte Ramón apparently refused to meet them.

501. Leonel Ramos testifies that he arrived late in the afternoon. He testifies that he observed an authentic demonstration by the local community to express its disagreement with the reopening of the landfill. He denies that the people had been "bused in" or paid to protest. He states that the protestors got to the site in privately owned vehicles, and that there were no buses from the State Government. The only buses and trucks at the site were those used by the company to transport their guests, food and drink, musicians, etc. Mr. Ramos denies that the protesters were either armed or intoxicated. The demonstration was ultimately dissolved by Mr. Ramos[397]

502. Dr. Núñez testifies that she learned of the incident on the morning that it occurred but remained in San Luis Potosí City to express her organization's concerns to Dr. Medellín while others travelled to spread the word in the *ejidos*. She also did not know of the planned "Grand Opening". She has reviewed the videotape that Metalclad has submitted as evidence and can identify many local residents by name. She also testifies that the tape combines two different demonstrations, the March 10th one, which she missed, and one held six days later[398].

503. The Respondent categorically rejects the Claimant's characterization of the protest. The independent contemporaneous evidence is that the demonstration (known as a "*manifestación*") was peaceful, that the protestors did indeed block the entrance to the site, but that they conducted themselves appropriately in the circumstances. Moreover, the video of that day's events offered by the Claimant as evidence shows precisely that. Indeed, Metalclad itself subsequently acknowledged that its decision to hold a "grand opening" was in error. In an internal memorandum, Ecosistemas del Potosí admitted that because of:

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395. Mr. Méndez testifies that food and drink and a band of musicians and other guests all arrived after the protesters, and could not get through either.

396. The protestors were shouting "vendido" at Dr. Rodarte Ramon. This word means "sold", meaning that Dr. Rodarte Ramon had sold himself to Metalclad. The Claimant asserts they were crying "damned" to Dr. Rodarte.

397. Witness statement of Mr. Leonel Ramos.

398. Witness statement of Dr Angelina Núñez.

"... an error of calculation, the company sent printed invitations that read 'Opening and Commencement of Operations.' When it realized that it was not going to be possible to have the results of the studies on time, it informed Pedro Medellín and the media that it was only going to be a facilities tour for a few outside guests."[399]

504. However, notwithstanding the objections of the federal and State authorities, Metalclad's public acknowledgement on March 9th that it had not yet complied with all of the State level requirements, and that it did not have the State Government's approval; the Claimant's assertion that it recast the event as a "Facilities Tour"; and, more importantly, the events that took place on March 10, Metalclad announced through a paid advertisement published in *El Heraldo* on March 11 the beginning of operations at El Confin:

"El Confin, Industrial Landfill and Integral Treatment of Controlled Waste, commenced operations yesterday. Tony Good (sic)[400] headed the shareholder's group that attended a tour of El Confin in order to show the technology and the materials to be used in the treatment and final disposal of industrial waste, and the safety and security systems to avoid affecting the inhabitants of the nearby towns.

ECONSA has invested a total of 20 million dollars and just yesterday it concluded training 80 persons that will be the initial labor base, and that will grow as the number of clients of the enterprise that treats industrial waste increases.

According to Humberto Rodarte Ramón, El Confin has a capacity to treat 36 thousand tons of industrial waste a year, and in San Luis Potosí 6 thousand are produced every month. 15 thousand tons of waste are registered in the country every day, an equivalent of 7 million tons a year.

Care has been taken of all details at El Confin, from the protection of the men that work in the cells, to the executives, medical attention, salaries, etc.

Yesterday, when operations began at El Confin, attendants toured the 10 thousand 96 square meters of the facilities' surface, whose total area is 814 hectares.

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399. Memorial.

400. This appears to be a misspelling of the name of the Claimant's employee Mr. Tony Wood.

> El Confín has construction and operation permit number 000456 issued by the National Institute of Ecology on May 11, 1993, and this is known by the General Direction of Regulations of the federal government.
>
> It also has the state land use license number GDZAR 301/93 issued by the Secretariat of Urban Development and Ecology of the state Government on May 11, 1993.
>
> Foreign invitees that attended the El Confín's facilities toured the facilities under a fierce sun and harsh cold wind, they had to walk among rivers of dust, but could observe closely the technology that will be applied in the treatment and final disposal of industrial waste."[401]

505. On March 13, 1995, Greenpeace, through Fernando Bejarano, established its first communication with Metalclad[402]. Mr. Bejarano contacted Mr. Ariel Miranda Nieto and requested that COTERIN allow representatives of Greenpeace, Pro San Luis Ecológico, the municipal authorities and the community to visit the site. Mr. Miranda responded on March 15th that the facilities could be visited the following day.

506. Contrary to Metalclad's contention that there was no major local opposition, Mr. Bejarano testifies that he found a well organized community that opposed the landfill. On March 16th, some 200 to 300 persons gathered at the landfill's entrance. However, Metalclad employees allowed only a few people to enter the site, including Dr. Núñez, Hermilo Méndez, and Fernando Bejarano. After touring the facilities, Dr. Núñez addressed the crowd just outside the landfill. It is Dr. Núñez' voice that is heard over the loudspeaker at the end of the tape urging the protestors to disband. Dr. Núñez and Mr. Bejerano testify that the protest that they attended was peaceful, that there were no armed persons and there was no sign of drunkenness or disorderly conduct. They cannot attest firsthand to the first protest but their understanding is that it too was entirely peaceful[403].

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401. Exhibit 96, Metalclad advertisement in *El Heraldo*, March 11, 1995.

402. The Claimant has alleged that during 1992, the agitation against the Aldretts and the landfill continued with a disproportionate and active involvement by Greenpeace Mexico (Declaration of Humberto Rodarte Ramón). Mr. Bejarano testifies that Greenpeace did not get involved in this issue until March 1995. He states that, although Dr. Angelina Núñez had raised the issue of the landfill with Greenpeace, it did not get involved immediately. In fact, Pro San Luis Ecológico itself was established in the latter half of 1993 (witness statements of Fernando Bejarano and Dr. Angelina Núñez).

403. Ibid.

507. Twelve days later, by letter dated March 22nd to SEMARNAP Secretary Julia Carabias, the *Ayuntamiento* requested that the decision of the Municipality to oppose the hazardous waste landfill be respected. The letter stated in part:

> "By these means, the community of Guadalcázar respectfully addresses you to inform you about the problem that we have had for approximately 5 years, and in which we have not been listened to for the solution of the same, nor any consideration has been given to the demands of the people. First of all, we are [a] united Municipality ready to defend our rights and autonomy, and thus we request that you hear us this time and that this sinister issue finish once and for all."[404]

The Completion of the Audit

508. At the end of March, the environmental audit of the site was completed. The report, comprising 42 pages plus annexes, was divided into five sections: Summary, Report, Action Plan, Required Investment and Annexes. The summary stated:

> "The audit consists of a comprehensive analysis of the activities and the infrastructure (of the site) for the purpose of reviewing the observance of environmental provisions and unrelated aspects, by conducting a study of the current situation, control procedures, maintenance, operation, labor capacity and emergency response... The *Resumen Ejecutivo*[405] was submitted pursuant to the results of the audit, containing the relevant issues and the measures to follow considering the current situation of the company."[406]

509. By letter dated March 28, 1995, PROFEPA provided COTERIN with a summary of the audit. COTERIN was instructed to prepare a plan and timetable of works and activities to correct irregularities found in the audit[407]. The letter stated that the plan would be analyzed by federal government officials whose requirements COTERIN would be required to incorporate in the plan. PROFEPA itself concluded its review of the environmental audit on March 28, 1995 and made the following findings. The audit concluded that:

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404. Exhibit 97, Letter from Guadalcazar Ayuntamiento to Secretary Carabias, March 22, 1995.

405. Exhibit 98 Executive Summary of Environmental Audit.

406. Ibid.

407. Exhibit 99, Letter from PROFEPA to COTERIN, March 28, 1995.

a) the site was technically suitable for a hazardous waste landfill;

b) however, several irregularities were observed, *inter alia*:

i) the waste deposited in the cells was not stored in the manner prescribed by the environmental technical standards and there was no proper supervision or follow-up of contaminating effects;

ii) there was contamination, consisting principally of oil, of the earth beneath the cells;

iii) the risk of explosion was 100 percent in the three cells;

iv) the three cells were 150 meters away from a stream, contrary to the minimum requirement of 500 meters;

v) the cells were constructed on an incline of less than 5 percent which could result in drainage problems;

vi) the company did not have an inventory of the kinds of waste stored or the location of various kinds of waste in the cells which increases the risk of chemical reaction.

c) COTERIN did not have an emergency plan;

d) the landfill was constructed without federal, state and local permits [check]; and

e) the construction was not in accordance with technical regulations and legal specifications for proper handling of toxic waste.

510. The Tribunal will see that the audit generated findings that were seized upon by the proponent and opponents. The Claimant would issue a press release declaring that the audit had given the site an endorsement. The opponents seized on the findings of environmental damage, COTERIN's failure to comply with the law and norms, and the risk of explosion.

Continued Municipal Opposition

511. By letter dated March 31, 1995, the officials of the Guadalcázar Municipality communicated to Governor Sánchez Unzueta their total opposition to the re-opening of the site because of concerns that it would threaten the health of the residents of

Guadalcázar. This decision was taken upon the unanimous vote of the *Ayuntamiento* in session on March 31, 1995[408].

512. In March, the Claimant once again failed to make a principal payment to CVD Financial Corporation[409].

The Alleged Contemplation of a Bribe

513. Metalclad has alleged that on April 2, 1995 it terminated its retainer with Bufete de la Garza when it learned of undisclosed conflicts of interest that the firm had as between Metalclad and the Governor and Dr. Medellín.[410] Dr. Rodarte Ramón (but not Mr. Kesler) alleges that the law firm also suggested bribing the Governor in order to "convince" him[411].

514. The evidence of Mr. de la Garza is that the firm did not have the conflicts alleged against it. Moreover, Mr. de la Garza's evidence contradicts that of Dr. Rodarte Ramón. Mr. de la Garza testifies that on April 28, 1995, during a meeting at the offices of Bufete de la Garza, attended by Messrs. Kesler, Neveau, Rodarte Ramón, García Leos and himself, Mr. Kesler asked Mr. de la Garza to step into the latter's office to discuss a confidential matter. Mr. Kesler told him that he and his family had already suffered a loss of approximately 12 million dollars because of the project's delay and, was, therefore, considering offering Governor Sánchez Unzueta 1 million dollars, through Mr. de la Garza, in exchange for the authorizations to operate the landfill. Mr. de la Garza testifies that he was very surprised and disappointed by Mr. Kesler's request; that it was a complete lack of respect to his level of professionalism and the work that had been put into solving the problem for over a year. Mr. de la Garza told Mr. Kesler that he was terminating their relationship.

515. The following day Mr. de la Garza wrote to Governor Sánchez Unzueta and Pedro Medellín advising them that he had terminated the relationship with Metalclad due to ethical differences[412].

516. The Respondent will submit in argument that Mr. de la Garza's evidence is to be preferred over that of Dr. Rodarte Ramón. The Tribunal will recall that Metalclad had

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408. Exhibit 100, Letter from Guadalcazar Ayuntamiento to Governor, March 31, 1995.

409. See Loan Modification Agreement contained as an attachment to the 10-K for the fiscal year ending May 31, 1995 at page 142. [Exhibit 10(E) intro]

410. Memorial at paragraph 93.

411. Witness statement of Dr. Rodarte Ramón at page 7.

412. Exhibit 101, Letter from Lic. de la Garza to Governor Sanchez Unzueta, April 29, 1995.

been telling its investors that the site was scheduled to be opened on March 10th. The demonstration showed the strength of the local opposition to the site ever opening. At the end of March, for the third time in three months, Metalclad failed to meet the payment schedule on its debt to CVD Financial Corporation. Around the time that its relationship with its legal counsel was terminated the company completely defaulted on its loan from CVD. The company, it will be recalled, had pledged all of its assets to secure the 3 million dollar loan.

517. The Respondent will submit that due to its lack of financial resources and its representations to investors, the Company's situation was desperate and it had to get its operation going in order to satisfy its investors. Its earlier attempt to influence the course of the environmental audit showed that the company would resort to inappropriate behavior to achieve its objectives.

518. The Respondent points out that Mr. de la Garza's testimony is buttressed by that of Governor Sánchez Unzueta. He testifies that having learned of the attempted bribe, when his State was subsequently being threatened with "blacklisting" by U.S. Ambassador James Jones, he provided the ambassador with a document in which he itemized Metalclad's inappropriate activities, including the suggested payment[413].

519. The Claimant's contention is further contradicted by a jointly signed letter dated April 28, 1995, in which Mr. Kesler and Mr. Neveau purportedly terminated the relationship, because Metalclad "required a service that could resolve their needs in a timely and efficient manner, and that it was obvious that Bufete de la Garza and [Mr. de la Garza] himself were too busy to adequately respond to our needs"[414].

The Audit of the Audit

520. On April 10th, Federal Attorney for the Environment Azuela met with representatives of Greenpeace Mexico to discuss the results of the audit and the authorities' intention to have "an audit of the audit"[415].

521. On April 15th, Metalclad failed to repay the entire unpaid balance of the CVD Financial Corporation Loan at its maturity[416].

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413. Witness statement of Mr. Sánchez Unzueta.

414. Witness statement of José Mario de la Garza.

415. Witness Statement of Antonio Azuela.

416. Ibid.

522. In a press release dated May 2, 1995, Metalclad and its Mexican subsidiaries announced that the geo-hydrological and geological studies and results of the environmental audit had been made public and were available from PROFEPA, INE and the company. The studies completed the environmental and risk studies filed in order to comply with the applicable regulations and obtain state and federal authorizations. The studies demonstrated that:

a) there was no underground water at La Pedrera;

b) the site was not a seismic zone;

c) there were no underground caverns;

d) the geological conditions were more than adequate for the establishment and operation of a hazardous waste landfill facility;

e) the site conditions and engineering construction and operation techniques, which exceeded Mexican standards, assured no environmental contamination or risk to the public's health[417].

523. The announcement, which appeared in the Mexico City newspaper, *Reforma*, was made by Salomón Leyva of Ecosistemas del Potosí[418].

524. By letter dated May 12, 1995, the Claimant's investment bankers, Oakes Fitzwilliams & Co., wrote to Mr. Kesler complaining about the landfill's failure to open[419].

525. In an internal memorandum dated May 24, 1995, PROFEPA considered the various alternatives for addressing the Guadalcázar problem. The memorandum's introduction recounted the site's history and reviewed the proponents and opponents:

> "In favor of the landfill were [former] Governor Teófilo Torres Corzo (who granted the land-use permit) and the State Congress which issued a favorable report in 1992. To date, Governor Horacio Sánchez Unzueta and the Congress have not publicly expressed opposition to the project. However, there is evidence of the favorable opinion from the Governor and the President of the Ecological Committee of the Congress, Lic. Juan Acosta; thus, on June 11, 1993 the Governor wrote a letter to the President of the

417. Exhibit 102 Metalclad Press Release, May 2, 1995

418. Ibid.

419. Exhibit 103 Letter of from Herbert Oakes, Jr. to Grant Kesler, May 12, 1995

Company... informing him that pursuant to the State Development Plan 1993-1997, the need for the establishment of a hazardous waste landfill and thermal treatment facility [was] recognized..."[420]

526. It noted further that those against the re-opening of the landfill were the previous PAN municipal government and the current PRI municipal government, the municipalities of the region, the Mexican Ecology Party, the PAN, Greenpeace, Pro-San Luis Ecológico, the *ejidatarios* and the Guadalcázar community. The press had reflected predominantly the sentiment of the different sectors that opposed the landfill.

527. In the "Analysis and Solutions" section of the memorandum, PROFEPA noted that:

"From the legal and technical perspective, the construction of the landfill is considered suitable. Thus, the company has obtained the federal and state authorizations and is only missing the construction license (municipal jurisdiction)..."[421]

528. It then stated that those opposing the operation of the landfill had never demonstrated that it was technically unsuitable. However, the construction and operation undertaken by COTERIN had violated applicable environmental regulations, as shown by the verification inspections of August 20 and September 25, 1991:

"Similarly, the environmental audit found serious violations with regard to the operation of the three storage wells, which do not comply with the standards established by the environmental regulations, as there is risk of explosion and pollution of the deep phreatic stratum. In addition [the audit] showed contamination of the soil by heavy metals and oils.

Under these conditions, from a legal and technical perspective, there are two options:

(1) Re-opening the landfill; or

(2) Closing it for good.

[...] reopening the landfill would imply the opposition of environmental groups and residents of the surrounding communities. The municipal authority would surely support any local activity undertaken against the operation of the hazardous

420. Exhibit 104, PROFEPA internal memorandum, May 24, 1995

421. Exhibit 104, at pages 5-6.

waste landfill. It must be noted, that the political parties with some influence in the locality such as PAN, PEM and even PRI have taken the opposition sentiment against the operation of the landfill as a [political] banner. That the municipality has in its favor, the lack of construction license, should not be forgotten."[422]

529. The section then discussed the permanent closure of the landfill. It noted that this operation would be justified based on the violations of the environmental regulations found in the August 20, 1991 and September 25, 1991 verifications visits.

530. It stated further:

a) the re-opening of the landfill could be justified by the geo-hydrological conditions of the site;

b) the landfill could be re-opened through an accord with the company or through an administrative resolution of the federal authorities;

c) the problem with the latter option is that the company is currently shut down by the municipality because it lacks a construction license and if the local closure remains and the license is not issued, the landfill could not operate. This would cause a conflict between the company and the municipality. It should be noted that the federal authorizations are issued without prejudice to the local authorizations.

d) the landfill could be shut down permanently through action by PROFEPA or INE; and

e) although the company could take an *amparo* against such action, the federal authorities would prevail as a result of the various violations of environmental regulations that were found to have occurred.[423]

531. Finally, the memorandum suggested suspending the signing of an accord with the company until the landfill situation and PROFEPA's course of action were defined.

Apparent Link to RIMSA

532. Dr. Núñez testifies that she believes that during this time Metalclad attempted to create the impression that her organization was collaborating with Residuso Industriales Multiquím, S.A. de C.V. (RIMSA), the company that owns and operates the landfill in

422. Ibid.

423. Ibid.

Nuevo León. She testifies that she did not know anybody from RIMSA nor had she ever had any contact with that company before she received an unsolicited letter from RIMSA[424].

533. Dr. Núñez testifies that in May she received a letter from RIMSA thanking her for information on the controversy but reserving all rights to take legal action against Metalclad.

534. Dr. Núñez testifies that she had never sent any correspondence to RIMSA, nor did she believe had any one from her organization.

535. By letter dated May 25, 1995, she informed Mr. Américo Montemayor, Public Relations Director of RIMSA, that Pro San Luis Ecológico had never sent any correspondence to RIMSA. In fact, she wrote, they did not have RIMSA's address until they received its letter dated May 18, 1995 acknowledging receipt of information on behalf of Pro San Luis Ecológico. Dr. Núñez requested a copy of the note or letter that had apparently been sent on their behalf, including the newspaper articles, as she believed someone "was putting up a filthy war against them"[425].

536. Attached to her witness statement is the exchange of correspondence with RIMSA. The Tribunal will see that the letter purportedly sent on behalf of Pro San Luis Ecológico that led RIMSA to reply, was not on the NGO's letterhead, nor had it been signed[426].

The Claimant Resorts to Congressional Pressure

537. On May 31st, Metalclad executed a Loan Modification Agreement with CVD Financial Corporation. Of the original principal amount of 3,025,000 dollars there remained an unpaid principal balance of 2,675,000 dollars and accrued and unpaid interest of 109,988.33 dollars for the period ending April 30, 1995.[427]

538. On the same date, May 31st, Mr. Kesler wrote to United States Senator Bill Bradley and Congressman Brian Bilbray (a copy of the letter addressed to Mr. Bilbray was received by Representative Christopher Cox on June 6) asking them to intervene on the company's behalf and to write President Zedillo, Secretary Carabias, Governor Sánchez

424. Witness statement of Dr Angelina Núñez.

425. Ibid.

426. Ibid.

427. The modification agreement extended the maturity date of the loan to June 30, 1996 and made certain changes to the relationship.

Unzueta, Ambassador Jones, and Mexican Ambassador Silva Herzog[428]. Mr. Kesler also informed the Mexican Embassy's Mr. Urteaga that the company's intention was "to send a similar letter to eight senators and 32 congressmen that we believe could help us"[429].

539. In the letter to Senator Bradley, Mr. Kesler represented that:

(1) "We have permitted and constructed a $20 million hazardous waste treatment facility";

(2) the facility can "[h]andle up to 250,000 tons of hazardous waste a year" [in fact, it was then permitted by the federal authorities to handle 43,200 tons a year];

(3) the Company had "obeyed all federal, state and local laws, invested $20 million, obtained all proper permits, and in every way acted in good faith to provide environmental infrastructure to Mexico";

(4) "Governor Horatio Sánchez Unzueta offered his support initially, in writing, before construction began. His unwillingness to give his support now is difficult to understand."

Public Consultation

540. While Metalclad sought to reorganize its finances and began to enlist the support of U.S. legislators, the "audit of the audit" process continued. On June 6th Antonio Azuela hosted a meeting of the outside technical experts and Greenpeace and Pro San Luis Ecológico.

541. By letter dated the following day, Rafaél González Franco of Greenpeace Mexico requested Secretary Carabias not to end the discussion and public consultation regarding the Guadalcázar landfill's audit results after only one technical meeting, between PROFEPA and Greenpeace and Pro San Luis Ecológico. Greenpeace noted that this first meeting was convened after a previous meeting with the Federal Attorney for the Environment on April 10, 1995, where he committed to open discussions and analysis of the environmental audit results. Greenpeace stated that:

a) it did not receive all the necessary information it was promised in preparation for the June 6 meeting;

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428. Exhibit 105, Letter from Kesler to Bradley, May 31, 1995.

429. Exhibit 106, Letter from Grant Kesler to Raul Urteaga.

b) it was just recently informed that it could review at INE the information it was missing beginning June 11, 1995;

c) neither the Guadalcázar Municipality, its advisors, nor the State authorities had received the Remedial Plan to clean and treat the 20,000 tons of hazardous waste remaining in La Pedrera;

d) the commission established by the UASLP and the Geology Institute of UNAM [the Autonomous University of Mexico] did not attend the meeting as was proposed by Greenpeace; and

e) in addition to the geo-hydrologic problems of the site, there remained other problems that had not been addressed, such as the threat to flora and fauna of the region, or the effects on the health of former employees (only three employees of a total of 22 handling waste and 70 working at the site were considered)[430].

542. Greenpeace argued that it would be bad precedent to conclude the public review and suggested opening the discussions to include the remedial plan, the definition of the site, and the technology to be used in the landfill that Metalclad sought to establish. Greenpeace would submit its report to the authorities as soon as it was able to gather all the information[431].

543. On June 8, 1995, Brian E. Hand, Managing Director of First Analysis Corporation (FCA), informed United States Senator Paul Simon that its venture capital funds were significant shareholders in Metalclad, because they had invested $2 million dollars in Química Omega, which had subsequently been acquired by Metalclad. FCA requested Senator Simon's help and support in resolving the problem of the delayed opening of the landfill.

544. In response to FCA's letter, on June 16, 1995, Senator Paul Simon requested Mexico's Ambassador Silva Herzog to use his office to expedite the opening of Metalclad's hazardous waste landfill. Senator Simon explained he was aware of the situation faced by Metalclad, a company with significant Illinois ownership. He understood that Metalclad had invested twenty million dollars in developing the site[432]; that it had received all of the necessary Mexican permits[433]; that the facility met or exceeded all national and international standards; that it had received broad support from the academic

430. Exhibit 107, Letter from Greenpeace Mexico to Secretary Carabias.

431. Ibid.

432. Exhibit 108, Letter from Senator Simon to Ambassador Silva Herzog. This sum was six times greater than the sum that the company's auditor had permitted the company to capitalize.

433. This was denied by the company's auditor.

and environmental leadership in Mexico[434]; and it was a good thing for Mexico, but that Governor Sánchez Unzueta had delayed giving approval for it to open and this was costing the company thousands of dollars daily of lost revenue.

545. Also on June 16, 1995, a public advertisement addressed to SEMARNAP Secretary Carabias was published in *El Pulso*, in which several public and social organizations warned her against opening the landfill. They requested instead the urgent application of the remedial plan to treat the waste buried at the site. They also claimed that the environmental audit report was incomplete and the studies were too preliminary and partial to evaluate the risk that the site posed to the environment and the health of the community[435].

546. By letter dated June 19, 1995, representatives of the Partido Verde Ecologista de Mexico[436] ("the Green Party"), informed SEMARNAP Secretary Carabias of their visit to the La Pedrera facility. The letter stated that the Green Party reached an agreement with the community not to allow the facility to operate. After addressing several of the technical problems of the facility, and concluding that the environmental audit was only a partial and initial study to assess the condition of the site, the letter ended with the demand that:

a) the closure order not be removed;

b) the company commit to complying with the remedial project;

c) the INE authorization to operate be revoked and a total closure order issued;

d) a geologic study of the country be done to find the best sites to establish hazardous waste landfills;

e) programs and methods of cleaning up the contaminated properties without risk to the community be established;

f) the federal government agencies commit themselves not to authorize the opening of the hazardous waste landfill[437].

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434. This was questionable in light of the division of opinion in those circles.

435. Exhibit 109. Open Letter Secretary Carabias published in *El Pulso*, June 15, 1996.

436. Green Ecologist Party of Mexico.

437. Exhibit 110, Letter from Green Party to Secretary Carabias, June 19, 1995.

547. By letter dated June 21, 1995 United States Senator Barbara Boxer requested that Ambassador Silva Herzog look into the matter of La Pedrera. Senator Boxer stated that after obtaining all required permits and meeting Mexican, United States and international standards for construction and operation, ECOPSA had established a hazardous waste treatment and landfill facility in San Luis Potosí. She understood that ECOPSA would create 400 Mexican jobs and handle 250, 000 tons of hazardous waste a year. However, it had been brought to her attention that the opening of the La Pedrera facility had been delayed, even though the site had been ready to operate since 1994.

548. On June 22, 1995, Mr. Neveau met with PROFEPA's Federal Attorney for the Environment, Antonio Azuela. In a letter of the same date recording the discussion, Mr. Neveau referred to proposals which it "historically considered as potential corporate commitments to the citizens/residents of La Pedrera and the State of San Luis Potosí"[438].

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438. Exhibit 111. Metalclad proposed, inter alia:

to commit to responsibly remediate the site. According to Metalclad, this would cost between four and seven million dollars (US), and therefore its request was for a five year operating permit. However, Metalclad had agreed to reduce this period and seek another site provided it received full State Governmental support. This agreement had been on the table from the beginning;

- to shut down La Pedrera when the new site was ready and the remediation process complete;
- to continue helping the communities with water supply, which it had been doing at no cost for nine months approximately, and to help them develop storage capacity;
- to continue selectively contributing to the completion of public [community] buildings, such as schools, churches, communication infrastructure;
- to help in the development of a remediation plan regarding unauthorized dump sites;
- to help local industries to minimize their waste output and to use clean technologies;
- to continue promoting foreign investment in the State and the country;
- to employ, as proposed, a technician hired by the state to oversee operations;
- to hire up to 400 employees at peak production and remediation;
- to continue providing medical service for its employees and to establish one day per week for local outpatient services to the general population; to continue providing medical service for its employees and to establish one day per week for local outpatient services to the general population;
- to formulate and underwrite a program with the UASLP for development of an educational curriculum on hazardous waste management;

549. Metalclad expressed the hope that PROFEPA would appreciate that the commitments were "extremely generous" considering the primary commitment to remedy the site[439].

550. On June 28, 1995, Ambassador Silva Herzog replied to Senators Simon and Boxer. His letters stated that:

- the project to develop and operate hazardous waste treatment facilities and landfills require a very careful consideration, both by federal and local authorities;

- in the particular case of Metalclad, his understanding was that the San Luis Potosí Government had specific concerns that required thorough examination by the local environmental authorities;

- in several instances, the San Luis Potosí Government had offered to work with Metalclad in finding the best way to proceed with its operations:

- he was sure that both Senators would be sympathetic to the need to take into consideration the views of the local population;

- such projects deserved to be thoroughly evaluated by the localities before any final decision was made; and

- all the clarifications and scientific explanations needed to be reviewed with the environmental authorities, both at the federal and local level.

551. Thus, Mexican federal authorities again advised of the concurrent role of the federal and local authorities, and the need to consider the opinion of the local community.

- to make possible IVA collection not available right now for clandestine dump sites;

- to make the area more attractive to investment by the natural result of the operation of the site;

- to foster the improvement of local infrastructure by the natural result of the operation of the site; and

- to commit approximately N$1 (one new peso) per ton of waste to the local community for most urgently needed projects as approved by the local legislative body.

The Tribunal should note that no steps had been taken to find another site in the year since Mr. Neveau made this proposal to the municipality

439. Ibid.

552. By letter dated June 29, 1995, Fernando Bejarano of Greenpeace requested a meeting with Secretary Carabias to make a presentation of the technical environmental audit review "Citizen's report regarding the environmental audit on the hazardous waste transfer station located at the "La Pedrera" site, Guadalcázar, S.L.P."[440] which contained the conclusions of a group of experts in the field.

553. In July, 1995, SEMARNAP released a report entitled, [Summary of] Technical Judgements of the Hazardous Waste Landfill Located in Guadalcázar, S.L.P.[441]. The report explained that pursuant to a request by the Municipality in April 1994, PROFEPA had initiated public consultations to discuss the hazardous waste landfill issue and had made the documents compiled in the environmental audit publicly available. The agency had also invited experts from several institutions to participate in working groups to discuss the audit[442].

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440. Exhibit 113, Dictamen ciudadano a la auditoria ambiental a la estacion de transferencia de residuos peligrosos ubicada en el sitio "La Pedrera, Guadalcázar, S.L.P.

441. Ibid.

442. Each of the group of experts wrote a report, according to their respective areas of expertise, which reports are summarized as follows:

> Instituto de Geología de la UNAM: "...considering the results and data before us, specifically with regard to the engineering design, we consider that the site is suitable for the construction of a hazardous waste landfill". (July 13, 1995, Dr. Marcos Adrián Ortega Guerrero)
>
> Instituto de Ingeniería de la UNAM: the lack of humidity at great depths shows the land is impermeable... The risk of usable water contamination at La Pedrera is low by using an appropriate design to protect against floods and by taking action to check the quality of the water leaking underneath the site". The study underlines the need to study in detail the superficial hydrology and to modify accordingly the drainage that protect the site from floods. The recommended study has already been done and found the current drainage appropriate recommending only the construction of a small additional drainage ditch (July 14, 1995, Dr. José Luis Fernández);
>
> Colegio de Ingenieros Civiles de Méxcio, A.C.: "the report concludes that the landfill complies with the standards issued by the INE and thus does not represent a risk". They also suggested the same study as the UNAM Institute of Engineering, and once they had before them such report, they agreed with the suggestion of constructing one additional drainage ditch (July 17, 1995, Jorge Arganis Díaz-Leal, President);
>
> Comisión Nacional del Agua (NWC): "...we have not found water in the region at 350 meters beneath the surface...50% of the water is absorbed in the first meter and eventually evaporates... the composition of the earth underneath the site represents a natural barrier... there is no possibility of contamination of the regional water deposits found below 350 meters under normal precipitation and drainage conditions... From the geo-hydrological perspective the site is suitable for a hazardous waste landfill provided it is constructed in the manner prescribed by the applicable technical standards and under the supervision of appointed experts" (July 20, 1995, Rubén Chávez-Guillén, in charge of under-waters);

554. The summary concluded that, from a technical point of view, the project was feasible. It stipulated that the project shall permanently and strictly comply with the environmental regulatory framework, technical standards and conditions established in the environmental impact statement and the authorizations obtained. In the event that the company did not observe the actions and deadlines established, the authorizations would be cancelled and the company would be obliged to remedy the site.

555. Dr. Medellin testifies that the State was concerned by the fact that one of the key experts, Dr. Adrián Ortega, gave only qualified support to SEMARNAP. Dr Ortega's Ph.D. thesis was on the subject of soil permeability affecting the underground movement of contaminants. He says the federal "norm" for soil permeability tested the wrong things and thus the tests performed at La Pedrera were not reliable proof that leaking liquids could not permeate the soil to any significant degree[443].

556. On July 31, 1995 Mr. Kesler sent a letter to Representative Chistopher Cox thanking him for the work he had done with the Mexican Embassy on Metalclad's behalf, and requesting that he "make one additional inquiry through channels you would deem appropriate to be sure that our project stays on track and is allowed to open in the very near future". Mr. Kesler stated that he believed Representative Cox would conclude, as he had, "that Metalclad had made enormous progress and continued to have very strong support from the federal government of Mexico." He enclosed an Update Report (dated August 1, 1995) on the project directed to "all those people with whom we have corresponded and given information with respect to our hazardous waste treatment facility located at La Pedrera, in the community of Guadalcazar, in the State of San Luis Potosí, Mexico." The Update Report provided a summary based on two letters dated June 28, 1995 and July 26, 1995, respectively from Federal Attorney for the Environment, Antonio Azuela, to Metalclad's counsel in Mexico, the latter of which enclosed the Summary of Technical Judgements of the Hazardous Waste Landfill Located in Guadalcázar, S.L.P. It stated:

- Since April 10, 1995, the Mexican Government, through SEMARNAP, had been conducting an investigation do determine whether:

Comisión Nacional de Seguridad Nuclear y Salvaguardas: the commission checked the levels of radioactivity found in the site and concluded "the radioactive levels measured in the cells and wells are similar to the those obtained in the vicinity of the landfill site, and three times lower than those found in San Luis Potosí City (July 17, 1995, Miguel Medina-Vaillard, General Director);

Secretaría de Salud – Servicios Coordinados de Salud Pública en el Estado de San Luis Potosí: the death rate for genetic deformities is lower in Guadalcázar than in the rest of the State and country.

443. Witness Statement of Dr. Medellin.

- the permit issued to a Metalclad subsidiary by a prior administration had been based upon a proper review and application of standards;

- the completed project at La Pedrera met all of the Mexican Standards; and

- there was no reason whatever to preclude the operation of the completed facility.

- Complete reviews had been completed by the Geological Institute of the UNAM, the Engineering Institute of the UNAM, the School of Civil Engineers, the National Water Commission, the National Nuclear Safety and Security Commission, and the Secretariat of Health.

- The facility at la Pedrera was properly permitted, was built according to all Mexican Standards (with significant increases over Mexican standards in several important respects) and there is no scientific reason to preclude operation.

557. Contrary to Metalclad's representation to Congressman Cox, the letter furnished by Mr. Azuela did not refer at all to the issue of whether La Pedrera was properly permitted. It referred only to technical aspects of the site to determine compliance with Mexicans technical regulations and its suitability with respect to the hazardous waste landfill. Metalclad's description was also misleading in respect of the issue of its own contention that SEMARNAP's investigation was intended to determine if there was any reason whatever to preclude the operation of the facility. That there may have been no scientific reason to preclude operation said nothing of other reasons, such as the fact that Metalclad had not obtained the municipal construction permit, the social problems arising from local opposition, or the lack of the State Government's support.

558. In August 1995, PROFEPA and INE jointly issued a document entitled Project for a Hazardous Waste Landfill Located in Guadalcázar, S.L.P,, To the Public Opinion [444] stated:

a) the environmental audit was completed in March, 1995 and the results were made public on May 2 and again on June 6 at a meeting attended by the National Water Commission, UNAM's Engineering Institute, the San Luis Potosí Government, the Municipality and the NGO's Pro-San Luis Ecológico and Greenpeace Mexico, the latter in their capacity as advisors to the Municipality;

444. Exhibit 114 Proyecto de Confinamiento de Residuos Peligrosos Ubicado en Guadalcázar, S.L.P., A la Opinión Pública

b) the landfill was located in a small, 15 square kilometer valley named La Pedrera. In the valley there was an 814 hectare property divided into two areas: a transfer station and the works for a hazardous waste landfill that were authorized in 1993 by the state and federal governments;

c) during November of 1990 and May 1991, after SEDUE authorized COTERIN to operate a transfer station, the company received approximately 20,000 tons of waste (55,000 barrels) which were placed into three temporary cells not authorized for that purpose. This waste was from the metal-mechanic, auto, chemical, pharmaceutical and agrochemical industries;

d) The management of the transfer station was so deficient that it was shut-down by SEDUE on September 25, 1991. In May 1994, in order to determine what action would be required to remedy the site, PROFEPA authorized an environmental audit. Among other things, the audit (which comprises eleven volumes of technical information and is available to the public) found as follows:

   i) there was a 100% risk of explosion in two cells thus any work in these places must be with maximum security;

   ii) the radioactive activity was within normal levels for the whole area;

   iii) there was no water within 345 meters of the surface, and no signs of contamination of wells in the region;

   iv) there was no evidence of effects on the pond at El Huizache, located 4.5 Km from the landfill;

and thus it was very important that remedial work at the site be conducted in accordance with measures approved by PROFEPA and under the supervision of a Citizens' Committee;

e) there were very few other sites in the nation that had as much unlawfully deposited hazardous waste as La Pedrera. Currently, there was only one other hazardous waste disposal landfill, located in Mina, Nuevo León, and there were three projects under review;

f) on August 10, 1993, COTERIN obtained an authorization from INE to operate a hazardous waste landfill, subject to 37 conditions. A few days later, Metalclad acquired most of COTERIN's shares;

g) COTERIN had obtained a state land use license on May 11, 1993. Previously, on February 19, 1992, the CNDH had issued a recommendation stating that in the event that the landfill was authorized, it must comply with

the applicable technical standards, and the San Luis Potosí Government shall fulfil its supervisory obligations pursuant to state law. The technical studies allowed the agency to confirm that the site complied with the applicable environmental standards [which are described together with main tests performed].

h) the only technical standard the landfill did not meet was the requirement to construct all confinement cells at least 500 meters from any surface stream. However, the standard provided an exception where proper, technically sound and effective works and measures are taken to prevent the possibility of contamination;

i) to open a hazardous waste landfill it was not only necessary to establish that the site was suitable, but also to demonstrate that the design, construction and operation of the landfill met the applicable technical requirements. These requirements would ensure that the previous experience with the transfer station will not be repeated. This explained why the INE authorization was granted subject to 37 conditions, such as a mandatory list of the type of waste that could be kept at La Pedrera, the type of confinement cells that must be used, and the proper means of covering the cells[445].

j) the document concluded by stating PROFEPA was interested in having local people participate in the supervision of the works at La Pedrera, and consequently invited the Municipality to participate, but was still waiting for a response[446].

Claimant's 10-K for May 31, 1995

559. On September 13, 1995 Metalclad filed its 10-K for the period ending May 31, 1995. The filing stated that "Construction for phases one and two [of La Pedrera] have been completed and the Company is ready to commence operations upon receipt of public support from state and local government officials to assure safe and uninterrupted operation of the facility"[447].

560. The 1995 10-K made a disclosure that complicated Metalclad's claim that it had a "permitted" waste landfill at La Pedrera. Annexed to its financial statements was a report of its independent certified public accountants, Grant Thornton, who advised:

445. Ibid.

446. Ibid.

447. At page 3.

"The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the financial statements, the Company has had substantial recurring losses from its operations and has been dependent upon external financing to sustain its operations. These factors, among others, as discussed in Note B to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern."[448]

561. Grant Thornton went on to note that:

"As discussed in Note B, the Company has not been granted all necessary governmental authorizations to open and operate its hazardous waste treatment facility in Mexico. The financial statements do not include any adjustments from the outcome of this uncertainty."[449]

562. It continued:

"Included in property, plant and equipment at May 31, 1995 is approximately $3,325,000 representing the company's investment in its hazardous waste treatment facility in Mexico. The company has not been granted all necessary governmental authorizations to open and operate the facility. The financial statements do not include any adjustments relating to the recoverability of the carrying amount of this asset that might be necessary should the company be unable to open and operate the facility."[450]

563. Metalclad dismissed Grant Thornton as its auditor.

Further Developments in Mexico

564. On September 14, 1995, Greenpeace-Mexico and Pro-San Luis Ecológico filed a criminal complaint with the Federal Attorney General (PGR)[451].

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448. At page F-1. [Emphasis added]

449. Ibid. [Emphasis added]

450. Ibid. [Emphasis added]

451. Exhibit 115 The complaint alleged, inter alia:

- in 1989, SEDUE closed the hazardous waste dump at Mecxquitic also owned by COTERIN, in response to community complaints;

- when COTERIN began working in La Pedrera in 1990, it told the community it was digging wells to provide water to the nearby farms and fields. All the works were undertaken without proper federal, state and municipal permits;

- notwithstanding this, COTERIN began depositing thousands of tons of hazardous waste at La Pedrera;

- in May 1991 [sic], SEDUE-SAN LUIS POTOSÍ shut-down the dump;

- on August 8, 1991, an inspection by SEDUE-SAN LUIS POTOSÍ determined that COTERIN personnel were continuing their usual activities in the four cells, and that cell number 1 was 75% full with waste received from the auto industry, cell number 2 was almost 100% full, etc.

- on August 19, 1991 [sic], SEDUE authorized COTERIN to construct a transfer station subject to submitting the required environmental impact statement. According to COTERIN, the site received 55,000 drums (20,000 tons) of waste from November 1990 to May 1991;

- in January 1993 and August 1993 the company obtained from INE the federal authorizations required to construct and operate a hazardous waste landfill;

- in August 1993, Metalclad acquired 94% of COTERIN. The transaction was facilitated by the Mexican Investment Board, an organization created to attract foreign investment under the NAFTA;

- in August 1994, Metalclad requested from PROFEPA authorization to conduct an environmental audit of the cells containing hazardous waste. The audit was conducted from December 1994 to March 1995;

- Greenpeace and Pro-San Luis Ecológico were invited to review the documents compiled during the first stage of the environmental audit. This is when the NGOs found evidence of serious violations to the environmental laws and the risk the site represents for the community. The audit plainly recognizes La Pedrera site is contaminated.

- in a meeting with the Attorney General of PROFEPA and SEMARNAP Secretary Julia Carabias, the NGOs noted the unsuitability of the site. In response, the PROFEPA official stated that the issue was not whether to initiate criminal actions, but to remediate the site, and that the only way to do it was, as suggested by Metalclad, to let them operate the site. This official position is a clear violation to the law.

- on August 2, 1994, US Ambassador James R. Jones wrote to SEMARNAP Secretary Julia Carabias requesting the lifting of the closure, as all the applicable requirements and authorizations had been obtained, and the measure would increase the confidence of foreign investors in these kinds of projects. On August 11, 1995, U.S. Senator Paul Simon wrote a similar letter to President Zedillo, adding that, most importantly, the situation harms the people of Mexico when Metalclad is not allowed to help solve the hazardous waste problem;

- currently, Metalclad intends to condition remediation of the site on conditioned operation. However, the transfer station never met the legal requirements to operate and the authorization granted then lacked any legal basis.

565. Greenpeace also issued a press release to announce that the criminal complaint had been filed.[452]

566. By letter dated September 19, 1995, UNAM Biology Institute Director Héctor M. Hernández Macías, Ph.D., prompted by the public debate that had recently appeared in several newspaper articles about the reopening of the La Pedrera hazardous waste landfill, and wishing to help the authorities in their decision-making process, informed Governor Sánchez Unzueta of the research he had coordinated at the UNAM since 1991 to study the distribution patterns of rare and endangered cactus species of the Chihuahua Desert. The research showed that the region located between Guadalcázar and El Huizache, where the site was located, coincided with the most important concentration of rare and endangered cactus species of the country, and probably of the North American Continent. On the basis that the Guadalcázar Municipality and adjacent regions were potential natural reserved areas, the Director urged the Governor to consider the information submitted before a decision was taken on whether to reopen the site[453].

567. By press release dated October 11, 1995, Greenpeace Mexico published a Spanish translation of a letter sent by Greenpeace Mexico and Greenpeace USA to U.S. Ambassador James Jones, requesting him to withdraw his support for Metalclad and the hazardous waste landfill in San Luis Potosí. They argued that the Ambassador should not promote the interests of a private entity in the host country. They considered that his efforts to influence SEMARNAP Secretary Carabias were unduly interfering with the environmental regulatory powers of the Mexican federal authorities. They expressed concern about his participation in the matter because Metalclad and its subsidiary, and a number of other Mexican officials, were under criminal investigation with regard to this matter. The letter also affirmed that:

> Metalclad's statements assuring they had completed all technical studies and obtained all necessary permits were false, and Metalclad had not yet submitted any remedial plan;
>
> Metalclad violated Mexican environmental law by conditioning the clean up of the site on obtaining authorization to open the dump, contrary to PROFEPA's letter of November 14, 1994 that prohibited COTERIN from receiving waste and operating until the dump was completely cleaned;
>
> the opening of the facility threatened the region's bio-diversity which, according to recent expert opinions, should be included in the National Natural Reserves

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452. Ibid. The officials identified in the complaint were, inter alia, Sergio Reyes Luján (former Director of INE), René Altamirano (former Director of Environmental Regulation at INE) and Jose Luis Calderon Bartheneuf (Deputy Attorney General of PROFEPA).

453. Exhibit 116, Letter from Dr. Hernandez (UNAM) to Governor Sanchez Unzueta.

Program because it was the home of a number of rare and unique endangered species; and

the San Luis Potosí Government and Guadalcázar Municipality opposed the reopening of the site. The Municipality had denied the necessary construction permit and this was ignored by Metalclad[454].

568. Furthermore, Greenpeace argued, Metalclad's attitude violated the spirit of the NAFTA. Article 1114 of the NAFTA prohibited the relaxation of law enforcement to promote or permit an investment[455]. Finally, the letter added, Metalclad had tried to intimidate Mexican officials by claiming that foreign environmental investment would stop if Metalclad's investment failed. The environmental organizations argued Metalclad should be the one that was worried as it was currently under a criminal investigation for disregarding Mexican law[456].

The Draft Complaint

569. In October 1995, Metalclad provided the Mexican Embassy in Washington with a copy of a draft NAFTA complaint. The complaint, a copy of which is attached as Exhibit 18, contains a quite different characterization of the events in question.

570. In the draft complaint, Metalclad states that the gravamen of the Claimant's case at that time was the "sinister, confiscatory, discriminatory, fraudulent and conspiratorial" conduct of Dr. Medellín[457]. In fact, Metalclad actually purported to name Dr. Medellín personally as a respondent. The Governor was portrayed as an innocent victim of his State Ecology Coordinator. This document was circulated by Metalclad in an attempt to pressure the Government of Mexico to in turn force the State and local governments to permit the project to proceed.

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454. Exhibit 117, Greenpeace Press Release, October 11, 1995.

455. Article 1114 states:

"(2) The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment... of an investment of an investor..."

456. Ibid.

457. Exhibit 118. In its Memorial, the Claimant states that "one man, the Governor of the State of San Luis Potosí, at the expense of the Mexican people and their environment, has used his office arbitrarily, prejudicially and unlawfully to deny this Claimant its rights under the North American Free Trade Agreement" (Preface, at page 28).

571. There are numerous inconsistencies between the description of the facts in the draft complaint and those in the Claimant's memorial.[458]

The Convenio de Concertación Agreement

572. On November 24, 1995, PROFEPA and INE signed a *Convenio de Concertación* entitled "*Convenio de Concertación* between the Federal Executive via the Secretariat of the Environment, Natural Resources and Fisheries through the National Institute of Ecology, hereby represented by its President, Eng. Gabriel Quadri de la Torre, hereinafter 'the Institute', and the Office of the Federal Attorney for the Protection of the Environment, hereby represented by its head, Antonio Azuela de la Cueva, hereinafter 'the Attorney's Office', on one part, and on the other part, Confinamiento Técnico de Residuos Industriales, S.A. de C.V. (Hazardous Waste Transfer Station), hereby represented by Eng. Ariel Miranda Nieto, in his capacity of proxy, hereinafter 'the Audited Enterprise', for Purposes of Conducting the Preventive and Corrective Activities Resulting from the Environmental Audit)"[459]

573. Under the Convenio de Concertación, COTERIN committed to:

- conduct the works and activities described in the Action Plan (which included the Remediation Plan) attached thereto, relating to the preventative and corrective measures to be taken as a result of the environmental audit;
- operate commercially for a maximum five year period;
- within a three year period, treat and dispose of the 20,500 tons of toxic waste that had been improperly disposed of in the three cells of the transfer station;
- use 34 of the 814 hectares for the landfill facilities, and set the remaining 780 aside as an abatement zone in order to develop a rescue plan for endemic species;

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458 Exhibit 118.

459. Exhibit 119, Convenio de concertación que con el objeto de llevar a cabo las actividades preventivas y correctivas de la auditoría ambiental, a que se refiere el mismo, celebran por una parte el Ejecutivo Federal por conducto de la Secretaría de Medio Ambiente, Recursos Naturales y Pesca, a través del Instituto Nacional de Ecología, representado por su Presidente el C. Ing. Gabriel Quadri de la Torre, a quien en lo sucesivo se le denominará "el Instituto" y la Procuraduría Federal de Protección al Ambiente, representada por su titular, el C. Lic. Antonio Azuela de la Cueva, a quien en lo sucesivo se le denominará "la Procuraduría" y por la otra, Confinamiento Técnico de Residuos Industriales (estación de transferencia de residuos peligrosos), representada por el C. Ing. Ariel Miranda Nieto, en su carácter de apoderado, a quien en lo sucesivo se le denominará "la Empresa Auditada".

- present for PROFEPA's approval a schedule of preventative and corrective measures necessary to bring irregularities into conformity, according to studies conducted under the Action Plan;

- provide PROFEPA all information related to compliance with the Agreement, on a monthly basis, or sooner if PROFEPA deems it necessary, and render a final report of the works and activities upon expiration of the Agreement;

- facilitate the tasks of the the Technical-Scientific Committee;

- facilitate the entrance of the Citizen's Oversight Committee established under the Agreement;

- allow PROFEPA to establish a residency in the facilities for purposes of surveillance and follow-up;

- contribute 2 new pesos (adjusted every six months in accordance with the inflation rate) per ton of waste to social works within the Municipality of Guadalcázar;

- offer a 10% discount off its treatment costs to enterprises delivering waste generated within San Luis Potosí;

- provide free medical services once a week, through its qualified medical personnel;

- hire Guadalcázar residents as its labor force;

- provide governmental authorities advise on remediation of polluted sites;

- provide any necessary support to higher education and investigation institutions to conduct or supplement geo-hydrologic, geologic, biologic or geo-chemical scientific projects that may be approved by PROFEPA; and

- organize courses on toxic waste management twice a year, directed to the federal, state and municipal public sectors, as well as the social and private sectors[460].

460. Ibid.

574. INE committed to revise and, if appropriate, modify the authorizations that had been granted for the operation of the toxic waste landfill, in order to adjust them to the results of the audit and the obligations under the Agreement[461].

575. PROFEPA committed to:

- supervise COTERIN's activities through regular inspection visits of authorized personnel;
- decide on the correction of deficiencies detected during the audit;
- establish a Technical-Scientific Committee comprising representatives of INE, UNAM and UASLP, to do the follow-up work on the remediation process; and
- promote the establishment of a Citizen's Oversight Committee comprising up to fifteen persons appointed by the *Ayuntamiento* of Guadalcázar[462].

576. The three parties agreed to review the commercial operation of COTERIN after the five year term in order to determine whether to extend it[463].

577. It is important to note that by entering into the *Convenio de Concertación*, federal officials did not purport to assert federal primacy in the area. Environmental Attorney General Azuela issued a press release to this effect:

> "Finally, it is important to make clear that the federal authorizations are a necessary but not sufficient requirement to operate a hazardous waste landfill. The company must comply with the state law on the matter whose interpretation and application falls exclusively within its authority."

578. This press release was published on November 25, 1995 in *El Nacional*[464].

579. The Governor responded on November 26, 1995 in a letter to the Potosinians, published in national and local newspapers. The Governor stated that, having found out in the media about the report of the *Convenio de Concertación* for the administration of

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461. Ibid.

462. Ibid.

463. Ibid.

464. Exhibit 120, PROFEPA Press Release, November 25, 1995.

hazardous waste in La Pedrera, he declared, *inter alia*:

> "The state authorities know nothing about the terms of the signed agreement.
>
> The powers of the state government in this case, are limited to issuing the land use license, which was issued on May 11, 1993, seven days before this administration took office. On the other hand, the power to issue the construction license is within the exclusive jurisdiction of the municipal authority and this license has been denied to date by the Guadalcázar *ayuntamiento*.
>
> ...
>
> The basic premise of our environmental policy is to consider the opinion of the experts and the community for the environmental decision making process as it is established by Article 10 of the San Luis Potosí Environmental Protection Act[465], which states in its relevant part: 'The co-ordination between State and municipalities, and the Federation as well as between them and the community, are necessary for the success of environmental actions' and 'the main actors of environmental cooperation are the social groups and organizations, as well as individuals, in general. The reorganization of the community's relation with nature, is the fundamental purpose of environmental co-operation.'
>
> Thus, the governor of the state of San Luis Potosí <u>again</u> ratifies that, in order to solve this problem, it is strictly necessary to fully respect the will of the people and of the authority of the Free Municipality of Guadalcázar...
>
> There is no room in San Luis Potosí to solve public problems without the consent of the community. The environmental decisions of the Federal authorities may be formally reasonable, but they will not prosper without the genuine agreement of the community, who knows that the consequences of an error, like the one already made in the illegal dump of "La Pedrera", affect future generations, not only us. For all these reasons, my government does not accept any undertaking, or pressures, against the will of the people. I fully trust in the wisdom, courage and intelligence of the Potosinians. To them I appeal, in them I rely. Only in ourselves, can we find just and long-standing solutions. Thus, fully assuming my constitutional responsibility as state governor, I call the parties and the Potosinians to continue working on a negotiated solution to the hazardous waste problem, a solution that

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465. Ley de Protección Ambiental del Estado de San Luis Potosí.

acknowledges before all things, an undersigned principle: San Luis Potosí is first."[466]

580. Metalclad then issued its own press release. It focused solely on the federal approval and omitted to note the federal authorities' express reference to the local approvals issue. The press release stated:

(1) "On Friday November 24, at 5 P.M. Mexico City time, Attorney General Antonio Azuela de la Cueva, the head of La Procuraduria Federal de Proteccion al Ambiente (PROFEPA), called a press conference to witness the signing of an historic agreement between the federal government of Mexico and one of Metalclad's Mexican subsidiaries.

(2) Signatories to the agreement included both PROFEPA and El Instituto de Ecologia (INE) along with principals of Metalclad.

(3) The agreement insures operation of Metalclad's hazardous waste treatment facility completed in March 1995 for a period of five years. The agreement requires that remediation of the old transfer station located on the site (which operated for about 90 days in 1991 by a prior owner) be completed within three years.

(4) On Saturday November 25, the federal government of Mexico published in several local and national newspapers a Desplegado (announcement to the people) outlining the steps the government has taken since March 10, 1995 when ostensible local opposition delayed the operation of the facility. The lengthy announcement concludes that the facility has been studied by the most prestigious institutions in Mexico and found to be a state-of-the-art, world class facility ready for operation..."[467]

D. THE DECEMBER 1996-OCTOBER 1997 PERIOD

Denial of the Municipal Permit

581. On December 5, 1995, the Municipality denied COTERIN's application for a construction permit on the grounds that:

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466. Exhibit 121

467. Exhibit 122, "Metalclad Announces Federal Approval for the Opening of its Waste Treatment Facility and Landfills in Mexico", November 27, 1995 [Emphasis added].

a) the Municipality had previously denied the construction license in October 1991, as ratified in January 1992, and this denial shall remain applicable to COTERIN;

b) COTERIN requested a construction license for something that had already been constructed, thus resulting in a logical and legal contradiction;

c) COTERIN's land use license was a nullity for purposes of applying for the construction permit, since the company had illegally constructed under a land use license that did not authorize the company to initiate construction or operations; and

d) it was of the personal knowledge of each and every member of the *Ayuntamiento* that the people of the Municipality were unanimously opposed to the *Ayuntamiento* granting a construction license to COTERIN[468].

The Municipality's First Challenge of the Convenio de Concertación

582. On December 15, 1995, the Municipality submitted a *denuncia popular*[469] and an administrative complaint to PROFEPA challenging the validity of the *Convenio de Concertación* between Metalclad, PROFEPA and COTERIN[470].

583. In the *denuncia popular*, the *Ayuntamiento*, representing the interests of its residents, stated that:

- In 1990, the General Direction for the Prevention and Control of Environmental Pollution authorized Salvador Aldrett to prepare an executive project for the construction and establishment of a hazardous waste landfill in La Pedrera. He used this authorization, with the authorities' consent, to transport toxic waste and materials to the site. This, in turn, motivated the subsequent authorization of a transfer station, that served as a cover-up for what would become a landfill.

- The landfill facilities thus operated in total disregard of the powers conferred upon the *Ayuntamiento* of Guadalcázar and the State of San Luis Potosí that had granted its consent to develop a controlled hazardous waste landfill

468. (Claimant's Exhibit 31)

469. "Public Denunciation."

470. Exhibit 123, Municipality of Guadalcazar Administration Complaint to SEMARNAP.

provided that it only receive waste generated by industries located within the State; that it be located far away from human population centers; and that the technical studies demonstrate that no harm to the ecology or human health would be caused.

- The subsequent authorizations that were granted motivated, nonetheless, an inspection visit that resulted in the closure of the landfill.

- On August 30, 1994, PROFEPA concluded that the landfill was totally irregular, because, among other things, the design and construction of the cells did not comply with applicable regulations.

- Consequently, PROFEPA:

  - ordered that the closure seals be partially lifted in order to conduct an environmental audit and carry out the remediation activities that resulted therefrom; and

  - expressly prohibited that any type of waste be introduced until the studies and remediation activities resulting from the audit were performed.

- Such measures are still in effect and have full force, since they have not been annulled nor revoked.

- However, the *Convenio de Concertación* authorizes COTERIN to simultaneously remedy the facilities and commercially operate the landfill.

- It therefore annuls or revokes the August 30, 1994 determination without having been duly reasoned and based on legal grounds.

- The *Ayuntamiento* thus requested that appropriate actions be taken to enforce the measures ordered under the August 30, 1994 determination.

584. In the administrative complaint, the *Ayuntamiento* stated that:

- On November 26, 1995, it only partially found out about the existence of the *Convenio de Concertación* in an extraordinary *Cabildo* session that was presided over by the Governor, in which a press release issued by PROFEPA and INE, and published in the local press, was read. It also partially found out about the *Convenio de Concertación* through an article published in "*Pulso Diario de San Luis*" on November 30, 1995 which reproduced the text of the *Convenio*, but not its annexes, which the *Ayuntamiento* has still not seen, because it had not been formally notified of the Agreement.

- It was challenging the validity of the acts that ordered the opening and commercial operation of the hazardous waste landfill, contained in the *Convenio de Concertación*.

- The *Convenio de Concertación* is contrary to the law because:

  - it contravenes the provisions of the PROFEPA August 30, 1994 determination, which are still in effect, without having been duly reasoned and based on legal grounds;

  - it invades the jurisdiction of the Municipality and contradicts the will of the people. The authorization of all acts relating to any type of construction and the operation of establishments are within the exclusive jurisdiction of the municipal authority. Therefore, only the *Ayuntamiento* of the Municipality of Guadalcázar may authorize COTERIN too construct the hazardous waste landfill facilities located at the La Pedrera site, as well as the operation of the establishment, in accordance with the following:

    - Article 83, section V of the San Luis Potosí Constitution provides that Municipalities are empowered to grant construction licenses and permits;

    - Article 44 of the Organic Act of the Free Municipality in force in San Luis Potosí provides that Municipalities are empowered to participate in the establishment and management of their territorial reserves and ecologic areas, and to control and supervise the use of land in their jurisdictions, in terms of the respective federal and state laws;

    - Article 5 of the San Luis Potosí Ecology and Urban Code authorizes the State Executive and the a*yuntamientos* to impose any restrictions on the use of land and constructions of any type as the urban and ecological equilibrium of the state territory may require;

    - Article 13 of the San Luis Potosí Ecology and Urban Code empowers the a*yuntamientos* to grant the municipal construction license, which is defined by Article 57, section V as the act whereby each a*yuntamiento* authorizes the execution of a building or works or any of the specific services identified in the Code's general rulings;

    - Article 37 of the San Luis Potosí Environmental Protection Act provides that the establishment and operation of any type of hazardous activities that may affect or impact the ecological

equilibrium or the environment of the Municipality or the State, requires a state environmental impact authorization issued by the competent state authority, or a land use license. Article 38 provides that *ayuntamientos* are authorized to supervise and control compliance with the provisions of environmental impact authorizations and state land use licenses for the construction, operation and maintenance of establishments that conduct hazardous activities;

- Article 16 of the Financial Act for the Municipalities of San Luis Potosí provides that no industrial, agricultural, livestock or handcraft establishment, including commercial establishments, may initiate operations without the prior authorization of the municipal authorities.

- In exercise of its powers, but mainly in defense of the legitimate interests of its residents, the Ayuntamiento of Guadalcázar denied COTERIN the construction license on October 1, 1991 and January 20, 1992, and ratified such determination on December 5, 1995, since the application was contradictory and inconsistent in that a construction license had been requested for something that was almost completely built.

- COTERIN committed to contribute 2.00 new pesos per ton of waste to social works in the Municipality of Guadalcázar, in contravention of Article 83, section IV of the Constitution of San Luis Potosí which empowers the municipalities to administer their own finances;

- It is not duly reasoned nor based on legal grounds because the site requires immediate remediation for purposes of protecting the ecological integrity of the territory, not for purposes of its commercial operation;

- It is contrary to the Federal Administrative Procedures Act that requires all public order and social interest acts to be published in the *Diario Oficial de la Federación* prior to its entry into force in order to allow interested persons to provide comments. Since the commercial operation of a hazardous waste landfill is in the public order and social interest, it should have been so published.

- It affects the Municipality in that, being harmful to the public interest, it is intended to have effects and obligate those who did not take part in it: the society, the Municipality and the *Ayuntamiento*.

585. The *Ayuntamiento* , on behalf of the people that it represented, therefore requested an injunction until the administrative complaint was finally resolved.

586. The complaint was dismissed by determination of SEMARNAP Secretary Carabias on December 27th. on the basis that:

- the Municipality had made use of a challenge procedure that no longer existed under Mexican law, since Article Two of the Transitory Provisions of the Federal Administrative Procedure Act (FAPA) provided that "All provisions that are contrary to this Act are hereby abrogated, in particular the different administrative procedures contained in the various administrative laws in those areas regulated herein";

- the complaint had not been submitted on time, since the Municipality acknowledged that it became aware of the *Convenio de Concertación* on November 26, 1995 and did not file the complaint until December 19, 1995, that is after the fifteen day period established in the FAPA;

- the Municipality had no legal interest in the matter, since it had not participated in the administrative procedure that COTERIN had been subject to, and the *Convenio de Concertación* does not limit the exercise of municipal authorities' powers;

- the object of the complaint is not strictly an administrative act; it is an agreement of an administrative nature[471].

587. SEMARNAP did not address the *denuncia popular* until February 9, 1996.

588. That same day COTERIN submitted an administrative complaint to the municipality challenging its decision to reject the application for a construction license. The complaint was dismissed by the Municipality on April 23, 1996.

The Municipality's Amparo Challenge Of SEMARNAP's Determination

589. On January 31, 1996 the Municipality initiated an *amparo* proceeding against SEMARNAP's decision to dismiss the Municipality's administrative complaint, and its failure to address the *denuncia popular*.

590. The Municipality argued that:

- SEMARNAP had erroneously asserted that the Municipality had made use of a

471. Exhibit 124, SEMARNAP Dismissal of Municipality's Administrative Complaint, December 27, 1995.

challenge procedure that no longer existed under Mexican law because the issues concerning COTERIN had not been resolved through administrative procedure that complied with the FAPA, because the controversies arising in relation thereto date back to 1990 and the FAPA only came into force on June 1995. The complaint filed by the Municipality is, therefore, not regulated by the FAPA. Rather, it is regulated by the General Environmental Law.

- The complaint had been filed on December 15, 1995, not December 19th, as evidenced by a copy of the envelope in which it was sent, that had been date stamped by the postal office, and it had never been formally notified of the *Convenio de Concertación*:

  - it only partially became aware of its existence in an extraordinary *Cabildo* session through a press release issued by PROFEPA and INE that did not reproduce its text;

  - it also partially became aware of the *Convenio de Concertación* through an article published in "*Pulso Diario de San Luis*" on November 30, 1995, which reproduced its text but not to its annexes.

- The municipality is the entity through which the community defends its interests, and the *ayuntamiento* is the representative of the municipality. It may, therefore, intervene before every type of authority where administrative provisions affect municipal interests. The Municipality of Guadalcázar has a clear legal interest in the annulment of the administrative acts challenged for being irregular and in contravention of the law. In addition, the *Convenio de Concertación* provides that COTERIN contribute 2.00 new pesos per ton of waste to social works in the Municipality of Guadalcázar, in contravention of Article 83, section IV of the Constitution of San Luis Potosí which empowers the municipalities to administer their own finances. Furthermore, the claim that the Municipality did not have a legal interest because it did not participate in the administrative proceeding that COTERIN was subject to actually fortifies the argument that its legal interests have been affected by administrative acts, without having been heard nor defeated in trial or through any proceeding.

- The *Convenio de Concertación* is an administrative act that cannot be simply considered as an agreement because its effects are not limited to the signatories and they affect third party rights. SEMARNAP issued mandatory acts that can only be exercised by an authority, such as the authorization to operate the landfill, the revocation of administrative agreements that were legally valid, and the invasion of the *Ayuntamiento*'s jurisdiction.

- SEMARNAP has not issued a determination regarding the admittance or rejection of the *denuncia popular* and has, therefore, not notified the *Ayuntamiento* of the respective process.

- Although the December 27, 1995 determination is apparently only declarative in nature, in practice it has positive effects because the of feasibility of the execution of the *Convenio de Concertación* in Guadalcázar. Since such determination is unconstitutional, the acts resulting from its enforcement are equally unconstitutional. The protection granted with regard to the December 27th determination must, therefore, extend to such acts.

591. The Municipality also requested that a provisional injunction be granted immediately, and, eventually, a final injunction.

592. On February 2, 1996, PROFEPA resolved to lift the 1991 temporary closure order on the site. The order to lift the seals stated, in pertinent part:

- In order to correct the irregularities that were detected in the environmental audit, an Action Plan, which included a Remediation Plan, was prepared and approved by PROFEPA. The plan contains more detailed and complete technical preventative and corrective measures than those ordered by the PROFEPA-SLP delegation in the August 30, 1994 administrative determination.

- Adequate handling and disposal of the existing toxic waste in the old cell and the polluted soil require the operation of the new cell.

- On November 24, 1995, the Federal Executive, via SEMARNAP, through INE and PROFEPA entered into a *Convenio de Concertación* with COTERIN, in which a modality in complying with the technical measures that were ordered in the August 30, 1994 determination was agreed through the approval of the Action Plan.

- It should be made clear that PROFEPA maintains its powers to supervise COTERIN's compliance with the provisions of the *Convenio de Concertación* and the 1996 Federal Environmental Law, its rulings and Mexican technical regulations.

- The enterprise should bear in mind that lifting of the closure is without prejudice to observance of the obligations prescribed by the local laws[472].

593. PROFEPA thus agreed to lift the total temporary closure that had been ordered on September 25, 1991 on COTERIN. It reiterated that the order to lift the seals did not

472. Exhibit 125, PROFEPA Resolution to Lift Closure Order, February 2, 1995.

prejudice the powers conferred upon the State of San Luis Potosí and the authorities or the Municipality of Guadalcázar by the local laws[473].

594. On February 6, 1996, the federal judge of the Second District in San Luis Potosí accepted jurisdiction in the *amparo* requested by the Municipality and granted a provisional injunction enjoining COTERIN from taking any further action pursuant to the *Convenio de Concertación,* pending the final resolution on the injunction[474].

595. On February 9, 1996, PROFEPA responded to the *Ayuntamiento's denuncia popular*. The response summarized the results of the audit and the general conclusions. It stated:

- the audit determined that there was no imminent risk of ecological imbalance, and no cases of pollution with dangerous repercussions to the ecosystems, its components or public health;

- in order to correct the irregularities that were detected in the environmental audit, an Action Plan, including a Remediation Plan was prepared and approved by PROFEPA;

- the need to urgently conduct the actions to remedy the landfill facilities in accordance to the terms and conditions of the *Convenio de Concertación* is evident;

- the studies that were prepared prior to the federal environmental authorities granting the authorizations to operate in addition to the analysis resulting from the environmental audit ensure that the site where the landfill is located complies with the requirements established in the applicable environmental

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473. Ibid.

474. Exhibit 126, Order of the District Court in San Luis Potosí, February 9, 1996. The Amparo Act (Ley de Amparo Reglamentaria de los Artículos 103 y 107 de la Constitución Política de los Estados Unidos Mexicanos) empowers district judges to grant an injunction where:

- the claimant so requests;

- the social interest is not prejudiced and no public order provisions are contravened; and

- the damage cause to the claimant by the execution of the act would be difficult to repair.

The provisional injunction may be granted upon submission of the amparo where there is an imminent danger that the act will be executed with notorious damages to the claimant, in order for things to remain as they are until a determination regarding the final injunction is rendered (Articles 124 and 130).

regulations;

- the technical and legal arguments of the local authorities during the public consultation organized by PROFEPA were unable to contradict the aforementioned considerations;

- it is important to remind the *Ayuntamiento* that the competent federal authorities have always acknowledged and continue to acknowledge the authorizations and further actions that with respect to works or activities that generate or could generate environmental effects and that are within its jurisdiction in accordance with the law, in no way preclude the governments of the federative entities and municipalities to exercise the powers conferred upon them. That is, the federal authority may only authorize or not a work or activity within its jurisdiction on environmental matters; so if pursuant to the corresponding state or municipal laws other type of permits, licenses or authorizations are required, it is the private person's obligation to obtain them from the corresponding local authorities in order to be able to conduct the work or activity.

- In the instant case, the environmental impact and operation authorizations that INE granted for the hazardous waste landfill in the municipality of Guadalcázar, San Luis Potosí, and the actions that PROFEPA has taken within the inspection process of COTERIN have in no way implied the inability of the Governments of the State of San Luis Potosí or the Municipality of Guadalcázar to issue the corresponding permits or authorizations.

- This is corroborated by:

  - point ten of the environmental impact authorization granted by INE on January 27, 1993[475];

  - paragraph 36 of the August 10, 1993 operation permit[476];

  - the August 30, 1994 administrative determination[477]; and

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475. "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."

476. "This authorization is framed in the Ecological Equilibrium and Environmental Protection General Act y its Rulings on Hazardous Waste; the enterprise, COTERIN, S.A. de C.V., will therefore be subject all provisions established in such legal documents, and the provisions that are applicable to the activities object of this authorization."

- the February 2, 1996 order to lift the closure[478];

- It concluded that the Municipality of Guadalcázar under no circumstances had been impeded to exercise the powers conferred upon it by the Mexican Constitution, the Constitution of the State of San Luis Potosí and other regulations emanating therefrom. "This is corroborated by the fact that, as the Attorney's Office has been made aware through several articles published in the local and national media, the Municipality denied the construction permit or license that had been requested by COTERIN, S.A. de C.V."[479].

The February Private Placement

596. While the legal proceeding challenging the *Convenio de Concertación* was underway, the Claimant engaged in a private placement of stock in Europe. The Offering Memorandum noted that the Company was offering 1,650,000 share and certain insiders (Messrs. Kesler, Neveau, and Guerra) were offering 950,000 shares.[480]

597. In preparing for its defense, the Respondent requested a copy of the Offering Memorandum. Although the document discloses "political opposition at the State Level; Opposition from Greenpeace",[481] it omitted to inform potential investors that the municipality had obtained a provisional injunction six days before the date of the Offering Memorandum.

598. As Mr. Dages' report notes, having exercised warrants valued at 2.25 dollars per share and sold them for $4 per share, the three insiders realized a profit of 1,662,500.00 dollars.

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477. "The studies are independent from those that could be requested by other competent authorities, as well as the respective permits."

478. "The enterprise should bear in mind that lifting of the closure is without prejudice to observance of the obligations prescribed by the local laws... It is also reiterated [to the enterprise] that the powers conferred upon the State of San Luis Potosí and the authorities or the Municipality of Guadalcázar by the local laws are not prejudiced."

479. Exhibit 127, SEMARNAP's response to the Municipality's *denuncia popular*, February 9, 1996.

480. Exhibit 142, Metalclad Offering Memorandum, February 12, 1996.

481. Ibid at page 6.

The Legal Proceedings Continue

599. On February 12, 1996, SEMARNAP filed a motion to appeal the provisional injunction. The motion was dismissed by the Circuit Court on February 22, 1996.

600. On February 13, 1996, COTERIN also filed a motion to appeal the provisional injunction. On February 15, the Circuit Court ruled against COTERIN's motion.

601. On February 16, 1996, COTERIN filed a motion to appeal the District Judge's:

- decision to accept the Municipality's request for an *amparo*; and
- omission to declare that he lacked jurisdiction over the matter.

602. On March 20, the District Judge suspended the *amparo* proceeding pending resolution of COTERIN's motion.

603. On February 23, 1995, the District Judge granted a final injunction[482].

The Private Placement

604. On February 28th, the Claimant completed its off-shore private placement. It raised $5,975,000 from this placement. Its 10-Q noted that each of Messrs. Kesler, Neveau, and Guerra successfully sold their offerings of 950,000 shares at 4 dollars a share[483].

605. Throughout the January-February period the Claimant's stock was trading between 4 and 6 dollars a share. The Federal judge granted the preliminary injunction against the *Convenio de Concertación* on February 6th and the final injunction on February 27th. The Claimant did not disclose these events to the market or to the subscribers to the private placement until its 10-Q for the reporting period ending February 29, 1996 (one day after the closing of its private placement) was filed on April 15, 1996.[484]

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482. Exhibit 128, Order of District Court in San Luis Potosí, February 23, 1996.

483. Exhibit 10[O] 10-Q for the period ending February 29, 1996, filed April 15, 1996, at page 8.

484. "Although the Company's landfill in the Mexican state of SAN LUIS POTOSÍ has been completed and employees have been trained in landfill operations, the Company is facing legal, political and social opposition which have caused substantial delays in commencing commercial operations at the landfill. During fiscal 1995, at the request of the Federal agencies of the Mexican government, the Company completed additional engineering and site studies, the results of which demonstrated the viability of the SAN LUIS POTOSÍ site as a hazardous waste landfill and the project has been endorsed by

Further Legal Proceedings

606. On March 13, 1996, Metalclad moved to challenge the San Luis Potosí District Judge's decision to grant a final injunction in the *amparo* requested by the Municipality.

607. On March 28, 1996 the Circuit Court ruled against COTERIN's motion filed on February 16th. The proceeding was thus reinstated.

608. On April 23, 1996, the Municipality dismissed Metalclad's administrative action challenging the decision to deny COTERIN's application for a construction permit.

609. On April 25, 1996, the San Luis Potosí District Judge withdrew from the *amparo* proceeding requested by the Municipality, having found that he lacked jurisdiction by reason of the fact that:

a) The enforcement of the agreement between PROFEPA, INE and Metalclad/COTERIN did not emanate from an executive authority over which he had jurisdiction (it had not emanated from the San Luis Potosí office of PROFEPA, but rather from a federal agency in Mexico City); and

b) To authorize a private party to conditionally conduct commercial activity is not enforceable by the State officer of PROFEPA.

610. In light of the court's jurisdictional decision, the matter was referred to a District Court Judge in Mexico City for further action.

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the Federal government of Mexico. However, the Company has not obtained the support of the state and local government for commercial operation of the facility. Because of the opposition by state and local officials, the Company not been able to establish a timetable for the commencement of revenue-producing activities of the landfill. Consequently, the Company has initiated legal proceedings in Mexico to enable it to open the landfill in accordance with the Federal permits to operate the landfill. These actions are in the process of being adjudicated and the Company is unable to predict their outcome. Furthermore, in response to the Company's legal actions, the local government has commenced legal action to prevent the opening of the landfill. With construction of the landfill and training of potential employees completed, the Company is ready to commence landfill operations upon receipt of public support from state and local governmental officials to assure safe and uninterrupted operations." [Emphasis added]

Form 10-Q at page 11.

In fact, the Municipality was the first to commence legal proceedings. In any event, it is not correct to say that the Municipality commenced proceedings "in response to" Metalclad's attempt to compel the issuance of a municipal construction license. It was in response to the INE-PROFEPA-COTERIN Convenio de Concertación.

611. On May 15, 1995, Metalclad requested an amparo in the District Judge in San Luis Potosí against the Municipality's dismissal of COTERIN's administrative action. The *amparo* was dismissed on June 25, 1996 by the District Judge in San Luis Potosí on the ground that COTERIN had failed to first appeal the decision to the administrative tribunal.

The 10-K for the Year Ending May 31, 1996

612. Metalclad's 10-K for the fiscal year ended May 31, 1996 (the "1996 10-K") stated, *inter alia*:

> "ECONSA, through a subsidiary, owns a completed hazardous waste landfill and treatment facility in the State of San Luis Potosí. The landfill is located in the remote area of La Pedrera, Guadalcázar and is known by its trade name, El Confin. It comprises 2,200 acres of land, has a permitted capacity of 360,000 tons of waste per year and is designed presently to handle approximately 160,000 tons per year when fully operational.
>
> "El Confin is presently not in operation because the governor of San Luis Potosí is actively opposed to its opening. Even though ECONSA believes the state has no authority over activities relating to hazardous waste management or permitting and the landfill meets or exceeds all applicable environmental standards, Mexican political custom accords the governor broad rights within his state. The Company is working with the Mexican federal authorities to resolve this dispute between federal and state authority. The Company has been assured by the highest level in the Mexican government that the Company's investment will be respected. The Company believes that the effort shown by the federal government of Mexico will be fruitful, however, no guarantees or assurances can be made."
>
> "There is currently administrative litigation involving the community, state, federal government, and the Company, in which the Company believes its positions are supported by the relevant facts and statutes. However, the Company also believes that even success in the litigation will not permit operation if the governor is actively opposed to the project"[485].

613. On June 7, 1996, the First District Judge on Administrative Matters in Mexico City accepted jurisdiction over the Municipality's *amparo*.

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485. Exhibit 10[P], 10-K for the fiscal year ending May 3, 1996 at page 4. [Emphasis added]

614. On June 20, 1996 the Circuit Court charged with resolving the appeal concerning the final injunction declared that it too lacked jurisdiction as a result of the District Judge's own lack of jurisdiction.

615. On June 25, 1996, the District Judge of San Luis Potosí dismissed COTERIN's request for an *amparo*, finding that it had failed to properly invoke its administrative remedies through the state administrative tribunal. COTERIN challenged the District Judge's decision, but subsequently abandoned its appeal on October 31, 1996.

616. Thus, the judicial decision rendered the Municipality's denial of the construction permit final.

617. On June 27, 1996, the *Ayuntamiento* appealed the District Judge's withdrawal from the *amparo*. Consequently, the First District Judge on Administrative Matters of Mexico City returned the file to the District Judge of San Luis Potosí, the proceeding having been suspended until the jurisdictional issues were definitively resolved.

Further Opposition From Greenpeace

618. By letter dated July 1, 1996, Greenpeace Mexico requested from PROFEPA information concerning COTERIN's obligations under the November 24, 1995 *Convenio de Concertación* . The request was made because Greenpeace had observed that after seven months of the signature of the agreement no remedial work had been undertaken by the company. Greenpeace requested, *inter alia*:

a) copies of the monthly reports the company was to submit to PROFEPA on the works and activities done pursuant to the action and remedial plan (sections 1 and 7 of the agreement);

b) copies of the "protective and corrective action plan and schedule to address violations" (section six of the agreement);

c) information on the current status of the activities under the company's Comprehensive Remedy Plan and Program;

d) a copy of the technical justification of delay in works and activities scheduled in the action plan (section eight of the agreement);

e) monitoring reports on the three confinement cells with the 20,000 tons of hazardous waste;

f) a report on the inspection activities of PROFEPA (section nine of the agreement); and

g) a report on the establishment of a PROFEPA office in the facility (section ten of the agreement).

619. Greenpeace further asserted that La Pedrera did not meet environmental standard NOM-055, and considering the scientific uncertainty of whether the underground waters might be contaminated, COTERIN's action and remedial plan should include the exclusive final disposal of waste in another landfill that met the technical standards.[486]

Negotiations Between the State and the Claimant

620. By memorandum dated August 21, 1996, San Luis Potosí Government's counsel Leopoldo Burguete Stanek of Bryan, González Vargas y González Baz briefed the State Government with the results of the meeting held that date between the State counsel, Metalclad lawyers and a U.S. Embassy official. Present at the meeting were Manuel García Barragán and Gustavo Carvajal for Metalclad, Salvador Ávila Lamas, Jaime Suárez and Leopoldo Burguete for the State, and John Harris on behalf of the U.S. Embassy. The meeting started with Metalclad lawyers insisting the only issue to discuss was the statements made by the San Luis Potosí Government in the last meeting in *Los Pinos* (Mexico's President's Office) that Metalclad had no legal participation in COTERIN, had not filed a record with the Foreign Investments Registry, and had made false statements to the U.S. Securities Exchange Commission. The State lawyers apologized and confirmed this was no longer an issue in the case.

621. However, they noted the State Government's views with regard to Metalclad's false statements to the Securities Exchange Commission, referring to the statement made by Metalclad affirming it had all the necessary permits to operate a hazardous waste landfill in Mexico. State counsel then explained COTERIN's violations of domestic law, and insisted that any solutions should acknowledge and address the violations. Prompted by Mr. Harris, State counsel stated that in order to solve the problem, it was necessary that the site be cleaned up and closed, and that COTERIN operate in another site. Metalclad mentioned a number of possible solutions but noted that to operate in another site, it was absolutely necessary to be able to operate in La Pedrera for a few months while the alternate site was built in order maintain investors' confidence. Metalclad agreed to prepare a proposal where the needs of the Municipality would be addressed so the Municipality could then face its socio-political circumstances in order to accept the opening of the site.

622. By letter dated August 22, 1996, COTERIN's Mexican counsel Manuel García Barragán and Gustavo Carvajal Isunza thanked San Luis Potosí counsel for the August 21 meeting and enclosed the company's proposal to solve the problem. The proposal document, entitled "Actions that Confinamiento Técnico de Residuos Industriales S.A. de

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486. Exhibit 129, Letter from Greenpeace Mexico to Proc. Antonio Azueta, July 1, 1996.

C.V. ("COTERIN") suggests in order to solve the Problem concerning the Hazardous Waste Landfill in La Pedrera, Municipality of Guadalcázar"[487] stated that COTERIN:

a) agreed to remedy the landfill in accordance with the deadlines established in the November 24th agreement with the federal environmental authorities, and to accelerate the process as much as possible;

b) needed to operate the landfill at least for the time it took to establish a new facility, including the permitting process. The company agreed to begin the remedial work immediately and its operations four months from the beginning of the clean up;

c) required the State Government to authorize the establishment of a new hazardous waste landfill in one of the sites selected by the University of San Luis Potosí. The company also requested State Government support to:

    i) obtain the federal permits as soon as possible;

    ii) issue the applicable state permit;

    iii) obtain the Municipality's approval;

    iv) solve any land ownership issue, if there was one.

d) finally, COTERIN promised that BFI-Omega, S.A. de C.V., a subsidiary of Browning-Ferries Industries and Metalclad Corp., would operate both sites.

623. By letter dated August 26, 1996, John H. Harris of the U.S. Embassy in Mexico informed San Luis Potosí Legal Affairs Director Salvador Ávila Lamas that he had briefed Ambassador Jones on the progress made during the August 21 meeting with Metalclad counsel. The U.S. Ambassador had also received the latest proposal of the company and was sure it would find a proper response from the State authorities. The fact that Metalclad was willing to change the location of the site in a short period of time, to work with the State to find and develop another site, and to work with the Municipality to answer any doubt was encouraging. The Ambassador expected the State Government would have a response in the next days, as the deadline for reaching a settlement would soon expire.

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487. Exhibit 130, Acciones que propone Confinamiento Técnico de Residuos Industriales, S.A. de C.V. ("COTERIN") Empresa Subsidiaria de Metalclad Corporation, al Gobierno de San Luis Potosí para resolver el Problema del Confinamiento de Residuos Peligrosos ubicado en la Pedrera, Municipio de Guadalcáza.

624. By memorandum dated August 26, 1996, San Luis Potosí Government counsel Leopoldo Burguete Stanek informed his client that COTERIN's proposals of August 22, 1996, were the same proposals the company had previously made.

625. By letter dated August 27, 1996, Salvador Ávila Lamas responded to Mr. Harris' letter of August 26, 1996. Ávila Lamas informed Mr. Harris that Metalclad's proposal was being reviewed with great care, considering time of the essence in the matter. The State's response would be made known to Mr. Harris as soon as possible.

626. By facsimile dated August 28, 1996, Fernando Bejarano of Greenpeace Mexico sent to Salvador Ávila Lamas a copy of a newspaper article published that date in *La Jornada* newspaper about the risks posed by the Guadalcázar facility. According to the article, Health Department officials declared that they had found so far that year 23 cases of mutations (nine of them brain-related), 91 abortions, and 34 types of cancer produced by the site's contamination, which had affected people of the region from 20 different surrounding communities. The Deputy Chief of the Sanitary Regulation of the State's Coordinated Public Health Services[488], Héctor Marroquín, claimed that the transfer station was now a "huge bomb" of 4 kilometers in diameter.

627. By letter dated August 28, 1996, Fernando Bejarano of Greenpeace Mexico provided *La Jornada* newspaper with a comment on a statement made in an article published by the newspaper on that date, suggesting that, because of their opposition to the opening of the landfill, Greenpeace, a local environmental group, and the Municipality of Guadalcázar were responsible for the thousands of tons of hazardous waste remaining in the site. Mr. Bejarano stated that it had been the on-going demand of Greenpeace, the Guadalcázar Municipality and the local environmental group Pro San Luis Ecológico that the site be cleaned and that the more than 20,000 tons of waste removed before closing the site permanently, as it was not located in a suitable place to operate as a hazardous waste landfill. Mr. Bejarano noted that the denial of the construction permit by the Municipality was not a legal prohibition for COTERIN-Metalclad to fulfil its obligation to clean the site. In Mr. Bejarano's view, the newspaper article did not address INE's responsibility for allowing the introduction of thousands of tons of hazardous in 1991 without requesting an environmental study, or PROFEPA's responsibility for not prosecuting the environmental crime and for not enforcing the company's obligation to clean up.

628. By facsimile dated September 9, 1996, Governor Sánchez Unzueta received a four page English description of the Foreign Corrupt Practices Act[489].

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488. Subjefe de Regulación Sanitaria de los Servicios Coordinados de Salud Pública del Estado.

489. Exhibit 131, Fax to Governor Sánchez Unzueta re: Foreign Corrupt Practices Act, September 9, 1996.

629. On October 2, 1996, Metalclad filed the notice of intent pursuant Article 1119 of the NAFTA[490].

630. On October 31 COTERIN filed a motion before the Supreme Court withdrawing from the appeal regarding the District Judge's decision to reject the *amparo* that it filed challenging the Municipality's denial of a construction permit.

631. On December 13, 1996, the Circuit Court resolved the *Ayuntamiento's* appeal regarding the San Luis Potosí District Judge's jurisdiction. On January 6, 1997, the Mexico City Administrative District Judge, received the file on the Municipality's *amparo* concerning its administrative challenge of the *Convenio de Concertación* and admitted the case definitively on January 13th.

Negotiations Between the Municipality and the Claimant

632. On October 30, 1996 Municipal President, Leonel Ramos and the Secretary of the *Ayuntamiento,* met with Metalclad officers at the *Casa de Gobierno* to analyze different ways to resolve the La Pedrera issue. Mr. Carvajal testifies that the Municipal officials "stated twice that the construction license would not be a problem if they had enough assurances of the safety of the landfill and after making sure the community would get the economic benefits they felt it deserved for hosting this investment". Mr. Ramos denies that the Municipal officials agreed that the construction permit would not be a problem. Consistent with the Municipality's position throughout, he states that:

> "The Municipality, and not only during my administration, has always expressed that the enterprise does not have the municipal construction license, much less the operating license, which are essential requirements provided for under the San Luis Potosí State Ecological and Urban Code and the Treasury Act for the Municipalities of San Luis Potosí."

633. Mr. Ramos continues:

> "The enterprise had twice requested the construction license and it was twice denied because it did not comply with the legal requirements. The second time the license was denied, it filed an *amparo* challenging the *Cabildo*'s determination; but this denial became final by the judicial authority's determination to reject the *amparo*."[491]

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490. Exhibit 132. Notice of Intention to Submit a Claim to Arbitration, received October 2, 1996.

491. Witness statement of Leonel Ramos Torres.

634. In November 1996, Metalclad submitted another proposal to the State Government. On December 12th Mr. Ramos wrote to Governor Sánchez Unzueta acknowledging receipt of Metalclad's proposal and advising him that that the Municipality could accept some points, but that it disagreed with others. He thus requested that the full *Cabildo* meet with the enterprise in San Luis Potosí City.

635. On December 26, 1996, the members of the *Ayuntamiento*, including the Municipal President, met again with COTERIN's counsel to informally discuss alternatives to resolve the issue. The Municipal President, the Secretary, and its counsel, Leonel Serrato[492], attended on behalf of the Municipality. Mr. Carvajal attended on behalf of the company. The Municipal officials were informed that the company had desisted from legal action against the Municipality in a good will gesture to promote negotiations that could lead to the remediation of the facility. The Municipal officials declared they were open in good faith to the dialogue and negotiations[493].

636. The Claimant asserts that: "The Parties arrived at agreement on a number of points... [which] included the Governor's 'revalidation' of the land use permit, the termination of the Municipality's *amparo* action, and issuance of the local construction permit"[494]. Mr. Carvajal testifies that the parties agreed that the company would remedy the transfer station and operate the landfill simultaneously. He also says that the parties would expeditiously work in the preparation of an agreement and protocol, to be completed, agreed and executed by January 30, 1997, after which the construction license would not longer be an issue[495].

637. Mr. Ramos Torres and Mr. Serrato testify that there was no agreement to operate the landfill; their testimony is corroborated by independent evidence.

638. Indeed, in the *Acuerdo de Entendimiento*[496] signed on January 8, 1997 by the Municipality and Metalclad there was no agreement to operate the landfill, revalidate the land use permit or issue the construction permit. The Municipality's main concern was remediation. While it is true that Metalclad stated that it needed to remedy the transfer

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492. In his witness statement, Mr. Carvajal states that Mr. Leonel Serrato assured, on behalf of the Governor, that the Governor was committed to resolving the problem, and that he was very concerned that this problem be raised before an international tribunal (at page 13). Mr. Serrato, has denied such allegation. He testifies that he was counsel for the Municipality, that he had no mandate nor was he in any official position to speak on his behalf (witness statement of Leonel Serrato, paragraph 12, at page 3).

493. Exhibit 133, Confidential memorandum from Leonel Serrato to Dr. Pedro Medellín.

494. Memorial, paragraph 126, at pages 98-99.

495. Witness statement of Gustavo Carvajal.

496. An agreement of understanding.

station while simultaneously operating the landfill, the Municipality made it clear that any agreement concerning commencement of operations had to be approved by the community. Furthermore, the discussion regarding the operation of the landfill referred to non-hazardous waste only. Even the draft prepared by counsel for the Claimant reflected this[497].

639. By facsimile dated December 27, 1996, Mr. Carvajal sent Mr. Serrato, a draft of an *Acuerdo de Entendimiento* reflecting his view of the discussions of the proceeding day for comment. The draft contained the following crucial elements:

> "1.2 The parties acknowledge the need to remedy, as soon as possible, the transfer station where the waste that was disposed of by the prior owners of the Enterprise is located.
>
> 1.3 The parties acknowledge that, for technical and economic reasons, the Enterprise needs to operate the controlled non-hazardous industrial waste landfill.
>
> 1.4 The parties acknowledge that, it being impossible to have the support of all the inhabitants of the Municipality in order to operate the landfill, it is essential that a great majority of the inhabitants support any decision in this regard."[498]

640. On January 8, 1997, the Municipality and COTERIN met again as scheduled in the December 26th meeting. At this time, all of the members of the *Ayuntamiento* and Mr. Serrato attended the meeting. Mr. Carvajal, and Javier Guerra attended on behalf of the company. The company acknowledged its prior wrongdoing, acknowledged not having complied with Municipal law and "public harmony" (its representatives admitted having funded the political campaign of an opposition candidate in the 1994 elections), and declared that they wanted to change this by establishing a direct and healthy relationship with the Municipal Government. The Municipality and the company signed an *Acuerdo de Entendimiento*. In the agreement, the parties acknowledged:

a) that respectful, reasoned and open dialogue was the most efficient way to reach a comprehensive solution to the problem of remedying and operating the La Pedrera landfill;

b) the need to remedy the site as soon as possible;

c) that because of technical and economic reasons, in order to remedy the site,

497. Exhibit 134. See also witness statements of Leonel Ramos Torres and Leonel Serrato Sánchez.

498. Ibid. [Emphasis added]

the enterprise needed to commercially operate the landfill, in a controlled manner and as a deposit for non-hazardous industrial waste;

d) that notwithstanding that the dialogue was being conducted with the authorities of the *Ayuntamiento*, any agreements would need the approval of the people of Guadalcázar; and

e) that the majority of the people of Guadalcázar had to support the opening of the landfill.

641. The parties agreed:

a) to work together to reach a solution to the remedial and operation problem of La Pedrera, and to sign an agreement and a further protocol detailing the negotiations held and commitments made;

b) to hold negotiations in three stages: (i) between the *Ayuntamiento* and the company representatives; (ii) with a citizen's ecology group; and (iii) with a representative group of of the community;

c) that the remediation and operation, if there was ultimate agreement on the latter, be conducted by another company;

d) that a citizen's committee be established to supervise the fulfillment of any agreement reached by the parties, and would be able to recommend a halt to the company's operations;

e) to cease and desist from any current legal action regarding the problem that may affect the commitments made in the agreement;

f) to decide by consensus what information would be publicly released;

g) not to cancel the negotiation unilaterally; and

h) to try to reach solutions and agreements before the end of the Municipal administration, and to establish a liaison mechanism to continue the negotiations and agreements with the next administration[499].

642. The agreement was defined as an outline to guide the negotiations and was not to be considered a legal contract. The parties declared that the agreement was signed without prejudice to other judicial or non-judicial actions and rights that may avail them. The agreement and all negotiations and discussions surrounding it were to be confidential.

499. Ibid.

The agreement was signed by Gustavo Carvajal Isunza on behalf of the company and Leonel Ramos Torres on behalf of the Municipality[500].

643. The *Acuerdo de Entendimiento* directly contradicts the Claimant's contention and is consistent with the Municipality's position throughout —as well as with the testimony of Messrs. Ramos and Serrato— regarding the need to remedy the site and to have the approval of the community in order for the landfill to operate. Also, as the Respondent has already stated, the Claimant and the Municipality agreed that if the site were to operate, it would do so as a non-hazardous waste landfill.

644. The Tribunal should note that in his transcription of the *Acuerdo de Entendimiento*, Mr. Carvajal has changed or omitted crucial words in this document. The Respondent will submit that this was not a mere error in translation. Both the Spanish and English versions of his witness statement omit the words.

645. The Respondent directs the Tribunal to the express language of the original *Acuerdo de Entendimiento*, a copy of which is attached as an exhibit to Mr. Serrato's written statement:

> "1.1 The parties privilege a respectful, reasoned and open dialogue as the most efficient way to reach a comprehensive solution to the problem of remedying and operating the controlled industrial waste landfill[501] located in the plot of land known as "La Pedrera" in "THE MUNICIPALITY" of Guadalcazar...
>
> 1.3 The parties acknowledge that, in order to remedy the site, "THE ENTERPRISE", for technical and economic reasons, needs to commercially operate the landfill, in a controlled manner and as a deposit for non-hazardous industrial waste...
>
> 2.3 "THE MUNICIPALITY" and "THE ENTERPRISE" agree that the remediation and, if it were the case, the operation of the industrial waste landfill located in the plot of land known as "La Pedrera" in the Municipality of Guadalcazar, S.L.P., will be performed by a company other than that in question (Metalclad Corp. and/or COTERIN, S.A.)...
>
> 3.1 It is the parties' intention that this Agreement not be considered a binding contract and that it simply serve as a guide for future discussions on the

500. Ibid.

501. In his transcription, Mr. Carvajal replaced the words "controlled industrial waste landfill" with "hazardous waste landfill" (witness statement of Gustavo Carvajal, at page 16).

remediation and operation of the non-hazardous industrial waste landfill in the plot of land known as "La Pedrera" in the Municipality of Guadalcázar, S.L.P."[502]

646. On January 8, 1997 the Supreme Court expressly confirmed the District Judge's decision to reject the *amparo* filed by COTERIN against the *Ayuntamiento*'s December 5, 1995 denial of a construction permit[503].

647. A further meeting of the Municipality and Metalclad was scheduled for January 11, 1997, but was not held until January 18th. The same persons attended both meetings. Mr. Serrato testifies that the company asked to begin the meeting by showing a video of Metalclad's facilities in Texas[504]. The Tribunal should note that Metalclad does not have any landfill facilities in Texas, or elsewhere for that matter. Thereafter, the parties discussed a proposal submitted by the company on November 11, 1996. The *Ayuntamiento* stated that the proposal was unacceptable because, in addition to being contrary to the *"Acuerdo de Entendimiento"*, the residents of the Municipality would not accept it. The company representatives told the *Ayuntamiento* that anticipating its negative response, the company had initiated a dispute settlement procedure under NAFTA to request the payment of damages. Having said this, the company's representatives ended the meeting and concluded all talks contemplated by the *"Acuerdo de Entendimiento"*[505].

648. Although the Memorial alleges tht the negotiations concluded on January 7,[506] by letter dated February 14, 1997, Gustavo Carvajal sent Mr. Ramos Torres, "the latest draft of the *Convenio de Concertación"* prepared by COTERIN's Board of Directors . Mr. Carvajal sent the draft in case the members of the *Ayuntamiento* wanted to analyze the company's proposal. The draft contained the following provisions:

a) the company committed to remedy La Pedrera pursuant to the remedial plan approved by PROFEPA, within 24 months after signing the agreement;

b) the company would commercially operate through another company for a maximum of 60 months;

c) commercial operations could be further extended only if approved by the Municipality of Guadalcázar, in addition to the competent federal and local

502. Ibid. [Emphasis added]

503. Exhibit 135.

504. Witness statement of Leonel Serrato.

505. Ibid. See Exhibit 133.

506. Memorial at paragraph 129, page 99.

authorities;

d) acknowledgement that the amendments to the 1996 environmental regulatory framework had reduced the type of hazardous waste that could be confined. Thus, La Pedrera could not receive foreign waste, *polychlorinated biphenyls*, radioactive waste, medical waste or liquids;

e) a fifteen member Guadalcázar citizens' committee would be established to supervise the operation of La Pedrera. The members would be appointed by the Municipality and would be paid by the company a salary equivalent to three times the minimum wage;

f) the citizen's committee could propose a stay of activities in La Pedrera if it received repeated and justified complaints of actions that could jeopardize the health and safety of the local people. The Municipality would hear the views of the company's representatives and PROFEPA, and two expert opinions. The experts would be designated by common agreement between the company and the Municipality;

g) The Municipality would be allocated one percent of the landfill's net income on a monthly basis, but no less than 1 million pesos, through an agreed mechanism. These funds would be preferably destined to care and improvement of the environment in the Municipality;

h) within six months, the company would gradually hire and train a minimum of 200 residents of the Municipality;

i) the company and the Municipality would cooperate in the development of public awareness campaign about the remedial and operation activities in La Pedrera, and would promote environmental culture;

j) remediation and operation of the La Pedrera landfill would be carried out according to the November 24, 1995 agreement between the company, INE, and PROFEPA, which would be incorporated therein.

The Amparo Is Rejected

649. On July 15 1997 the Administrative District Judge issued her decision rejecting the *amparo* filed by the Municipality of Guadalcázar against SEMARNAP's determination on the administrative complaint and its omission to resolve the *denuncia popular*. She concluded that the Municipality did not have standing to file an *amparo* since it was acting in its official capacity and, therefore, could not invoke individual constitutional rights (*garantías individuales*). Rather, it should have initiated a constitutional dispute action.

The July-August 1997 Newspaper Stories

650. During late July and August 1997 the media, in particular *Excelsior*, a Mexico City newspaper, published a series of articles on the La Pedrera landfill. This reflects a continuing interest in this matter, but it cannot be taken as evidence of anything more. As for some of the events or statements atributed to officials that the press reported in error, the Respondent directs the Tribunal to the witness statement of Secretary Julia Carabias.

The "Real de Guadalcázar" Reserve Administrative Decree

651. On September 20, 1997, the San Luis Potosí government promulgated an administrative decree declaring the region historically named "Real de Guadalcázar" (comprising an area of over 188,758 hectares) as a natural protected area.

652. The Tribunal should note that Article Four of the Transitory Provisions of the Decree preserves existing permits and authorizations: "The permits, licenses or authorizations granted prior to the entry into force of this measure will continue to have its legal effects..."[507] and Article Seven provides that:

> "The General Coordination of Ecology and Environmental Proceedings, pursuant to article 121, section II of the Political Constitution of the United Mexican States and 15 of the Political Constitution of the State of San Luis Potosí, may authorize public or private works within the "Real de Guadalcázar" State Reserve's core areas, provided that projects submitted demonstrate and assure the sustainability of natural resources and that the existing ecological legal framework, the applicable legal provisions and the guidelines established in the respective handling program are observed."[508]

The Circuit Court Orders the Reinstatement of Part of the Amparo Proceedings

653. On January 14, 1998 the District Judge resolved a motion filed by the municipality challenging the failure to request it to provide an address for service of court documents in Mexico City when the amparo was admitted. The Judge resolved in that the January 24, 1997 notification of the admittance of the amparo had not been properly made, and ordered that proceedings be reinstated as from that date. The District Judge's decision of July 15, 1997 thus became invalid and the injunction was re-established. A constitutional hearing was set for March 3, 1998.

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507. Claimant's Exhibit 29.

508. Ibid. [Emphasis added]

III. THE RESPONDENT'S SUMMARY OF THE FACTS

The Contaminated Transfer Station Site

654. While under Mexican ownership, COTERIN was authorized to construct a transfer station at La Pedrera. During the purported construction of the station, COTERIN accepted delivery of over 20,000 tonnes of hazardous waste which were stored in unprotected conditions. This resulted in a federal closure order being issued on September 25, 1991. The Claimant conceded in January 1994 that the site was contaminated and posed a serious threat to the health and safety of the local community.

655. COTERIN's acceptance of the large volume of hazardous waste without authorization angered the local community and made them suspicious of COTERIN—whether Mexican or foreign owned—and of the federal authorities who had approved the transfer station. Residents and citizens' groups of Guadalcázar , the *Ayuntamiento*, and those of the surrounding municipalities sought remediation of the site and opposed the construction of a landfill. (They in turn were later joined in their opposition by Pro San Luis Ecologico and Greenpeace Mexico).

656. The nationality of COTERIN's owners was irrelevant to the community's views on the landfill; even the idea of a landfill was not opposed; it was the nature of the toxic waste sought to be disposed of there.

657. The *Ayuntamiento* governs the municipality. Members of the council are elected every three years. During the relevant period, three councils were elected. Each time, the candidates who opposed the establishment of the landfill were elected. By law, councillors are elected on the basis of proportional representation and most of the *Ayuntamiento's* decisions concerning the landfill were unanimous. The former Governor notes that before the last election in 1997, all candidates for the office of municipal president publicly pledged to oppose the project's opening.

The Federal View

658. COTERIN's actions created a problem for the federal authorities. The waste improperly buried necessitated remediation. Within their jurisdiction, the responsible federal officials supported the idea of a solution that would both solve the immediate problem of the unremediated waste and would contribute to resolving the nation's hazardous waste problem. As Secretary Carabias and Federal Attorney Azuela have testified, ultimately the federal authorities lifted the closure order and signed a *Convenio de Concertación* with the Claimant. This was done not because they were boosters of the project or its proponent. (They did not know that Metalclad had no experience in the business). They did so because they wanted remediation to occur and were satisfied that the technical studies demonstrated that the site was adequate from a geological point of view.

The State's View

659. For its part, the State government of Governor Sanchez Unzueta agreed on the need for a hazardous waste landfill somewhere in the State but, given the social controversy that COTERIN had engendered, as well as having technical reservations about La Pedrera, questioned whether it was the proper site.[509] The Governor consistently told the Claimant and the local community that the landfill project would not be permitted to proceed unless the local community consented to it. His public statement on January 13, 1994 pointed out that the State had warned the Claimant of the problems with COTERIN and the contaminated site before the Claimant acquired it. In late January 1994, having advised that even if the science demonstrated that the site was adequate, there was no guarantee that the people would accept it, the Governor offered the State's support in searching for another site and expediting the permitting of such a site.

The Municipality's View

660. For their part, having experienced what COTERIN had done under color of federal approvals, and what Metalclad attempted to do, three succeeding municipal administrations of Guadalcázar (and the other eleven *altiplano* municipalities) were strongly disposed against COTERIN and the landfill, both when it was proposed by the original Mexican owners and by Metalclad. The Tribunal has received the evidence of the three municipal presidents who chaired the *Ayuntamiento* during the relevant period. They testify that there was consistent and widespread opposition to the landfill.

The Nature of the Opposition

661. The Claimant has referred repeatedly to the studies that concluded that the landfill was technically capable of safe operation. It characterizes the Alemán study as "fraudulent". In the first place, the Alemán study pre-dates the Claimant's acquisition of COTERIN. Mr. Alemán points out that many of the defects ascribed to his study by Metalclad are simply inaccurate. He stands by his study and says that he was in no way influenced by his relationship with Mr. Vargas Garza.

662. While the study was one of the reports that was critical of the site's suitability, the responsible State officials have testified that their positions were not based solely on that study. Their position was based on community opposition and Dr. Medellín 's (and his advisors') technical concerns, and further studies resulting from the involvement of the NGOs.

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509. In the last days of the departing State administration in 1993, the State granted a land use permit. However, the incoming administration was concerned about the project. Governor Sanchez Unzueta would only support it if the local people supported it.

663. It warrants noting that the Humara study, which is trumpeted as conclusively demonstrating the Alemán study's "fraudulent" character, was itself prepared by a member of the family that owned La Pedrera prior to its acquisition by Mr. Aldrett.

664. Quite apart from the merits of the two studies, the Tribunal will recognize the fact that many of the people who become involved in a controversial and complex issue such as the siting of a hazardous waste landfill, particularly ordinary citizens, are by no means experts, nor should they be expected to be such. They are entitled to their opinions and such opinions need not be based on science. As Leonel Serratto observes, one of the Claimant's directors was angered when one of the members of the *Ayuntamiento* asked whether he would store a barrel of hazardous waste in his home. The expert evidence shows that in the case of hazardous waste landfills, concerned people are skeptical of the views of experts.

665. The relevance of the Alemán study is simply that it, like many other sources formed part of the large volume of information (comprising Metalclad/COTERIN's statements and behavior, technical studies, the statements of federal, State, and municipal authorities, media reports, advertisements, meetings, demonstrations, discussions amongst neighbours, friends and families, and so on) that shaped the participants' views.

666. In this regard, the Tribunal is directed to the evidence of Dr. Núñez from Pro San Luis Ecológico, Mr. Berejano of Greenpeace, the three former municipal presidents, and Hermilo Mendez, the man who was appointed *Regidor* of ITAC the *Ayuntamiento* in 1993. It can see that their opposition was neither contrived, nor based on a "fraudulent" study, nor manipulated by State officials or RIMSA.

667. The Tribunal will also have the opportunity to view the videotape that the Claimant has adduced as evidence of the "unruly mob" on March 10, 1995.[510] It will see that the only apparently inebriated individual was a local resident who was inside the company's compound. The only person that seemed armed on the tape was a company security guard. The predominantly female demonstrators were admittedly angry.

668. Every witness who has provided a witness statement for the Respondent's defense and who testifies as to the nature of the opposition, testifies that it was deeply seated and genuine.

669. Opposition to the opening of the La Pedrera site continued unabated throughout the 1991-97 period. The Respondent has adduced many letters and decisions from municipal councils imploring State and federal authorities not to allow the landfill to open. (After the federal government signed the *Convenio de Concertación* in 1995, the municipality commenced legal proceedings against it and secured an injunction).

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510. Letter from Mr. Pearce to Mr. Perezcano dated January 19, 1998. ICSID Administrative Record.

Knowledge of the Municipal Permit

670. When it was wholly Mexican-owned, COTERIN applied for a municipal construction permit.

671. The Claimant has implied ignorance of the municipality's assertion of its permitting authority until years after it acquired the company. COTERIN's application was denied by the Municipality on September 30, 1991.[511] In January, 1992, the *Ayuntamiento* reaffirmed the earlier decision to deny COTERIN the construction permit and, after hearing the views of residents, resolved further that it should in the future deny any permit that COTERIN required in order to construct or operate the landfill.

672. The permit's denial on two occasions is highly relevant to this proceeding in that the denial to a wholly-Mexican-owned firm is the best evidence that none of the actions complained of in this case were based on discriminatory intent. The evidence is that the local people were motivated by distrust of what COTERIN had done as well as by the merits of having large quantities of hazardous waste disposed of in their community in perpetuity, not by the ownership of the capital of the investment.

673. Moreover, it was not even the landfill *per se* that was the basis for the objection: it was the nature of the waste sought to be deposited there. As the 1996 Acuerdo de Entendimiento showed, the municipality was prepared to contemplate Metalclad's operating the site as an industrial landfill while it remediated. The municipality's objection was to the hazardous waste.

The "Invitation" to Invest in Mexico

674. The Claimant alleges that it invested in Mexico only because of the "invitation" of federal and state officials. This was contradicted by its own documents and by the fact that the Claimant purchased an interest in what became ECO-Metalclad (with its proposed investment in Santa Maria del Rio, SLP) in 1991, well over a year before it began to consider acquiring COTERIN.

675. The Claimant's implication that the most senior officials of the Mexican government regarded it as a key contributor to assisting the government in addressing the nation's environmental problems is denied by one of those officials. The evidence of Ambassador Santiago Oñate is that insofar as the Claimant seeks to present an image of close personal relations with senior Mexican officials, it is grossly exaggerated.[512]

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511. Denial of the application for construction permit for an Industrial Waste Technical Landfill. Official letter 79-X-1991, issued by the Municipal Presidency of Guadalcazar S.L.P. on October 1st, 1991: "...after analizing the solicitor company does not have:
    1. Environmental Impact Study required by Federal SEDUE.
    2. Use of Land Permit issued by the State Government.
    3. High Risk control arrising from this project."

512. See the witness statement of Ambassador Santiago Oñate.

Federal Primacy

676. With respect to the alleged claim that representations were made as to exclusive federal jurisdiction, both Ambassador Oñate and Mr. Altamirano reject the claim. Mr. Altamirano points to the express wording of the two permits that he issued to COTERIN in 1993 and to the fact that his superior found it necessary to try to convince Governor Sanchez Unzueta of the project's merits[513].

The June 10th Meeting

677. The allegation that the Governor was fully briefed of its plans, drawings and the like for La Pedrera in June of 1993 is contradicted by the Claimant's public statements six months later when it acknowledged that in the June meeting it had merely raised the possibility of acquiring La Pedrera. The former Governor denies that it even did that. The Claimant committed in January to provide a large volume of documents pertaining to the acquisition of COTERIN and the federal permits.

678. As for this commitment, the State officials testify that they did not receive many of the documents that the Claimant had committed to deliver to them.

679. The Tribunal will recall that Dr. Medellin's evidence is that when La Pedrera was raised with him in August, he told the Claimant that there was strong local opposition. The State's January 13, 1994 public statement is consistent with his testimony. It expressly noted that the State had warned the Claimant and that it had informed it of the need to obtain the consent of the local community.

680. The Claimant did not take issue with the State's assertion but rather publicly acknowledged the need to secure the consent of the local community. It failed to do so. Its public proposal in January to spend 5 million dollars remediating the site if it was able to operate at the same time (a proposal reiterated in June of that year and subsequently) was rejected. The municipality told the Claimant that it must first remediate the site and then it would be willing to talk about commercial operations.

The Claimant's Alleged Lack of Knowledge of the Local Permits Issue

681. The implication that the claimant was unaware of the municipal construction permit is belied by its own documents.

The Claimant's Lack of Experience and Capital

682. The Claimant was undercapitalized and had no hazardous waste management experience. As a result, it was obliged to borrow heavily (and to dilute its stock substantially) in order to finance its entry into the business. As Ms. Williams has testified,

513. Witness statement of René Altamirano at paragraphs 27, 29, and 40.

unlike the two major U.S. and Canadian waste management companies, as a novice, Metalclad had unrealistic expectations.[514]

683. When it sought to prove its hazardous waste credentials to the Governor in early 1994, having never operated a landfill—let alone a hazardous waste landfill—before, the Claimant represented that it was "one of the largest and most respected asbestos abatement contractors in the western United States". In fact, Mr. Kesler (the person who actually made this representation to the Governor) had already closed the asbestos abatement division.

684. On May 27, 1994, the State and Metalclad representatives announced an agreement to remediate the site, find a new site, and acknowledged that La Pedrera would be permitted to receive new waste only if the local community consented. These terms were set out in Dr. Medellin's letter of the previous day to Claimant's local counsel.

685. The Claimant has characterized Dr. Medellín's letter of May 26, 1994 as expressing the State's full support and then has accused the State of reneging on it. It vilifies Professor Milán for writing a proposal on the studies for the alternative site, even though that is what the Claimant had agreed to. Dr. Medellín's letter clearly contains qualifications, the most important ones relating to the La Pedrera project's approval by the local community and the relocation of the landfill to another site. Professor Milán's letter is fully consistent with the evidence that the May 27th agreement was aimed at finding an alternative site.

686. The Tribunal is directed to the press accounts of the news conference. They are cited not as independent evidence of the facts contained therein but as confirming the direct evidence of Dr. Medellín and the intent of his May 26th letter.

687. The Claimant seeks to explain this by asserting that at the press conference Dr. Medellín tended to emphasize the other site rather than emphasize La Pedrera. The Memorial and Mr. Kesler's witness statement portray the May 27th announcement as aimed solely at the opening of La Pedrera for commercial operation. In fact, the site was to be opened for remediation and after that, only if the State and the local community agreed with the company , would COTERIN be permitted to receive new hazardous waste. Moreover, both parties agreed to find an alternative site.

688. In the Respondent's submission, the plain terms of the agreement as confirmed by three newspaper accounts of the press conference are to be preferred over the Claimant's version of these events.

689. It is the Respondent's submission that due to the representations that Metalclad made to its investors, it had to open the La Pedrera site. It had to be able to say that it was operating there because it told its investors that it had all the necessary approvals[515].

514. Expert Report of Marcia Williams at page 48, paragraph 117.

690. Notwithstanding Dr. Medellín's express terms, the Claimant made different representations to the public markets. On May 31, 1994, Metalclad announced, through Mr. Kesler, an agreement with the State officials of San Luis Potosí. According to Metalclad's press release, Governor Sánchez Unzueta called a press conference at his office on May 27, 1994, "to announce an agreement had been reached with Metalclad Corporation that insures that Metalclad will be the dominant waste management company in San Luis Potosí". The Metalclad press release then stated:

> "Dr. Pedro Medellín, coordinator of ecology for the state, announced that, after many months of work and discussion, an agreement had been reached between the following salient terms:
>
> - Metalclad would characterize and remediate the prior Aldrett transfer station;
> - Metalclad will receive full state support, as well as local encouragement, for using the recycling, landfilling, incineration and waste minimization for all forms of hazardous waste technologies;
> - The state will cooperate with Metalclad in locating additional sites for facilities in San Luis Potosí for future use, in accordance with the governor's economic development plan, thus creating an environment for expansion of economic development in a way that fully protects the environment.
> - Metalclad subsidiary, Química Omega, will immediately establish a waste oil and liquid waste collection facility in San Luis Potosí, providing a solution for the problem of hazardous materials that find their way into the public sewers."[516]

691. As noted in the Statement of Facts, the press release went on to quote Mr. Neveau as saying that the company would be constructing a "world class facility" that would be "leap-frogging 20 years of technological environmental development in the United States".

692. The implication of this press release is that the May 27th agreement had allowed the Claimant to cross another hurdle and that it would now be constructing a "world class" facility at La Pedrera.

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515. See Medellín Witness Statement.

516. Exhibit 1. [Emphasis added]

693. Metalclad's press release was silent on the continuing key contingency: namely, the State's insistence that La Pedrera could receive new hazardous waste only if the local community and the authorities approved.

The Continued Opposition at the Municipality's Level

694. Local opposition continued unabated. In June 1994, the Claimant made a formal submission to the Municipality. It said that it would employ modern technology and proposed, among other things, to classify and treat the waste unlawfully deposited at the site prior to September, 1991, to provide training and employment to residents of nearby communities, and to allow municipal officials and experts from the UASLP to supervise COTERIN's activities at the site.

695. The Claimant was unable to convince the Municipality. In June, Mr. Neveau advised the Governor that the negotiations had failed and asked him to intervene and compel the Municipality to allow the project to continue. The Governor declined to do so.

The NGO's Involvement

696. Municipal opposition was supported by citizens groups. During this period, Pro San Luis Ecologico became actively involved in opposing the project. In addition, in July 1994 the Governor received a letter from the *Democratic Campesinos Union* complaining that hazardous waste deposited at the landfill site had contaminated the *ejido* El Huizache, causing damage to crops and harm to the health of its residents. PROFEPA also received a letter signed by the President of the Municipality and the entire *Ayuntamiento*, asking PROFEPA to remediate the landfill site and not to authorize COTERIN to operate the site.

Different Reasons Given for Construction

697. The Memorial has asserted that the Claimant commenced construction at the site openly and without objection on May 16, 1994. This is contradicted by the Claimant's own documents.

698. The significance of the May date is that when "construction" commenced, Messrs. Kesler, Neveau and Robinson all claimed their bonuses for the ground breaking of the landfill facility. These bonuses originated in the Claimant's acquisition of ETI (ECO-Metalclad) and were negotiated in consideration of the three individual's agreement to give up a consulting contract for the Santa Maria del Rio site. The assignment of the "triggering event" from one project to another was apparently not disclosed to the company's shareholders. More important for the purposes of this proceeding, the Claimant has apparently included these bonuses in its list of expenditures for which it claims damages from the Respondent.

699. Leaving that aside, the Respondent submits that the Claimant used the cloak of the environmental audit and remediation work to launch construction work at the site. COTERIN sought the removal of the closure seals ostensibly for the purpose of having the audit conducted.

700. Throughout the summer of 1994, the Claimant told PROFEPA that it was performing work related to maintenance. In this regard, the Tribunal will recall that COTERIN received written admonitions from the local PROFEPA delegate that it was conducting unauthorized activities at the transfer station site.

701. On July 18, 1994, for example, the Claimant's facility manager, Mr. Ariel Miranda Nieto wrote to PROFEPA and gave assertions that from the date that the Claimant had acquired COTERIN "until today", COTERIN had done nothing but "maintenance work". Yet the Claimant now says it started constructing openly as of May 16th, 1994.

702. On August 16, 1994, PROFEPA conducted a verification visit and found that unauthorized levelling work in respect to the transfer station was being carried out. The inspector suspended the work on the grounds that COTERIN was only authorized to perform maintenance work.[517] The inspector otherwise found the site to be in the same state as it was when the shutdown order was issued.

703. By letter dated August 19, 1994 COTERIN responded to the August 16th inspection report by submitting that the construction of a bridge and a road to the site and the levelling of cell number two was "maintenance work" required by the federal environmental regulations.[518]

704. On September 20, 1994, COTERIN informed PROFEPA that the environmental audit was underway and that it would be necessary to undertake certain maintenance work which would start immediately if PROFEPA did not object. In fact, COTERIN did not have to engage in this deception because, in respect to federal jurisdiction, INE had already authorized construction of the landfill (even though the transfer station was still shut down).

705. In September and October, therefore, while telling Mexican officials that it was performing only maintenance and remedial work, Metalclad accelerated construction of the landfill at the site. This in turn allowed three directors to claim substantial bonuses.

706. Evidence that the Claimant did not view its work as being "maintenance" work is contained in a Form 10-K report that the Claimant filed on September 14, 1994. The Claimant advised the market that:

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517. Exhibit 2 Verification Report, PROFEPA-SLP, August 16, 1994, at page 5.
518. Exhibit 3 Letter from COTERIN to PROFEPA-SLP, August 19, 1994, at page 1.

"The Company is concentrating its efforts on development, construction, and start-up of phase one at El Confin...Due to market knowledge and existing customer contacts included in the acquisitions of COTERIN and Quimica Omega, management believes that the landfill will operate at full capacity approximately 10 months after opening. The Company believes that the completion of El Confin will enable it to commence hazardous waste treatment and disposal in the fourth quarter of calendar 1994 and be the first firm in Mexico to provide integrated solutions to hazardous waste treatment and disposal."[519]

707. The report went on to review the original agreement with the vendors of COTERIN. It recalled that the "agreement with the minority shareholders of COTERIN required that the Company pay them 500,000 dollars at the execution of the agreement and, upon the occurrence of certain contingencies related to the utilization of the site, requires that the Company pay an additional 1,500,000 dollars and 5% of the gross revenues of COTERIN from its landfill operations for a 10-year period, employ two of the minority shareholders, and provide any required remediation services on the previously operated cells of the landfill."[520]

708. Metalclad then stated that: "...the Company believes that the contingencies upon which the additional payments to the prior owners are conditioned will not occur and the Company will not be obligated to pay the minority shareholders of COTERIN any further amounts."[521] The "contingencies" that the September 9, 1993 amendment agreement contemplated were the Governor's expression of support and the issuance of a municipal construction permit.

709. On the one hand, Metalclad was representing to the investing public that the landfill was almost constructed and ready to operate. On the other hand, it was saying that the contingencies that it had earlier stated were necessary to be met for the landfill to be constructed to operate and therefore oblige it to pay the vendors the balance of the purchase price would not occur. The two disclosures were inconsistent.

710. The private placement representation was made to the European investors who were about to invest in the share offering arranged by Oakes Fitzwilliams & Co.

711. The Respondent will submit that, leaving aside the fact that the Governor's support and local approval had not been obtained, this statement was unrealistic even in terms of federal approvals. The 10-K mentions later that a site audit had been agreed with federal authorities and later acknowledges that the audit had not yet even commenced.[522] (It would not formally commence until December.) It was not possible that the site would be permitted to be opened—even at the federal level—without the audit having been

519. Exhibit 10(H) at page 3. [Emphasis added]
520. Ibid. at page 5.
521. Ibid.
522. Exhibit 10(H).

completed. Given that PROFEPA had issued the audit resolution on August 30th, this could not take place in calendar year 1994 because the audit would not commence until December.

712. Under no circumstances, therefore, could the site "commence hazardous waste treatment and disposal in the fourth quarter of calendar 1994".

713. The Claimant also stated in its 10-K that: "... the company expects to perform an environmental audit of the area previously utilized as a transfer station during the next 12 months to determine if any remediation needs to be accomplished"[523].

714. The 10-K stated further: "If the study demonstrates that remedial work is required, the agreement being negotiated with PROFEPA will provide for site remediation over a period of several years."[524]

715. It is submitted that the suggestion that there was a possibility that remediation might not have to be performed on the 20,000 tonnes of buried waste was misleading. Identifying what had been buried and what steps were needed to remediate the site was the objective of the PROFEPA audit as the Claimant well knew at the time.

716. Indeed, the Claimant itself affirmed this nine months earlier in its January 11, 1994 advertisement in *El Pulso*:

> "...we recognize that a serious danger exists in the event that the facility, approved by the Federal Government, cannot be operated given that the number of containers existing on the site may reach up to 120,000 in number representing close to 30,000 tonnes of dangerous and toxic waste deposited only in ditches which do not meet the construction standards and are only covered with dirt, without complying with the minimum safety conditions and standards and which may pose a great danger to the health of the inhabitants of the communities. Given this grave danger METALCLAD CORPORATION is ready to treat and confine these wastes investing the amount of 5,000,000.00 dollars to meet these ends, thereby avoiding further damage that, at this moment, is already posed to the detriment of the environment."[525]

717. Later, in April, Mr. Kesler had written to Dr. Medellín recognizing the need for remediation.[526]

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523. Ibid., page 5. [Emphasis added]

524. The 10-K describes at length the design of the landfill (by Harding Lawson and Associates) and its plans to carry out "inorganic treatment operation" (treatment neutralization and processing of a broad range of inorganic waste) in conjunction with the landfill operation. [Emphasis added]

525. Exhibit 1.

526. Exhibit 72, letter of April 25, 1994.

718. The Respondent submits that this 10-K filing was typical of the Claimant's behavior throughout the relevant period:

- It downplayed the site's need for remediation. (Indeed, in all of the SEC filings up to this point, the Claimant had never even admitted that there was somewhere in the order of 20,000 tonnes of hazardous waste buried at the site.)

- It made no reference to the fact that the landfill project was encountering stiff local opposition.

- It did not report to investors that prior to its acquiring the site COTERIN had already been refused a construction permit by the municipal authorities.

- It did not advise that the May 27th agreement had made the site's opening conditional upon obtaining local approval and that the agreement contemplated establishing the landfill at an alternative site.

- And, although this last event occurred after the reporting period but prior to the date of the filing, it did not inform investors that Mr. Neveau's proposal to the municipality had been rejected by the *Ayuntamiento* and that Mr. Neveau had then written to the Governor asking him to compel the municipality to permit the project to proceed.

719. The Claimant also described to investors the "encouragement it has received from the state" with respect to the idea of transferring the kiln from Santa Maria del Rio to La Pedrera. The State supported transferring an incinerator to La Pedrera to incinerate the wastes from the transfer station that could not be landfilled during the remediation. The State's support of the project depended on the municipality and the *Ayuntamiento* did not want the La Pedrera site to open at all.

The Audit

720. On August 30, 1994, federal authorities agreed with COTERIN that a comprehensive independent environmental audit should be conducted by a qualified expert (Dr. José Antonio Ortega Rivero of Corporacion Radian) to assess the situation at the site and to prepare a detailed list of the origin, type, location and quantity of the hazardous waste deposited in the confinement cells. COTERIN was ordered to refrain from operating the landfill until completion of the audit and any remedial work required upon review of the audit.

721. During this time, the Claimant unsuccessfully attempted to have Dr. Ortega join its Board of Directors. Dr. Ortega declined the offer.

The Claimant's Financial Position

722. Throughout the relevant period, far from having the financial strength to see an inherently risky investment through the process of permitting, contending with local social opposition, and engaging in legal proceedings (all processes which—as Ms Williams' report demonstrates—an experienced U.S. hazardous waste landfill operator would have planned for), the Claimant had little in the way of financial resources. As Metalclad's own auditors would find and the Respondent's experts have testified, there was a serious doubt as to whether the Claimant itself (let alone COTERIN), was a going concern. The one investment that the Claimant made in Mexico that did carry on business, Quimica-Omega, was bought and paid for with Metalclad stock.

723. The Chicago Partners have pointed out that in January 1994 when the Claimant publicly announced that it would spend 250 million dollars in the State of San Luis Potosi and that it would spend 5 million dollars to remediate the site, the Claimant had cash reserves of only 1 million dollars and debt of over 11 million dollars. By September of that year its cash reserves were down to 318,000 dollars.

724. The Claimant's precarious financial state sheds light on Mr. Neveau's (and Mr. Guerra's) attempt to subvert the environmental audit by inviting the independent auditor to join its Board of Directors.

725. It was at this time that the Claimant made a private placement to European investors. It represented that it was completing construction of the landfill and that it expected to be in commercial operation by the fourth quarter of 1994 (while telling federal and state officials that it was engaged in work related to the audit, to maintenance, and to remediation).

726. The Claimant misled both the governments and its potential investors. Pursuant to the May 27th agreement with the State, the Claimant had put a proposal to the municipality. It was rejected in June. This lead Mr. Neveau to appeal to the Governor. Two weeks before the private placement, the Claimant's Chairman was writing to its legal counsel expressing his view that the company should not apply for the construction permit to avoid raising awareness of the issue and asking for his opinion on whether the federal permits took precedence over the municipal construction permits. (Legal counsel advised it did not take precedence.) The audit had not yet begun and on August 30th, Metalclad had been instructed by PROFEPA that it could not accept any new waste until the audit was completed and a remediation plan was agreed.

Misrepresentations and Omissions in its Reports to Investors

727. The evidence of the Respondent's accounting and securities experts is that the Claimant's reports to the market were misleading. By omitting to inform investors of the site's history, its difficulties in securing State and local approvals and support, that the May 27, 1994 agreement with the State was aimed at finding another site rather than at securing the opening of La Pedrera and so on, the Claimant made commitments to its investors that it would be operating by the end of 1994. This forced Metalclad to meet impossible deadlines.

The Municipal Shut-Down Order

728. On October 26, 1994, Municipal officials visited the site. They were refused access to it. They climbed a nearby hill to observe and then issued a shutdown order on the grounds that COTERIN had not obtained a construction permit as required by municipal law.

729. On November 15, 1994, COTERIN applied for a municipal construction permit. The application attached COTERIN's existing federal and state authorizations and noted that it had first applied for a municipal construction license in October 1991.

More Selective Disclosure

730. In a prospectus filed with the SEC on November 30, 1994, the Claimant added:

- "Although the company...expects to complete the construction of the hazardous waste landfill at El Confin in the fourth calendar quarter of 1994 and commence landfill operations in the first calendar quarter of 1995, there can be no assurance that the company will be successful in its landfill operations."

- "The company believes that it has obtained the support of state and local governmental agencies to operate the facility and has conducted an extensive public awareness and social development plan; however, 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."

- "Participation in ownership of foreign subsidiaries exposes the Company to the effects of potential economic, political, and labor developments, including political instability, nationalization of assets, local inflation and currency fluctuations and restrictions..."

- "Although the INE has granted unconditional permits to construct and operate El Confin, there can be no assurance that construction or operating permits will be granted for additional sites."

- "Although the company has selected sites for El Confin and its other planned facilities in areas where governmental approvals can be obtained, where potential claims from surrounding land owners are anticipated to be minimal, and where public response to a hazardous waste treatment facility is not expected to be unreasonably adverse, there can be no assurance that negative public response would not result in delays, increase costs, or closure of any proposed facility. Because of the lack of facilities in Mexico similar to those proposed to be developed by the company, the company can not predict whether citizens' groups will actively challenge the grant of any license or permit the company may obtain"[527]. The claim that the company had obtained the necessary "support of state and local governmental agencies to operate the facility" was unsupportable, given that five months earlier the *Ayuntamiento* had declined the company's offer, one month previously the shut-down order had been issued by the municipality, and the State would not support the site unless the local community and authorities consented. Equally unsupportable was the claim that the company had selected the La Pedrera site (and others) where potential claims from surrounding land owners were anticipated to be minimal and where the public response was "not expected to be unreasonably adverse".

Construction is Almost Completed

731. On January 1, 1995, a new municipal council was sworn into office. COTERIN's application for a construction license had been left for the incoming *Ayuntamiento* to consider. Although the shutdown order remained in effect, COTERIN accelerated its construction of new works and facilities at the site, reporting to PROFEPA on January 26, 1995, that "construction of the hazardous waste landfill has been speeded up and is almost 80% complete".[528]

732. One of the reasons given by the Municipality when it denied the permit was that COTERIN applied for a construction permit for something that had already been substantially constructed. Therefore, the Municipality found the existence of a "legal contradiction" in that the works were mostly completed before Metalclad actually applied for the permit.

527. Exhibit 10(K) [Emphasis added]
528. Exhibit 90.

The Push to Open the Landfill

733. In February, the Claimant began to push to open the landfill. It claimed to State officials that the U.S. government (the Department of Commerce and the United States Embassy in Mexico) as well as the Mexican Embassy in the United States wanted to see progress on the issue. The company itself wanted to inform the investment community of the progress of the hazardous waste landfill.

734. It decided to host a "Grand Opening" of the site, inviting U.S. and Mexican government officials, and investment analysts and others from Europe, the U.S. and Mexico. This was done even though the federal audit had not yet been concluded, the municipal council remained staunchly opposed, and the State government continued to have reservations because of municipal opposition. The Claimant's attempt to force the landfill's opening was considered a provocation by the local people and their elected officials.

735. Four days before the "Grand Opening", the Claimant wrote to its shareholders advising them that the landfill project had "rock solid local support" and "full political support from President Ernesto Zedillo at the top ... on down to the environmental enforcement agencies of Mexico, the Governor of the State of San Luis Potosi ... to the community of Guadalcázar and the micro communities that surround our site" and that the commercial opening of the landfill was scheduled for March 10, 1995[529].

736. These statements were untrue. The Claimant had not complied with the legal requirements to commence operations. The agreement with PROFEPA had provided that a *Convenio de Concertación* would be executed by the company with PROFEPA to address the necessary remedial work identified by the audit and when such work would be completed. This had not yet been done because the audit itself had not been completed. The Claimant was advised by the Mexican Embassy in Washington, D.C. that it would be premature to hold a "Grand Opening."

737. Nor had the Claimant secured the agreement of the State or the Municipality as to commencement of operations. It had begun construction without applying for a municipal permit and then after the shut down order was issued, applied for a municipal permit and then resumed construction.

738. In short, the Claimant did not have "rock solid local support."

The March 10th Demonstration

739. On March 10, 1995, the "Grand Opening/Facilities Tour" was held. It provoked a spontaneous demonstration by local residents. The evidence is overwhelming that the event did not unfold as portrayed by the Claimant's pleadings and testimony.

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529. Exhibit 93. Metalclad Letter to Shareholders, dated March 6, 1995. [Emphasis added]

The Completion of the Audit

740. At the end of March, PROFEPA provided COTERIN with a summary of the environmental audit and asked it to prepare a plan and timetable for the remedial action necessary to correct irregularities found in the audit.

The Ayuntimiento's Response

741. At the same time, the newly elected *Ayuntamiento* communicated to the Governor its opposition to the opening of the landfill, citing its concern that it would threaten the health of the residents of Guadalcázar. This decision was taken on March 31, 1995, after a unanimous vote of the *Ayuntamiento*.[530]

The Termination of the Retainer with Local Counsel

742. On April 29, 1995, the Claimant's local counsel, José Mario de la Garza, advised State officials that he had terminated his relationship with Metalclad for ethical reasons. He later advised Governor Sánchez Unzueta that he found it necessary to resign upon being instructed by Mr. Kesler to offer the Governor 1 million dollars in order to secure the landfill's opening.

743. The Governor brought this to the attention of the U.S. Ambassador.

744. The Claimant asserts that it terminated the retainer because it became aware of undisclosed conflicts of interest. The Tribunal will note that its letter to the firm purporting to terminate its services is silent on the issue of undisclosed conflicts of interest. Rather, it states that the firm was not sufficiently attentive to its interests and was not responding in an efficient and timely manner.

The Audit of the Audit

745. After the audit was completed, COTERIN was instructed to prepare a plan and timetable of works to correct the irregularities found by the audit. It was advised that the plan would be analyzed by federal officials whose requirements COTERIN would be required to incorporate in the plan. PROFEPA itself completed its own review of the environmental audit on March 28, 1995 and concluded that, although the site was technically suitable for a hazardous waste landfill, there were a number of irregularities.

746. Both the proponent and the opponents found much in the audit to support their positions. The Claimant issued a press release declaring that the audit had given the site

530. The Mexican Constitution and State law require that a pluralistic council be elected. In other words, there is proportional representation of the accredited political parties. This makes the unanimous nature of the decision significant.

an endorsement. The opponents seized on the findings of environmental damage, COTERIN's failure to comply with the law and norms, and the risk of explosion.

747. During the ensuing months of 1995, PROFEPA and SEMARNAP held meetings to discuss the technical findings of the audit. Secretary Carabias testifies she decided to have "an audit of the audit" by having the findings reviewed by university professors from different institutions. This, she hoped, would help to assuage the concerns of the opponents.

748. Meetings of experts were held, both in Mexico City and in San Luis Potosi, but they failed to change the views of the Municipality, Pro San Luis Ecologico, and Greenpeace Mexico. Secretary Carabias admits that these meetings failed to assuage the concerns of the local people. She has no doubt that the opponents were motivated by a good faith belief that the landfill would endanger the neighboring communities.

Further Misrepresentations to U.S. Legislators

749. During this time, the Claimant represented to U.S. legislators that it had all necessary permits, even though its application to the municipality was outstanding. Further, it did not have the State's support and the support of the local community (two things that it had said that it needed to obtain). The Claimant also represented that it would employ many more people than its internal plans contemplated, and that the facility would handle up to 250,000 tonnes of existing wastes (when its State permit allowed 36,500 tonnes per year and the existing federal permit authorized the site to take only 43,200 tonnes annually).

750. The Claimant wrote to U.S. legislators, notably Senators Bill Bradley of New Jersey, Paul Simon of Illinois and Barbara Boxer of California, asking them to in turn write to various Mexican officials including President Zedillo asking the federal government to take whatever measures were available to it to ensure that the hazardous waste landfill opened. Senators Simon and Boxer obliged.

The Governor's Response

751. The Claimant criticizes severely the then-Governor for responding to the letters written to the Mexican government criticizing his actions. It alleges that "in a drastic overreaching of his public power, Governor Sanchez Unzueta, on December 10, 1995, disseminated a letter he sent to U.S. Senator Paul Simon to various significant Mexican and U.S. officials" and to the Claimant's two largest investors.[531]

752. The Claimant orchestrated the letter-writing campaign against the Governor. In addition to the letters from U.S. legislators to senior Mexican officials, the Claimant circulated a letter from Oakes Fitzwilliams & Co. that threatened it with default under its

531. Memorial at paragraph 200.

financing agreement. First Analysis venture capital fund also wrote to U.S. legislators. In the Respondent's submission, it was entirely reasonable for the Governor to respond to those who were criticizing his administration on the basis of an incomplete understanding of the facts.

753. The Claimant knew or ought to have known that its complaints and those of its agents would be communicated to Governor Sanchez Unzueta and that he would respond to them.

754. A year and a half earlier, the Claimant had committed to deliver many documents relating to its acquisition of COTERIN and the site to the State government and did not do so. By this time, the Governor had:

- heard that the Claimant had announced that it was the "cornerstone" of his development plan on the basis of a thirty minute meeting;

- seen advertisements and news stories from American trade journals prematurely announcing the opening;

- seen the Claimant twice publicly denounce his administration in the local newspapers before issuing a conciliatory statement (after the Governor had corrected it);

- seen the May 27, 1994 agreement ignored as the Claimant pressed ahead to try to convince the municipality and when that failed, had asked him to compel acceptance of the project (when he had repeatedly affirmed that he would not force the opening over the wishes of the community);

- seen the results of the attempt at the March 10th "Grand Opening";

- been advised that Metalclad's former local counsel had resigned due to ethical reasons;

- seen letters to the President of the Republic and the Mexican Ambassador forwarded to him which showed that U.S. Senators had been misled as to the true state of affairs; and

- then had his State threatened with blacklisting by the U.S. Ambassador acting at the Claimant's behest.

755. Naturally, the Governor responded to the false accusations being made against him and his officials.

The Results of Grant Thornton's Audit

756. On September 13, 1995 Metalclad filed its 10-K for the period ending May 31, 1995. For the first time, the Company stated that "Construction for phases one and two [of La Pedrera] have been completed and the Company is ready to commence operations upon receipt of public support from state and local government officials to assure safe and uninterrupted operation of the facility."[532]

757. Annexed to its financial statements was a report of its independent certified public accountants, Grant Thornton, who advised that:

> "...the Company has had substantial recurring losses from its operations and has been dependent upon external financing to sustain its operations. These factors, among others, as discussed in Note B to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern."[533]

758. Grant Thornton went on to note that:

> "...the Company has not been granted all necessary governmental authorizations to open and operate its hazardous waste treatment facility in Mexico. The financial statements do not include any adjustments from the outcome of this uncertainty."[534]

759. It continued:

> "Included in property, plant and equipment at May 31, 1995 is approximately $3,325,000 representing the company's investment in its hazardous waste treatment facility in Mexico. The company has not been granted all necessary governmental authorizations to open and operate the facility. The financial statements do not include any adjustments relating to the recoverability of the carrying amount of this asset that might be necessary should the company be unable to open and operate the facility."[535]

760. Metalclad then dismissed Grant Thornton as its auditor.

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532. Exhibit 10(N), at page 3. [Emphasis added]
533. Ibid. at F-1. [Emphasis added]
534. Ibid. at F-2. [Emphasis added]
535. Ibid. at F-14. [Emphasis added]

The Convenio de Concertación

761. Eventually, in the autumn of 1995, PROFEPA, INE and COTERIN negotiated a *Convenio de Concertación*. PROFEPA agreed that so far as the federal government was concerned the site could be operated and the commercial operation could coincide with the remediation of the buried waste.

762. The announcement of the *Convenio de Concertación* created considerable controversy. Although Federal Attorney Azuela issued a press release stating that the federal government was agreeing to the site only insofar as federal jurisdiction was concerned and PROFEPA was not purporting to bind the local governments, the perception of the state and municipal governments was that there was a risk that the federal government was attempting to do so. There ensued a series of legal skirmishes as the municipality and Greenpeace sought to prevent PROFEPA from implementing the *Convenio de Concertación*. In addition, after the *Convenio de Concertación*, local residents threatened civil disobedience to stop the site from operating.

The Claimant's Representation of the Convenio de Concertación

763. As noted above, when the federal government announced the agreement its press release stated:

> "... it is important to clarify that the federal authorizations are a necessary requirement but are not sufficient for the operation of a hazardous waste facility. The company should comply with state legislation on the matter, whose interpretation and application falls exclusively to the local authorities."[536]

764. Although this clearly showed that the federal government was not guaranteeing the landfill's opening, the Claimant portrayed it as such. On November 27th, Metalclad issued a press release that announced on *PR Newswire* that the agreement "insures operations of Metalclad's hazardous waste treatment facility completed in March 1995 for a period of five years".

765. As the expert report of Dr. Zmijewski notes, on November 27th, 1995, the Claimant's market capitalization and stock price increased dramatically. However, the Claimant omitted to inform investors of the reaction of the State and municipality to the news of the agreement.

The Municipality's Response

766. Under State law, the State is obliged to assist a municipality in legal matters. In this case, after being asked for help by Guadalcázar , the Governor recommended that Mr.

536 Exhibit 120, November 25, 1995.

Serratto assist it. His evidence is that after he ascertained the municipality's lack of financial resources, he agreed to act on a *pro bono* basis. He testifies that his client was the municipality, not the State.

767. It is also Mr. Serratto who identifies a major omission in the Claimant's recounting of the negotiations between the municipality and the Claimant. It was he who noticed that Mr. Carvajal's description of the January 8, 1997 Acuerdo de Entendimiento omitted the key words "non-hazardous" when it described the agreement that contemplated the possibility that the Claimant could operate the landfill while it remediated the site. The municipality was prepared to accept the possibility of the Claimant receiving industrial wastes, but only non-hazardous industrial waste.

768. Mr. Ramos-Torres, who signed the agreement, concurs.

IV. THE LEGAL SUBMISSIONS

A. Introduction

769. The specific obligations of Chapter Eleven are informed by certain rules of international law which, taken together, serve to focus the inquiry on the legally relevant facts.

770. The Claimant has made many allegations that, even if true, are legally irrelevant.

771. Before discussing the claims advanced in this proceeding, the Respondent will address the general legal framework which should guide the Tribunal.

B. Interpreting the NAFTA -- Applicable Principles: Article 102

772. The governing rule of the interpretation and application of the NAFTA as a whole is set out in Article 102: "The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law."

773. The interpretation of Chapter Eleven is governed by the actual terms of the NAFTA, taken in context, as well as the "applicable rules of international law". The latter include Article 31 of the *Vienna Convention on the Law of Treaties*[537].

774. In the case of *In the Matter of Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products,* the Panel interpreted this to mean that it should commence its inquiry by identifying the "plain and ordinary meaning of the words used" in the Agreement; such identification would consider "the meaning actually to be attributed to words and phrases looking at the text as a whole and examining the context in which the words appear"[538].

775. Under Article 31 of the *Vienna Convention*, a NAFTA provision must be examined not in isolation but rather in light of the entirety of the Agreement, including its Preamble and Article 102(1), which states the Agreement's objectives[539]. Both inform the Tribunal of the Parties' intentions and place the Agreement's words in their proper

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537. *In the Matter of Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products*, 1 T.T.R. (2d) 975 at paragraph 119.

538. Ibid. at paragraph 120.

539. Ibid. at paragraph 122.

context.[540] Other agreements that were made in connection with the conclusion of the Agreement may also be considered.[541] They form part of the context within which the words of the provision in question are examined.

776. International agreements express the common intention of the Parties. It necessarily follows that the objective of treaty interpretation is to ensure that the Agreement is interpreted and applied in a manner that gives effect to that common intention.[542] The principle of good faith in interpreting an international agreement underlies the concept that the interpretation should not lead to results that are manifestly absurd or unreasonable.

C. Preliminary Issues

777. Article 1131 of the NAFTA states that in an investor-state arbitral proceeding, "A Tribunal established under this Section shall decide the issues in accordance with this Agreement and applicable international law".

778. Rules of international law and of Chapter Eleven direct the Tribunal to the legally relevant facts and issues. These rules are:

a) The rule of non-retroactivity, which establishes that the Respondent cannot be held responsible for acts or omissions that allegedly occurred prior to the NAFTA's entry into force;

b) NAFTA Articles 1119 and 1120, which provide specific temporal limits to the claims which can be advanced in this proceeding; and

c) The imputability rule, which holds that a state is internationally responsible only for the acts and omissions of its officials and organs.

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540. Ibid. Moreover, it is a well established practice for WTO Panels and the WTO Appellate Body under the Understanding on Rules and Procedures Governing the Settlement of Disputes under the Marrakesh Agreement Establishing the World Trade Organization to rely on the preamble or the "objectives" provision of an agreement for purposes of establishing the meaning of an expression contained in a substantive provision of that agreement. See *E.C. Measures Concerning Meat and Meat Products (Hormones)*, WTO Doc. WT/DS26/AB/R, January 16, 1998 (AB-1997-4), at paragraph 165; *United States – Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/AB/R, April 29, 1996 (AB-1996-1), at page 30. See also Sir Ian Sinclair, *The Vienna Convention of the Law of Treaties*, 2nd edition (Manchester: Manchester University Press, 1984) at pages 127-128.

541. See *The Vienna Convention on the Law of Treaties*, article 31:2(b).

542. Lord McNair, *The Law of Treaties*, (Oxford: Clarendon Press, 1961) at page 365.

1. The Non-retroactivity Rule

a) Content of the Rule

779. Article 28 of the *Vienna Convention* sets out what Sir Ian Sinclair has called "the basic rule of non-retroactivity of treaties", namely, that unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act that took place before the date of the treaty's entry into force[543].

780. NAFTA Article 2203 states that, "This Agreement shall enter into force on January 1, 1994, on an exchange of written notifications certifying the completion of necessary legal procedures." This is in fact what happened.

781. By virtue of Article 1117, the Tribunal is empowered to consider alleged breaches of Section A of Chapter Eleven. Since NAFTA entered into force on January 1, 1994, it was only as of that date that the three Parties became bound by the obligations contained therein, including those of Chapter Eleven.

782. Metalclad acquired COTERIN (and other companies in Mexico) prior to January 1, 1994, and thereafter Metalclad and its investments enjoyed the protections of Chapter Eleven as of that date. This is made clear by one of the explanatory notes to the Agreement, NAFTA Note 39, which states that "this Chapter covers investments existing on the date of entry into force of this Agreement as well as investments made or acquired thereafter".

783. If an alleged contravention of Chapter Eleven took place after the Agreement's entry into force, NAFTA Note 39 confirms that a claimant with an existing investment is entitled to seek relief. However, NAFTA Note 39 does not make Chapter Eleven retroactive in effect. It simply clarifies that the Chapter applies not only to new investments made after January 1, 1994, but also to those that were in existence at that time.

b) Application of the Rule to This Case

784. The rule provides a temporal limit on the legally relevant facts in this arbitration. Insofar as the Claimant alleges that acts or omissions of Mexican officials at any of the three levels of government that occurred prior to January 1, 1994, give rise to liability, such allegations must be dismissed. The Respondent cannot be held responsible internationally for events that occurred prior to the Agreement's entry into force. Pre-1994 events may be relevant to explaining subsequent events, but they may not ground liability.

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543. *The Vienna Convention on the Law of Treaties.*

785. The Counter-Memorial refers to events occurring prior to the NAFTA's entry into force only because they explain the pre-existing opposition, the Claimant's activities in San Luis Potosi and the rest of Mexico, the steps that it took to protect itself contractually in the event that certain contingencies prevented it from constructing and operating the landfill, and the statements of federal and State officials. However, they do not form legally relevant facts for the purposes of proving a breach of the NAFTA once it entered into force.

2. The Rule Against Anticipated Breaches

786. There is a second temporal limitation in this case. It is found in the text of the NAFTA itself. This rule also serves to determine the legally relevant events.

a) Content of the Rule

787. This rule concerns the arbitrability of events that had not yet occurred when the arbitration commenced, and is set forth in Article 1119, entitled Notice of Intent to Submit a Claim. It states that:

> "The disputing investor shall deliver to the disputing Party written notice of its intention to submit a claim to arbitration at least 90 days before a claim is submitted, which notice shall specify:
>
> . . .
>
> (b) The provisions of this Agreement alleged to have been breached and any other relevant provisions
>
> (c) The issues and factual basis for the claim. . ." [Emphasis added]

788. The focus of Article 1119 on acts that have already occurred is reinforced by Article 1120. That article precludes a potential claimant from taking a matter to arbitration under Section B until "six months have elapsed since the events giving rise to a claim".

789. These articles refer to breaches that are alleged to have already occurred. An investor is not entitled to initiate a claim based on an anticipated breach of the Chapter. Having identified provisions of the NAFTA and the "issues and the factual basis for the claim" (subparagraph c of Article 1119), the claimant frames the matter that is to be considered by the tribunal[544].

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544. Article 1119 is consistent with other international arbitral rules. Under the International Chamber of Commerce's rules governing Terms of Reference, a party to a dispute under arbitration may not add new claims during the course of the proceedings. Such a prohibition is designed to prevent "hindering the preparation of a defense in an orderly way" and "delaying the proceedings."

b) Application to the Rule to This Case

790. Like the rule on non-retroactivity, this rule also provides a temporal limit to the legally relevant facts. The Claimant filed its Notice of Intent to Submit a Claim to Arbitration on October 2, 1996. Thus, by reason of this rule, the claim (and the Tribunal's jurisdiction to entertain it) is confined to alleged acts or omissions occurring before the date six months prior to October 2, 1996. Any act or omission occurring after April 2, 1996, (the date established by Article 1120) cannot be advanced in this claim[545].

791. As in the case of the events that predated NAFTA's entry into force, the Respondent has adduced evidence of events that occurred after the date on which the events which may be the subject of this proceeding in order to rebut the Claimant's allegations. Strictly speaking, however, they are legally irrelevant.

792. In summary, Metalclad may not base its claim on alleged acts or omissions of Mexican officials that occurred either before January 1, 1994 or after April 2, 1996.

3. The Imputability Rule

a) Content of the Rule

793. The third rule of international law that establishes the legally relevant facts in this case is the rule of imputability. A State can be internationally responsible only for the acts or omissions of its officials and organs[546]. Accordingly, the acts or omissions of persons who are not officials of the State cannot be imputed to the State in order to find liability.

794. The rule arises in expropriation cases where a complaint is made against the acts of non-state actors who are claimed to have caused the investor loss. Arbitral decisions routinely distinguish between acts imputable to the state and acts imputable to other actors, including the claimant itself.

795. There have been attempts to circumvent the rule by alleging that a state's failure to stop the acts of non-state actors amounts to a breach of international law. In the *ELSI*

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545. Once again, Articles 1119 and 1120 are consistent with international arbitral practice. The ICC's Terms of Reference of the International Chamber of Commerce are similar to the NAFTA's rules on Notice of Intent because both define the legal issues under dispute.

546. It is unnecessary for the Tribunal to review the nuances of different theories of the role of imputability or attributability in the law of state responsibility. See generally Draft Articles on State Responsibility, represented in the Report of the International Law Commission on the Work of its Twenty-ninth Session, U.N. Doc. A/32/10/ (1977), reprinted in [1977] 2 Y.B. INT'L L. COMM'N 1, 9-11, U.N. Doc. A/CN. 4/SER A/1977/Add. 1 (Pt. 2). See also Gordon A. Christenson, "The Doctrine of Attribution in State Responsibility," in Richard B. Lillich, *International law of State Responsibility for Injuries to Aliens* (University Press of Virginia: Charlottesville), 1983, at page 321.

case (*Case Concerning Elettronica Sicula S.P.A. (ELSI)* (United States v. Italy)), for example, the United States argued, *inter alia*, that the occupation of a factory by laid-off workers gave rise to liability on the Respondent's part because it "tolerated the unlawful" act of occupation of the plant by the workers[547]. The U.S. claim was based upon a provision in the applicable bilateral treaty that was analogous to NAFTA's Article 1105 (which sets out the obligation to accord full protection and security).

796. A Chamber of the International Court of Justice rejected this claim, stating:

> "The reference in Article V to the provision of 'constant protection and security' cannot be construed as the giving of a warranty that property shall not in any circumstances be occupied or disturbed. The dismissal of some 800 workers could not reasonably be expected to pass without some protest... In any event, considering that it is not established that any deterioration in the plant and machinery was due to the presence of the workers, and that the authorities were able not merely to protect the plant but even in some measure to continue production, the protection provided by the authorities could not be regarded as falling below "the full protection and security required by international law"; or indeed as less than the national or third-State standards..."[548]

b) Application of the Rule to This Case

797. The imputability rule assumes central importance in this proceeding because the history of the Guadalcázar site involves a complex interaction between state and non-state actors, specifically:

a) State actors: (i) the federal, (ii) State, and (iii) municipal governments;

b) Non-state actors:

i) members of the public, including *ejido* organizations, academics, and non- governmental environmental organizations; and

ii) the investor (and its investments, COTERIN and ECOPSA).

798. The Claimant's Memorial obscures the actions of state and non-state actors, particularly in the context of the evidence of local opposition to the hazardous waste landfill. This mischaracterizes the voluminous evidence of genuine local opposition (which began long before the contaminated site was acquired and continued thereafter) and

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547. 28 I.L.M. 1109 (1989).

548. Ibid. [Emphasis added]

overlooks the impact of the investor's own missteps on the other actors in the controversy.

799. The Claimant's conduct legitimized and inflamed pre-existing local opposition to the landfill. Neither the local opposition nor the Claimant's own conduct can be attributed to the Respondent in order to hold it liable under the NAFTA.

800. In the Respondent's submission, the evidence is overwhelming that the pre-existing and continuing public opposition was not contrived, but instead was a fact that demanded a response from the local and State officials. The actions of successive municipal *Ayuntamientos* and State officials are no different from those of governmental officials in any other country who are obliged to respond to intense local concerns. To similar effect, nonviolent official and citizens' public statements of opposition to the project cannot be deemed to be a violation of international law. International law does not impose an obligation on Mexico to restrain political speech for the benefit of a foreign investor.

801. This rule is particularly germane to the analysis of the "fair and equitable" treatment and expropriation claims addressed below.

802. The *ELSI* case is instructive. At issue in that case was the decision of the Mayor of Palermo to requisition a plant owned by an Italian company that was in turn owned by two U.S. investors. The United States argued that the requisition was an expropriation, a denial of full protection and security, and an arbitrary and discriminatory act that violated the Friendship, Commerce and Navigation Treaty between Italy and the United States. The International Court found that there was no expropriation or denial of full protection and security, and rejected the claim that there was an "arbitrary or discriminatory act".

803. The Court's discussion of the alleged "arbitrariness" of the Mayor's act is instructive:

> "It was of course understandable that the Mayor, as a public official, should have made his order, in some measure, as a response to local public pressures; and the Chamber does not see, in this passage of the Prefect's decision, any ground on which it might be suggested that the order was therefore arbitrary."[549]

804. The Respondent directs the Tribunal to the Court's judgment in *ELSI* because, while the facts differed from the case at hand, it made a number of findings that are of relevance to the present case:

a) the Court ruled that acts of non-state actors such as the workers who occupied ELSI's plant are not to be imputed to the state;

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549. At pages 1140-1141.

b) the respondent's failure to stop the workers from occupying the plant as a protest did not amount to a denial of the obligation to accord "full protection and security". In this regard, the state does not warrant that a foreign investor will be immune from protests and other like acts;

c) the impact of public opinion and pressure on local officials was given weight in finding that the mayor had good reason to act as he did;

d) the requisition order, which affected the company's rights of ownership, was nevertheless found not to be an expropriatory act; and

e) even the fact that a domestic court had subsequently found the requisition to be unlawful did not automatically lead to a finding that the local official had committed an act that constituted a breach of an international treaty. This is of interest to the instant case because, although the Claimant commenced a legal challenge of the municipality's denial of the permit, the challenge failed. Even if it had succeeded and the denial had been overturned, that would not mean there was a breach of the NAFTA.

805. The Respondent concedes that the La Pedrera site was controversial and that it spurred strong rhetoric on both sides. It notes that the Claimant itself did not shy from using such rhetoric. For example, shortly after it acquired COTERIN, the Claimant published an advertisement entitled "Enormous Misinformation" in the local newspapers in which it criticized State officials. This led the Governor to respond formally to its criticisms.

806. In the Respondent's submission, rhetoric generated by a complex and highly emotional debate over a hazardous waste landfill is normal and does not give rise to liability under Chapter Eleven.

D. The Respondent's Answer to the Specific Claims

807. The Claimant's Memorial is based upon three specific sets of claims:

a) Articles 1102, 1103, 1104, and 1106: the alleged breach of the national treatment and the most-favored nation obligations, or the better treatment of the two, and the obligation not to impose certain performance requirements;

b) Article 1105: the alleged failure to accord the Claimant treatment in accordance with international law, including fair and equitable treatment and full protection and security; and

c) Article 1110: the alleged expropriation of the investment, by direct and indirect acts or by measures tantamount to expropriation.

1. Article 1102: National Treatment

a) Content of the Rule

808. The Claimant has alleged that the requirement that it obtain the Municipal permit "was enforced selectively and singularly upon Claimant"[550]. This, it says, gives rise to a breach of national treatment on the part of the Respondent.

809. Article 1102 distinguishes between national treatment at the federal level and at the state or provincial level. With respect to the federal level, the Party is obliged to:

> "...accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, conduct, operation, and sale or other disposition of investments."

810. Paragraph 2 sets out the same formulation of the standard of treatment with respect to the treatment of "investments of investors of another Party".

811. With respect to a state or province, paragraph 3 states that:

> "the treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part."

812. Article 1102 does not require formally identical treatment. It simply requires treatment to be no less favorable than that accorded to domestic persons. In addition, in order to be applied, there must actually be a domestic investor or investment that is "in like circumstances" to the foreign investor or investment.

b) Application of the Rule to this Case

813. *Prima facie*, the "like circumstances" requirement would appear to be satisfied for the federal government as there are hazardous waste landfills in Nuevo Leon and Sonora. However, even though there are two other landfills operating, neither had the environmental liability nor faced the local opposition that La Pedrera has. In addition, the

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550. Memorial, paragraph 214 at page 140.

Tribunal will recognize that in a highly regulated industry such as this, the governmental concerns are largely site-specific. Consequently, it is impossible to compare the treatment of different proponents at different sites. For these reasons, there are no investors or investments in like circumstances for the purposes of applying Article 1102[551].

814. The lack of a comparable domestic investor or investment is even more obvious at the state and local level. With the exception of COTERIN itself when it was wholly-owned by Mexican nationals, there is no domestic investor or investment in the State of San Luis Potosi that is in like circumstances to Metalclad or COTERIN. There is presently no other hazardous waste landfill in operation or in the permitting and approval stage (except for Metalclad's other apparently abandoned project at Santa Maria del Rio). At the municipal level, as the Tribunal will recall, the municipality of Guadalcázar is a remote agrarian economy with little industrial activity. After the landfill, the next closest thing to an industrial site is a gas station.

815. In these circumstances, given the absence of another investor or investment in like circumstances, the only standard for comparing the treatment accorded to Metalclad is how COTERIN was treated when it was wholly-owned by Mexicans. There is no evidence to support a claim that COTERIN was treated differently by the State or the municipality depending on the nationality of its ownership.

816. The evidence shows, moreover, that recognizing the problems associated with the site, the State warned the Claimant about La Pedrera and urged it from the beginning to seek another site. It showed Metalclad the report on alternative sites that had been drafted by the local university professors. It later entered into an agreement to lend all reasonable support to the search for another site and to expedite the permitting process. This is evidence of the State's good faith and the absence of discriminatory intent.

817. Similarly, in the negotiations with the Claimant in 1996, the municipality was prepared to allow it to operate the site as a non-hazardous industrial waste site[552]. Thus, it was not the landfill *per se*, or the investor, but rather the type of waste that was objectionable. Once again, this does not show discrimination against the investment or the foreign investor; if there was any discrimination at all, it was against the type of waste (of Mexican origin, it should be noted) sought to be disposed of in the municipality.

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551. In addition, the Claimant states that the treatment that it has received at the hands of federal authorities has been exemplary. At page 57, paragraph 26 of its Memorial, for example, it states:

> "All during the process of due diligence analysis, permit applications, numerous tests, studies and evaluations, an extensive audit, and the construction and approval of the landfill facility, Mexican federal officials have been competent, readily available, diligent, energetic, professional and supportive. This is true for the Company's dealings with officials in the office of the President, SECOFI, SEMARNAP, INE and PROFEPA."

552. The Tribunal is directed to the witness statement of Leonel Serratto on this point, where he notes that Mr. Carvajal's rendition of the agreement omits the words "non-hazardous."

2. Article 1103: Most-Favored-Nation Treatment

a) Content of the Rule

818. The Claimant has alleged that the Respondent has failed to accord most-favored-nation (MFN) treatment to it and/or its investment, contrary to Article 1103.

b) Application of the Rule to this Case

819. This claim simply cannot be advanced in this proceeding. Like Article 1102, Article 1103 requires the Tribunal to consider the treatment accorded to Metalclad or COTERIN in the light of treatment that is accorded to investors or investments of the other NAFTA Party (Canada) or of a non-Party. There is no evidence whatsoever on the record to support such a claim and other than simply pleading this breach, Metalclad has not elaborated such an argument, nor adduced evidence in support thereof.

3. Article 1104: Standard of Treatment

a) Content of the Rule

820. The Claimant has alleged a breach of Article 1104, Standard of Treatment, which requires each Party to accord to investors of another Party and to investments of investors of another Party the better of national treatment and MFN treatment.

b) Application of the Rule to this Case

821. Since there is no denial of national treatment and no denial of MFN treatment, there can be no breach of Article 1104.

4. Article 1106: Performance Requirements

a) Content of the Rule

822. The Claimant has asserted that the Respondent has violated NAFTA Article 1106 (Performance Requirements)[553]. It cites Article 1106(1)(f), which provides:

> "No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, engagement, conduct or operation

553. Claimant's Memorial at pages 150-52, paragraphs 231-236.

of an investment of an investor of a Party or of a non-Party in its territory:

* * *

(f) To transfer technology, a production process or other proprietary knowledge to a person in its territory . . ."[554].

823. Similarly, Article 1106(3) prohibits a Party from conditioning the receipt of an advantage by an investment on compliance with domestic content requirements, requirements to accord a preference to domestic goods or producers, and requirements that relate the volume or value of imports or domestic sales to the volume or value of exports.

b) Application of the Rule to this Case

824. There are three elements to the claim:

- that the Claimant supplied to the state government "drawings, studies, designs, operating manuals, safety manuals, financial data", and "most of what is necessary to construct and operate a hazardous waste facility"[555];

- that this "technical and financial information, for which Metalclad had spent millions of dollars gathering and developing, that the Governor obtained, was used as a basis for organizing a group of local Potosinian industrialists for the

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554. The focus of Article 1106 is to prevent conditions from being placed on investments that would result in discriminatory treatment of imported goods or services. Thus, the other subparagraphs of Article 1106(1) prohibit a Party from imposing the following requirements:

(a) to export a given level or percentage of goods or services.

(b) to achieve a given level or percentage of domestic content;

(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;

(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;

(e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;

. . .

(g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

555. Claimant's Memorial at page 151, paragraph 232.

purpose of constructing and operating a landfill in lieu of Metalclad"[556]; and

- that the Claimant was forced by the Respondent to agree to: "build a laboratory of which the UASLP would have full use; to provide free medical care weekly to the community; to provide culinary water to the community while giving credit to the state therefor; to help the municipality with unrelated problems such as industrialized crops; to provide free consulting to the federal government regarding hazardous waste matters; to provide collateral funding for education; and, several other such contributions"[557].

825. First, there is no evidence offered in support of the claim that Metalclad either possessed "proprietary information" on how to construct or operate a landfill or that it transferred such information to the State. Metalclad itself had no experience in landfill construction and operation and hired others to do the work. It has presented no probative evidence that it had actually ever purchased or developed any such technical information.

826. Second, the evidence of State officials is that contrary to its public commitment to do so made on January 14, 1994, very little in the way of technical information was ever submitted by Metalclad to the State.

827. Third, the Claimant has presented no evidence that its proposals for the landfill site were copied, given to any private interests, or otherwise misappropriated. This claim is pure speculation, contrary to the presumption of good faith. The former Governor and Dr. Medellín have denied the allegation.

828. Fourth, the Claimant has presented no evidence, nor can it, that any level of the Mexican government required it to transfer technology, a production process, or other proprietary information to any Mexican person or company. (This is the gravamen of a complaint under Article 1106:1(f)).

829. Fifth, the Respondent does not concede that the other "requirements" alleged by Claimant —such as providing medical care, water, or "free" consulting on waste disposal —were imposed by governmental authorities at all on the Claimant. The evidence is that these were proposed by the Claimant on its own initiative in an attempt to develop goodwill and to secure approval for its operation.

830. Sixth, even if governmental authorities had imposed such requirements, however, this would not constitute a violation of Article 1106. None of the "requirements" that the Claimant has identified are prohibited under Article 1106. To the contrary, Article

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556. Claimant's Memorial at page 88, paragraph 101.

557. Claimant's Memorial at page 151-52, paragraph 235.

1106(5) states that:

> "Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs."[558]

831. In summary, Metalclad has not made out even a *prima facie* case of violation of Article 1106(1)(f), and has not alleged facts that would support the claim of a violation of any other provision of Article 1106.

5. Article 1105: Fair and Equitable Treatment and Full Protection and Security

832. Article 1105 provides:

> "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security".

833. The minimum standard of treatment incorporated in this Article is treatment "in accordance with international law". This standard of treatment can be divided into two express components —fair and equitable treatment and full protection and security— and one residual component— other standards of treatment mandated by international law.

a) Fair and Equitable Treatment

(1) Content of the Rule

834. The phrase "fair and equitable treatment" is not defined in the NAFTA.

835. In accordance with Article 31 of the *Vienna Convention*, the phrase must be interpreted in good faith in accordance with its ordinary meaning, in its context, and in the light of its object and purpose.

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558. Further, note that Article 1106(4) provides:

> Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage... on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.
>
> Thus, the NAFTA Parties did not prohibit governments from imposing any requirement that would be beneficial to the local economy; rather, only those measures that have a direct impact on trade are prohibited.

836. The ordinary meaning of the word "fair" is "just, unbiased, equitable; in accordance with the rules" and the ordinary meaning of the word "equitable" is "fair and just"[559].

837. The meaning of "fair and equitable treatment" is clearer when viewed in its context. The qualifying words "in accordance with international law" in Article 1105(1) signify that the drafters' intention was to incorporate the public international law meaning of "fair and equitable treatment". Although the phrase is widely employed in bilateral investment treaties, there is no agreement as to the phrase's precise meaning. Interpretations include:

a) The fair and equitable treatment standard requires that, subject to essential security interests, protection afforded under the Convention shall be that generally accorded by the Party concerned to its own nationals, but, being set by international law, the standard may be more exacting where rules of national law or national administrative practices fall short of the requirements of international law. The standard required conforms in effect to the "minimum standard" which forms part of customary international law[560];

b) A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable. No standard defined by other words is likely to be material. The terms are to be applied independently and autonomously[561].

c) The concept of fair and equitable treatment is closely related to the facts of a given case[562].

838. Other contextual elements relevant to interpreting this phrase include NAFTA Article 1114(1)[563], the preamble[564], and the North American Agreement on Environmental

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559. *The Concise Oxford Dictionary of Current English* (8th Edition).

560. *Draft Convention on the Protection of Foreign Property*, OECD, 1962, Notes and Comments to Article 1.

561. F.A. Mann, "British Treaties for the Promotion and Protection of Investments", (1982) BYIL 241.

562. E. Lauterpacht, *Aspects of the Administration of International Justice* (Cambridge: Grotius Publications, 1991), at pages 119-122.

563. "Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns".

Cooperation (the "NAAEC"), an agreement negotiated after the conclusion of the NAFTA and which entered into force immediately after NAFTA's entry into force. All three NAFTA Parties are signatories to that agreement.[565]

839. Article 3 of the NAAEC recognizes the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities. Article 5 of the NAAEC imposes an obligation on each Party to effectively enforce its environmental laws and regulations. Article 6 of the NAAEC requires each Party to provide private access to remedies, including the right to seek injunctions, where a person suffers or may suffer loss, damage or injury as a result of conduct by another person contrary to that Party's environmental laws and regulations.

840. This is relevant to the Tribunal's consideration of the administrative proceedings and the *amparo* (including the injunction against the *Convenio de Concertación*) challenge initiated by the municipality. There was a genuine issue as to whether, in allowing Metalclad to simultaneously operate and remediate, the federal authorities had acted consistently with PROFEPA's August 30, 1994 resolution in which it decided that COTERIN could not receive any new waste at the site until after the site was remediated. The NAAEC provides additional legal context for interpreting the obligations of the NAFTA insofar as there are claims that an investor alleges that a legal proceeding involving the enforcement or lack thereof of an environmental law constitutes a breach of Chapter Eleven.

841. The fair and equitable treatment standard requires the Respondent to act in good faith, reasonably, without abuse, arbitrariness or discrimination. In assessing whether the Respondent has complied with this standard, the Tribunal must take into account the environmental provisions of the NAFTA and the NAAEC and must make its assessment in the light of all relevant facts and circumstances. The Tribunal may examine the practice of other States in similar circumstances to assist in its assessment[566].

(2) Application of the Rule to this Case

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564. The relevant part of the preamble includes the objective to ensure a predictable framework for business planning and investment in a manner consistent with environmental protection and conservation. Moreover, the Parties resolved to preserve their flexibility to safeguard the public welfare and strengthen the development and enforcement of environmental laws and regulations.

565. The preamble to the NAAEC includes *reconfirming* the importance of the environmental goals and objectives of the NAFTA, including enhanced levels of environmental protection and ***emphasizing*** the importance of public participation in conserving and enhancing the environment.

566. Reference to the practice of States as guidance for what constitutes the international legal standard is supported by Article 38(1)(b) of the *Statute of the International Court of Justice*. In addition, international law publicists support using the practice of states to put the international legal standard into context: see K. Scott Gudgeon, "United States Bilateral Investment Treaties : Comments on their Origin, Purposes and General Treatment Standards", *International Tax & Business Lawyer*, 1986, Vol. 4, at page 125.

(a) Relevant Facts and Circumstances

842. The Claimant was not denied fair and equitable treatment because all actions of the Respondent in this matter, when assessed in the light of all relevant facts and circumstances, were taken in good faith, and reasonably, without abuse, arbitrariness or discrimination.

843. The Claimant has variously argued that Respondent has failed to accord it treatment in accordance with international law (and/or has indirectly expropriated its investment), by:

> " . . . failing to protect Claimant's rights, leaving Claimant victim to prejudice, governmental capriciousness, scandal and corruption . . ."[567]

844. In particular, it is alleged that there was:

> "A public campaign by the Governor and his administration to arouse the local residents to oppose the operation of the landfill, through the use of invective, misinformation, prejudice, all of which was done in total disregard of the overwhelming evidence in support of the factual conclusions of federal and scientific authorities who certify the landfill project as fully meeting all technical requirements."[568]

845. The Claimant's Memorial complains further that Governor Sanchez Unzueta, as part of a "malicious pattern," "began to withdraw his support by public criticisms of the Company and its project," including an allegedly "incendiary speech to a crowd in Guadalcázar," and "a later fiery speech in Guadalcázar"[569]. It also makes much of the March 10, 1995 protest demonstration.

846. By way of introduction to the response to these allegations, the Respondent wishes to remind the Tribunal of Judge Tanaka's famous dictum in the *Barcelona Traction* case where he stated that "bad faith can not be presumed"[570].

847. In this proceeding, the Claimant has done precisely the opposite. It has presumed bad faith at every turn, so much so that it has cited the remotest and flimsiest of evidence

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567. Claimant's Memorial at page 108, paragraph 149.

568. Claimant's Memorial at page 44, paragraph 9.

569. Claimant's Memorial at Preface, pages 30 and 32.

570. *Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)*, Second Phase, Separate Opinion of Judge Tanaka, February 5, 1970, at page 160.

to support its claim of *mala fides* on the part of State and municipal officials[571]. The Respondent considers that allegations based on rumor and innuendo and fed by press reports (which, the evidence shows, the Claimant had a hand in creating), many of which are contradicted by independent evidence, fall far short of the standards of cogency and probative value that are required to sustain such serious allegations.

848. In addition, at the risk of stating the obvious, it warrants observing that the acts at issue relate to the establishment of a controversial hazardous waste landfill. In assessing whether they are consistent with the fair and equitable standard, the following facts and circumstances are relevant:

a) the dangerous nature of the materials to be stored at the landfill;

b) the fact that such materials will take many years to neutralize (if at all);

c) the need to ensure that such a landfill complies with an array of environmental regulations and requirements and the time and resources required to determine compliance;

d) the multilayered nature of the approval and permitting process and the time and resources required to obtain the necessary approvals and permits;

e) the fact that local and NGO opposition to hazardous waste facilities through legal and political channels is typical and that such opposition can prevent a facility's establishment in a particular location;

f) the fact that significant delays in the opening of such a facility are normal; and

g) the inherently unpredictable and costly nature of siting hazardous landfills.

849. The evidence of the Respondent's expert, Marcia Williams, contains a detailed discussion of the specific circumstances relevant to the siting of hazardous waste landfills.

850. To the "generic" features of this kind of investment must be added the special facts of this case:

a) the site was contaminated by the Claimant's predecessor in interest;

b) it led the former President of the Republic to declare that this type of activity was unacceptable;

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571. The Chronology's reference to "Governor Unzueta buys expensive home and is questioned as to where the money came from", without further evidence or mention again in the body of the Memorial or the witness statements is a typical example.

c) it had been shut down by federal order;

d) it had generated popular protests and decisions of successive *Ayuntamientos*; and

e) regrettably, it led to mistrust of the federal environmental authorities, given what had occurred under the color of federal authorizations.

851. To this must be added the events of the Claimant's own making:

a) its public criticism of State authorities;

b) its condescending attitude towards the local residents;

c) its propensity to make announcements that were not true or which omitted important facts;

d) its publishing of advertisements and public declarations of the landfill's imminent opening when the site was not authorized to open;

e) its campaign against the Governor and state officials in *El Heraldo* and other newspapers;

f) its decision to involve itself in the campaign for the presidency of the municipality;

g) its pressing ahead with construction after its proposal was rejected by the *Ayuntamiento*;

h) its misrepresentation of the purpose of the construction activity;

i) its continuing construction after the municipal shut down order;

j) its "Grand Opening" ceremony;

k) its apparent attempt to have its local counsel arrange a payment to the Governor;

l) its foreign letter-writing campaign based on misrepresentations to foreign legislators; and

m) its efforts to invoke diplomatic pressure.

852. In short, the Claimant was aware of the considerable local opposition to the project and the complex approval and permitting process, including the requirement to obtain a local construction permit, when it purchased COTERIN. Through ineptitude and inappropriate actions, it proceeded to make matters worse.

853. The facts, as established by independent evidence (much of which is of the Claimant's making) and by the direct evidence of the witnesses who have filed statements in connection with the Respondent's case, do not support the allegations on which this part of the claim is based:

a) The Governor did not embark on a public campaign to arouse opposition. He recognized the pre-existing opposition, warned the Claimant of it, and was forced to respond to the protests of those who opposed the landfill;

b) He did not use invective, misinformation and prejudice;

c) He warned the Claimant that even if the scientific studies showed the site was adequate, that would not necessarily solve the problem of local opposition;

d) He never endorsed or supported the La Pedrera project and therefore did not "withdraw" such support;

e) He did criticize the Claimant but only for its inappropriate and precipitous acts;

f) He did not give an incendiary speech at Guadalcácar;

g) He did not orchestrate the event at which an encephalitic child was presented to him by one of the local residents; and

h) The erection of the statue of Benito Juarez had nothing to do with the Claimant, the landfill, or the controversy.

854. As for the other allegations made against the Governor and the State generally, the Claimant's allegations of scandal and corruption have been denied categorically by the individuals against whom the allegations were made. Their testimony is that the March 10th event was a spontaneous demonstration precipitated by the unexpected news that the landfill was to commence operations that very day. The evidence of Hermilo Mendez is that the community neither needed nor received encouragement or assistance from any State official. The evidence contradicts the allegation that there were paid demonstrators hired by the government.

855. The videotape evidence also contradicts the allegation that some of the protestors were armed and drunk. The videotape reveals many angry but orderly protestors, only

one apparently armed person (a Metalclad security guard), and one apparently intoxicated man (who was inside COTERIN's compound when it was blocked).

856. The Respondent concedes that the society actively opposed the toxic waste site, that pressure was brought to bear on local, State and federal officials, and that Governor Sanchez Unzueta, Dr. Medellin, and numerous municipal officials made public statements expressing concern about the project. The Respondent also concedes that the refusal of the municipality to issue the construction permit reflected the deep-rooted opposition of the majority of the local residents, as well as concerns over the perceived health and safety risks of having a hazardous waste disposal facility located in the area. Finally, the Respondent concedes that the Claimant did not obtain the support of the Governor and the local community.

857. None of these amount to a breach of Article 1105.

(b) Allegations of the Complainant

858. The Complainant's allegations of violations of the fair and equitable treatment standard are unfocused and indiscriminate. They can be classified into five categories: (i) transparency and predictability; (ii) political and social criticism; (iii) delays; (iv) reliance on representations of officials; and (v) other.

859. At paragraph 165 of its Memorial, the Complainant alleges that the Respondent's actions relating to the landfill were disjunctive, contradictory and lacking in transparency and predictability. At paragraph 177 the Complainant argues that the fact a new federal law made it clear that local construction permits were required beginning January 1, 1997, was evidence that the law prevailing before the regulation was neither transparent nor predictable.

860. Quite apart from the facts, there is no authority for interpreting fair and equitable treatment to extend to transparency and predictability requirements.[572]

861. However, even if they were encompassed in the standard, prior to purchasing COTERIN, the Claimant was aware of the legal requirements of all three levels of the government. In addition, it incorporated the contingencies of gubernatorial support and local permitting approval into the option agreement. Although the Governor's support was not a legal requirement, the Claimant recognized that his approval above and beyond that expressed in specific permits was required to open the hazardous waste landfill. The Claimant later expressed its recognition and acceptance of an additional requirement quite independent of the municipal permit issue, namely, the need to obtain the support of the local community.

572. These matters are addressed in Chapter 18 of the NAFTA.

862. The facts show no lack of transparency or predictability. In any case, the legal instruments memorializing the Claimant's exercise of its option to acquire COTERIN demonstrate that it was aware that COTERIN would be expected to obtain a municipal construction permit.

863. At paragraphs 177, 202 and 204, the Complainant implies that actions of the Governor—allegedly pressuring the federal government, making statements that he supported the people (who generally were opposed to the landfill), provoking anti-Metalclad prejudice in the community—violate the fair and equitable treatment standard.

864. The Respondent notes that the Governor was himself responding to the actions of the Claimant. He warned it against seeking to develop La Pedrera but the Claimant insisted on proceeding. Given the various acts of the Claimant, it is hardly surprising that he responded at times critically. As for expressing support for the community, the Governor's position was completely consistent throughout. As for stirring up anti-Metalclad prejudice, the Governor's statements were against an investor who resorted to the litany of acts set out in paragraph 83 above.

865. Actions taken in response to an investor who behaves in this fashion do not come close to a violation of the fair and equitable treatment standard.

866. As for the allegation that delays were caused by the actions of the Respondent, either through the approval and permitting process, by reason of the political and social debate over the landfill, or because of the legal proceedings, and that they amount to a violation of the fair and equitable treatment standard, the expert evidence is that such delays are the norm when establishing hazardous waste landfills.

867. With respect to the allegations in paragraphs 166 and 212 that the Claimant relied in good faith to its detriment on the representations of the Respondent regarding exclusive federal authority over the approval and permitting process, the evidence demonstrates that this claim is false.

868. With respect to the allegation that the Respondent was obliged to file a Constitutional Controversy against the Municipality of Guadalcázar (paragraph 174), even supposing that the Complainant's interpretation of Mexican domestic law were correct, which it is not, there are many legal, policy and political considerations that would influence such a decision. The decision not to commence a Constitutional Controversy does not amount to a violation of the fair and equitable treatment standard.

869. With respect to the alleged hearsay statement of a Director of RIMSA to two Wall Street analysts that Metalclad would never open the landfill (paragraph 210), the comments or acts of a private citizen are not attributable to the Respondent.

b) Full Protection and Security

(1) Content of the Rule

870. The phrase "full protection and security" is not defined in the NAFTA.

871. In accordance with Article 31 of the *Vienna Convention*, the phrase must be interpreted in good faith in accordance with its ordinary meaning[573], in its context, and in the light of its object and purpose.

872. As in the case of "fair and equitable treatment", the qualifying words "in accordance with international law" in Article 1105(1) signify that the drafters intended to incorporate the public international law meaning of "full protection and security".

873. Under public international law principles, the obligation to provide "full protection and security" does not make the state absolutely liable for injuries inflicted upon the foreign property[574]. In *Asian Agricultural Products Ltd. v. Republic of Sri Lanka (AAPL)*, the ICSID Tribunal stated:

> "The Arbitral Tribunal is not aware of any case in which the obligation assumed by the host state to provide nationals of the other Contracting State with "full protection and security" was construed as an absolute obligation which guarantees that no damages will be suffered..."[575]

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573. The ordinary meaning of the word "protect" is "keep safe, defend, guard" and the ordinary meaning of the word "security" is "a secure condition, a thing that guards or guarantees". *The Concise Oxford Dictionary of Current English* (8th Edition).

574. Brownlie, in *System of the Law of Nations: State Responsibility (Part I)* (Oxford: Claredon Press, 1983) at 171 (hereinafter, *System of the Law of Nations*) rejects the absolute liability theory:

> "[N]o state has been prepared to accept such a standard of liability as guarantor. Even capital-exporting states, such as the United States, were appreciative of the difficulties which face states coping with severe internal crises. In short, the theory of absolute liability was not mirrored in the practice of states".

575. *Asian Agricultural Products Ltd. v. Republic of Sri Lanka* (I.C.S.I.D.), (1991) 30 ILM 580 at 599-600. This rule follows the judgment of the International Court of Justice in *Case Concerning Elettronica Sicula S.p.A (ELSI)* (United States v. Italy), 1989 ICJ 15. In *ELSI*, the ICJ had to determine whether the term "most constant protection and security" contained in a Treaty of Friendship, Commerce and Navigation between Italy and the United States made Italy absolutely liable for any damage occurring to the property of the Raytheon Corporation. The ICJ rejected such an interpretation finding instead that:

> "The reference in Article V ["most constant protection and security"] cannot be construed as the giving of a warranty that property shall never in any circumstances be occupied or disturbed."

874. A state which exercises due diligence, even where the foreign property has suffered injury, will have discharged its obligation to provide full protection and security. A state complies with its due diligence obligation where it acts reasonably in the protection of foreign property[576].

875. The state is not expected to anticipate the unlikely, or to take exceptional preventative measures on the off chance that some untoward incident might happen[577].

(2) Application of the Rule to this Case

876. The Claimant's allegations of violations of the full protection and security obligation are based on the demonstration at the landfill site and the alleged deployment by the Governor of state police to the landfill facility (paragraphs 182, 204 and 212).

877. In the case of the demonstration, the action was prompted by local opposition to the landfill, was not organized by the Respondent and, contrary to the allegations of the Claimant, was peaceful. The facts of this case were even less intrusive than those considered in the *ELSI* case where the protesters actually entered the plant in question. The International Court of Justice rejected the argument of the United States that by permitting workers to occupy the plant after its requisition, Italy had violated its "most constant protection and security obligation". In rejecting the U.S. argument, the Chamber noted most importantly that the occupation was entirely peaceful and that the United States had not shown that any damage occurred.

878. As for the State police, they were assigned to the site in March and again after the *Convenio de Concertación* to provide security. This is evidence of the State's adherence to the obligation. The Respondent denies that there was any inappropriate use of the police, and in fact a Mexican court so held[578]. Nor has there been any evidence adduced of any damage to the landfill site or injury to any person at the site resulting from a denial of full protection and security.

879. Accordingly, there is no basis for a claim that the Respondent violated its obligation to provide the Claimant and its investment full protection and security.

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576. Lillich, *op. cit.* at page 232.

577. J. Latham Brown, *Public International Law* (London: Sweet & Maxwell, 1970) at 193.

578. Decisions of amparo initiated by COTERIN.

c) Other Standards of Treatment Accorded by International Law

880. The minimum standard of treatment incorporated in Article 1105(1) includes all other standards of treatment afforded by customary international law.

881. At paragraphs 170 and 172, the Claimant argues that, while the Convenio de Concertación was not a "concession" agreement *per se*, it did grant the Claimant vested rights with respect to its investment—i.e. the right to construct, the right to operate and mediate under the specific terms and conditions of the *Convenio de Concertación* and the right to expect the fruition of its investment without interference from the grantor of those rights.

882. The Respondent points out that the Claimant never reached the position of having vested rights. As PROFEPA's press release stated on the day that the *Convenio de Concertación* was signed, the Federation did not bind the local authorities. There was, therefore, no right to operate the investment.

6. Article 1110: Expropriation

883. It is important at the outset to identify precisely the nature of the investment at issue. The Claimant asserts that its variously valued 25 or 20 million dollar "state-of-the-art landfill" is its investment. The Respondent points out that the Claimant invested in a piece of undeveloped land with a shut-down transfer station that was widely known to be an environmental liability, subject to local opposition, without all of the necessary permits. Thus, the only real investment was the land.

884. To obtain damages under Article 1110, the Claimant must establish that the Respondent directly or indirectly expropriated the Claimant's investment, or took a measure tantamount to expropriation. As in the rest of its Memorial, as evidence of this specific claim, the Claimant has amassed a set of acts and statements that do not withstand serious scrutiny.

885. In the Respondent's submission, therefore, the expropriation claim must fail as well. The unfocused and indiscriminate pleading does not prove a breach of Article 1110.

886. International tribunals, domestic courts and publicists have examined various forms of expropriation. There is general agreement on the distinction to be made between direct and other means of expropriation.

a) Direct Expropriation

887. Direct expropriation is understood to involve a formal government measure that transfers ownership of property to the state and thereby divests foreign investors of their

ownership rights[579]. An example is the Libyan legislation enacted in 1974 that expressly provided for the nationalization of all of the properties and interests, rights and assets of the California Asiatic Oil Company and the Texaco Overseas Petroleum Company[580].

888. Although a claim of direct expropriation of investment has been advanced, clearly this is not the case. There is no official measure of any level of the Mexican State that purports to deprive the Claimant of its interest in its investment or of its investment's interests in the land.

b) Indirect Expropriation or a Measure Tantamount to Expropriation

889. The Claimant has also alleged that various actions of the Respondent's officials constitute an indirect expropriation or a measure tantamount to expropriation. It has alleged, at paragraph 249 of its Memorial, that the following actions of the Respondent have expropriated the Claimant's investment: "officially promoted demonstrations against Claimant; public aspersions of the Claimant; threats of violence; *male fide* negotiations; public dissemination of false and misleading information about Claimant's investment designed to arouse community antipathy to the project and destroying Claimant's goodwill; filing of an inapt legal action barring operation of the project; use of armed state police, twice, to intimidate employees and vendors at the landfill, while insuring that the landfill did not open; repeated public declarations that the landfill will never open; the federal government's abdication of its duty to Claimant: 'we can do no more with this Governor' and finally, an official act decreeing Claimant's investment to be circumscribed within a just-created ecological preserve."

890. This lengthy list of alleged acts should alert the Tribunal to one of the fundamental defects of the Claimant's case, namely, its inability to identify the measure that had the effect of allegedly expropriating the investment. It is submitted that the Claimant has not done so because it cannot do so.

891. As noted above, in interpreting the terms "indirect expropriation" and "measures tantamount to expropriation", the starting point is to examine their ordinary meaning in the light of the object and purpose of the Agreement.

892. The dictionary definition of "expropriation" is "to take away (property) from its owner"[581] or "to deprive of ownership"[582]. The inclusion of the terms "indirect" and

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579. Sornarajah, "The International Law of Foreign Investment" (Cambridge University Press, Great Britain 1994), at pages 281-282; Westberg, J.A., "International Transactions and Claims Involving Government Parties -Case Law of the Iran-United States Claims Tribunal" (International Law Institute, Washington, D.C., 1991), at page 107.

580. *Texaco v. Libyan Arab Republic*, (1979) 53 International Law Reports 419, at 426.

"measure tantamount to" ensures that Article 1110 reaches certain measures that have the same effect as a direct expropriation but differ as to their form[581]. The association between those various terms establishes that only those forms of State action that the Parties consider to be an "expropriation" for purpose of Article 1110 are captured by its disciplines.

893. A review of the writings of publicists and arbitral decisions suggest that there are at least three fundamental elements that are required for a finding of expropriation, namely: (a) the action at issue results in substantial interference with or deprivation of the Claimant's property or property rights[584]; (b) such interference or deprivation is permanent or irreversible[585]; and (c) the expropriatory effect is attributable to the State[586].

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581. *The Concise Oxford Dictionary*, 8th Edition, (Clarendon Press, Oxford, 1990) at page 413.

582. *Webster's New World Dictionary of the American League Language*, Guralnik, D.B., ed., Second College Edition, (William Collins Publishers Inc., Cleveland, Ohio, 1980) at page 495. The full definition is: "1. to take (land, property, etc.) from its owner; esp., to take for public us or in the public interests, as by right of eminent domain; dispossess - 2. To transfer (property) from another to oneself 3. To deprive of ownership; dispossess."

583. Indirect is defined to mean, *inter alia*, "not straight to the thing aimed at... secondary," and tantamount is defined as "to amount to as much... having equal force, value, effect, etc.; equal or equivalent (to)," ibid. at pages 716 and 1454 respectively.

584. Mapp, W. *The Iran-United States Claim Trbiunal, The First Ten Years 1981-1991*, (Mancherster University Press, Manchester and New York, 1993) at pages 152 and 155. For an application of this standard, see the Tribunal's award in *Starrett Housing Corporation, Starrett Systems, Inc., Starrett Housing International, Inc. v. the Government of the Islamic Republic of Iran, Bank Marzaki Iran, Bank Omran, Bank Mellat*, Interlocutory Award No. I.T.L. 32-24-1 [4 Iran-U.S. C.T.R. 122], of 19 December 1983, 85 *International Law Reports* 359, at page 390; and *Tibbetts, Abbett, McCarthy, Stratton v. TAMS-AFFA Consulting Engineers of Iran*, et al. (Case No. 7) AWD 141-7-2 [6 Iran-U.S. C.T.R. 219] of 29 June 1984, at page 225. See also Westberg, J.A., "Applicable Law, Expropriatory Takings and Compensation in Cases of Expropriation; ICSID and Iran-United States Claims Tribunal Case Law Compared," (1993) 8 *ICSID Review-Foreign Investment Law Journal* 1, at page 13, and Higgens, R., "The Taking of Property by the State: Recent Developments in International Law" (1982) 176 *Hague Recueil* 262, at page 351.

585. For example, when the period of interference with property or property rights is unreasonable and when the taking is not, or ceases to be, temporary (Sohn and Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens", 55 *The American Journal of International Law* 545 (1961), at page 559. *International Technical Products Corporation and ITP Export Corporation v. The Government of the Islamic Republic of Iran and its Agencies*, et al., Award No. 196-302-3 [9 Iran-U.S. C.T.R. 206] of 28 October 1985, at pages 240-241; or, in the case, of the appointment of managers over investors' projects, the action ensures that there is no reasonable prospect of return of control (*Sedco, Inc. for Iteself and on Behalf of Sedco International, S.A., and Sediran Drilling Company v. National Iranian Oil Company and the Islamic Republic of Iran*, Award No. ITL 55-129-3, [9 Iran-U.S. C.T.R. 248] of 24 October 1985, 84 *International Law Reports* 489, at pages 516-517. See also, Westberg, *International Transactions and Claims Involving Government Parties: Case Law of the Iran-United States Claims Tribunal*, (International Law Institute, Washington, D.C., 1991) at page 130.

894. In this regard, it is necessary to point out that in this case there has been no regulatory taking in that a fully perfected operating investment was shut down by government fiat.

895. To the contrary, this is a case where the investor insisted on, and persisted in, making its investment in:

a) a notoriously risky and controversial industrial facility;

b) in a contaminated site;

c) where there had been strong local opposition;

d) which opposition had been sufficiently brought to its attention so as to lead it to insert contractual language in its 1993 and 1996 legal instruments relating to the purchase of COTERIN;

e) where it acknowledged that, in addition to the necessary legal permits, it needed to secure the consent of the State Governor and the local community, and

f) where it ultimately failed to obtain such consent —in the case of the Governor because he conditioned his approval on that of the municipality, and in the case of the Municipality because it did not want to accept hazardous waste in its vicinity.

896. In short, the facts of this case are far different from the kinds of facts that have formed the basis for a finding of an indirect expropriation.

897. With respect to municipality's legal challenge of the *Convenio de Concertación*, the Memorial complains that, "For eighteen months, Claimant was denied access to and the benefit of its investment, victimized by a process that took its property without hearing or just compensation"[587] and that "The company is not a party to the *amparo* but is the victim of the procedure: neither the federal government nor the municipality has gone forward with the action which lies dormant"[588]. In fact, the Claimant actively participated

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586. Aldrich, G. "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal," 88 *The American Journal of International Law* (1994), 585 at pages 590, 598, 602, and 603, citing Iran-United States Claims Tribunal cases; Brower, C.N., "Current Developments in the Law of Expropriation and Compensation: A Preliminary Survey of Awards of the Iran-United States Claims Tribunal" (1987), The International Lawyer 639, at page 641; Comeaux, P.E. and Kinsella, N.J., "Protecting Foreign Investment Under International Law: Legal Aspects of Political Risk," Oceana Publications, Inc.

587. At paragraph 44, page 65 of the Memorial. Chronology complains that.

588. At page 17, chronology of the Memorial.

throughout the *amparo* proceedings, as did the federal and municipal authorities. The Claimant's failure (and SEMARNAP's) to successfully challenge the validity of the different procedural acts (such as the judge's acceptance of the *amparo* and the provisional and final injunctions) under the applicable rules of Mexican *amparo* procedure, does not constitute a breach of NAFTA. There is nothing discriminatory about such rules of general application.

898. With respect to the complaint that the federal court took an excessive amount of time to resolve the injunction, the implication that the case sat dormant is not borne out by the evidence.

899. Moreover, as the International Court found in the *ELSI* case, the allegation of a denial of justice (implicit in this particular complaint) is an extremely serious one and in that case the Chamber found there was no basis for finding that a sixteen month period prior to a judgment amounted to such a denial. The Court's observation applies equally to the facts of this case. The fact that the injunction was later temporarily vacated (it was reinstated after an appeal) does not mean that its granting constituted a breach of an international legal obligation.

900. The Claimant alleges that "In an official meeting the Town Council of Guadalcázar refuses to consider the company's application for a construction license made 13 months earlier"[589]. The Claimant, however, omits to note that during this 13 month period many events took place:

- the site continued to be shut-down by municipal order[590];
- the audit took place;
- the Claimant attempted to force the opening of the landfill on March 10th.
- the results of the audit were reviewed by a number of institutions (the "audit of the audit");
- there was a public consultation process regarding the audit.

589. At page 15.

590. The Claimant asserts through its expert report entitled "Administrative, Procedural and Legal Violations of Mexican and International Law Concerning the Authorization and Oversight of the 'La Pedrera' Landfill" that the Municipality issued a stop-work order in violation of Mexican law, including constitutional provisions. However, it never attempted to challenge the order before Mexican courts, and this allegation cannot properly be raised before this Tribunal.

The Claimant also initiated an *amparo* proceeding against the *Ayuntamiento's* denial of the construction permit. A Mexican judge rejected the *amparo* because COTERIN had failed to exhaust its right of appeal. The Supreme Court of Mexico expressly confirmed the judge's decision.

901. The domestic legal proceedings are relevant to the Tribunal's consideration of this case and, it is submitted, the Tribunal should both take notice and give effect to them.

902. In summary:

a) As seen in the Respondent's Facts, the Admission and Denials Annex, the many documents of the Claimant's own making, other documents in the case, and the direct evidence adduced by the Respondent, the vast majority of the "facts" alleged to support the claim are not facts at all;

b) Any of the very things that the Claimant alleges constitute the elements of indirect expropriation were responses to its own actions.

c) There has been no substantial interference with or deprivation of the Claimant's property or property rights;

d) There is no expropriatory effect of any governmental action; and

e) Perhaps most tellingly, the Claimant cannot point to the date on which the alleged expropriation crystallized.

903. When the facts of this case are examined the context of the NAFTA and in the light of previous cases and the writings of publicists, it becomes clear that the actions complained of do not come close to constituting an indirect expropriation or a measure tantamount to expropriation. To the Respondent's knowledge, there has been no successful expropriation claim involving a pre-existing regulatory scheme, where the investor had advance knowledge of the regulatory requirements, and of the strong opposition toward its investment.

904. Looking at the range of actions considered in expropriation claims, and taking into account the elements to be met to establish such claims, it is clear that the actions at issue in this case do not fit within the class of actions having expropriatory effect in terms of (i) the degree of interference, (ii) the attribution of any losses to acts of the State, and (iii) the existence of some action that crystallizes the expropriatory effect. None of the kinds of facts that were central to findings of indirect expropriation are paralleled in this case. Indeed, the facts at issue do not even rise to the class of actions that may interfere with investments to a significant degree (i.e. strikes, economic and political changes, and even revolutions) but are not expropriatory.

905. A finding of expropriation on the facts of this case would lead to an unprecedented result. In the Respondent's submission, it would be surprising to all three NAFTA Parties that where a foreign investor sought to make a high risk investment in a highly regulated field, where public opposition to its project was widely known, and the investor knew of both prior to making its investment, a NAFTA Party could be held responsible for that investor's calculated business decision to proceed in the face of known risks.

906. It is not the purpose of Article 1110 to protect investors who make poor business decisions with full knowledge and understanding of the risks involved, who breach domestic laws, and who fail to use common business sense. The NAFTA does not provide recourse for poor business decisions any more than does the domestic law of a state.

E. Compensation and Valuation

907. In the unlikely event the Tribunal were to find that acts attributable to the Respondent did have an expropriatory effect on the investment of the Claimant, compensation would be payable in accordance with NAFTA Article 1110.

908. The only issue for the Tribunal in order to determine the amount of compensation, as with any international expropriation where a taking has been found, would be a twofold analysis: first, what is the standard of compensation; and second, what is the most appropriate method of valuation?[591]

1. Standard of Compensation

909. Unlike in many international investor-state arbitrations, the standard of compensation in the present arbitration is not contentious: it is "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place"[592].

910. This standard has three components, the "expropriated investment" must be identified; the date of the expropriation must be identified; and once the investment and the date of its taking are ascertained, the "fair market value" of the investment on that date

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591. Lauterpacht, E., "Issues of Compensation and Nationality in the Taking of Energy Investments", 8:4 *Journal of Energy and National Resources Law* 241 (1990) at 245; Westberg, J.A., *International Transactions and Claims Involving Government Parties: Case Laws of the Iran-United States Claims Tribunal* supra page 211, fn.2; Khalilian, S.K., "The Place of Discounted Cash Flow in International 'Commercial Arbitrations: Awards by Iran-United States Claims Tribunal" 8 *J. Int'l Arb.* 31 (1991) at page 39; Lieblich, W.C., Determining the Economic Value of Expropriated Income-Producing Property in International Arbitrations", 8 *J. Int'l Arb.* 59 (1991) at page 59.

592. NAFTA Article 1110:2.

must be determined based on appropriate criteria, including going concern value or asset value including declared tax value of tangible property.[593]

911. The "expropriated investment" (if any) was COTERIN. It is the entity to which Claimant refers throughout its pleadings as its "investment" and its "enterprise" for the purposes of Chapter Eleven of the NAFTA. The evidence shows that COTERIN is the owner of the La Pedrera site and the holder of the authorizations and licenses that have been issued to date by federal and state authorities. Accordingly, when assessing the fair market value of COTERIN, the Tribunal must take into account COTERIN's liabilities (financial and political), not just those assets which together comprise the La Pedrera facility.

912. The Claimant did not attempt to identify when the alleged interference with its investment crystalized into an expropriation. Instead, American Appraisal Associates (AAA) purported to assess the value of the La Pedrera facility as at January 2, 1997 (the date that this matter was submitted to arbitration), adding that its value would not differ materially at any date after March 10, 1995. As the Tribunal will know, having read and heard the evidence, the La Pedrera facility was subject to a federal closure order until February 2, 1996 and, until February 6, 1996, its federally permitted capacity was about one tenth of the annual operating capacity that AAA used for the basis of its discounted cash flow analysis. Accordingly, it can be seen that "date of expropriation" is an important issue for the Tribunal to address.

913. The third issue concerns the method of assessing the fair market value of COTERIN. Article 1110(2) contains an illustrative list of valuation criteria and directs only that they be considered to the extent that they are appropriate. In this case the investment in question is not a "going concern" and thus has no earnings history upon which to assess its value as a going concern. Despite this, AAA has purported to assess the La Pedrera facility as a going concern that would operate at its assumed legal operating capacity for 90% of its economic life, without taking into account a plethora of negative contingencies that are specific to this case, or negative contingencies that are specific to the hazardous waste management industry. Accordingly, it will be necessary for the Tribunal to assess whether going concern value (or more properly, potential going concern value) is an appropriate valuation criterion in this case.

914. Moreover, there is no basis for valuing the landfill as a "going concern" for the following reasons:

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593. Ibid.

a) The Claimant has never run a landfill anywhere before. There is no evidence that it has the necessary expertise to operate the business;

b) Related to this point is that fact that the Claimant's business plans exhibit serious miscalculations; and

c) The Claimant itself was the subject of a "going concern" opinion by its auditors.

2. *Method of Valuation*

915. Other than stating 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", Article 1110 does not dictate the method by which "fair market value" shall be determined.

916. The Claimant seems to have confused the standard of compensation with the method of valuation. The Respondent agrees that, under NAFTA Article 1110:2, the standard of compensation is "equivalent to the fair market value" of the expropriated property. However, "fair market value" is to be determined according to the most appropriate method of valuation and does not necessarily mean that the expropriated enterprise will be valued as a going concern as the Claimant insists. As noted above, La Pedrera never operated before and COTERIN and ECOPSA definitely are not going concerns. Nor likely is Metalclad insofar as the hazardous waste business is concerned.

917. "Fair market value" is the "the price that a willing buyer would have paid to a willing seller for the asset on the date of the taking in circumstances in which each had good information, each desired to maximize his financial gain, and neither was under duress or threat".[594]

918. A summary of the methods used in recent ICSID and Iran-U.S. Claims Tribunal cases suggests that there are four basic valuation methods: (i) the book value method, (ii) the replacement value method, (iii) the liquidation value method, and (iv) the discounted cash flow ("DCF") method.[595]

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594. Friedman, P.D., and Wong, E., "Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies" 6:2 ICSID Review – Foreign Investment Law Journal 400 (1991) at 404. See also, *Starrett Housing Corp. v. Iran,* Award No. 314-24-1, 16 Iran-U.S. C.T.R. 112 (1987), Final Award at paragraph 277.

595. Friedman, P.D., and Wong, E., "Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies" 6:2 ICSID Review – Foreign Investment Law Journal 400 (1991) at 405. The authors suggest that the liquidation value method may be a specific application of the DCF method:

> If an owner of an unprofitable enterprise could realize a greater sum from the sale of the individual assets comprising the enterprise than in its continued operation, assuming rational economic behavior,

3. DCF Method Is Inappropriate Where The Investment Is Not A Going Concern

919. The DCF method of valuation values an income-producing asset by estimating the cash flow that the asset would be expected to generate over the course of its life, and then discounting that cash flow by a factor that reflects the [time value] of money and the risk associated with the cash flow.

920. Since the DCF method of valuation is based on a calculation of all anticipated profits that the expropriated enterprise could have earned over its lifetime, it is appropriate only where the asset being valued was a "going concern" at the time of expropriation. Where it was not, an alternative method that more accurately yields the real "fair market value" of the asset is appropriate.[596]

921. Both ICSID and Iran-U.S. Claims Tribunal panels have refused to apply the DCF method of valuation where they found that the expropriated enterprise was not a going concern and, therefore, did not have a reasonable expectation of future profits which could be discounted using the DCF method of valuation. Criteria which indicate that the enterprise is not a going concern have included the following:

- its appearing never to have gone into operation[597]
- its having only generated revenues for less than one year and having a project that was "in its infancy"[598];

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such owner would liquidate rather than continue to operate the enterprise. The cash flow which such an enterprise could be expected to generate would therefore simply be the price of each asset comprising the enterprise when sold off. No discount rate would need to be applied to the cash flow since one would assume that the sale of assets would take place in the immediate future (pages 406-7).

See also J.A. Westberg, *International Transactions and Claims Involving Government Parties: Case Law of the Iran-United States Claims Tribunal*, (Washington, D.C.: International Law Institute, 1991), page 211, fn.2.

596. S.K. Khalilian, supra. See also Gann P.B., "Compensation Standard for Expropriation", 23 *Columbia Journal of Transnational Law* 615 (1985) at 618-619 for a recitation, from R. Smith, "The United States Government Perspective on Expropriation and Investment in Developing Countries", 9 J. Transnatl L. 519-520 (1976), of the U.S. Department of State's perspective on the valuation of expropriated property, including its recognition, at page 618, that, "There may be circumstances in which application of this [going-concern - i.e. DCF] method is impracticable, or where it might operate unfairly - for example, where an investment has a limited history of operating results...." This perspective is also discussed in *Sola Tiles v. Government of the Islamic Republic of Iran*, 83 I.L.R. 460 (1987) at fn.18.

597. *Benevenuti et Bonfant v. People's Republic of the Congo*, 21 I.L.M. 740 (1980) at paras. 4.86-4.94. See also P.D. Friedland and E. Wong, supra at pages 408-411.

- its having only "the briefest past record of profitability";[599] and

- its having a factory, which was neither fully equipped nor fully operational, such that any estimation of future profits, would be "highly speculative".[600]

One of the lengthiest discussions about whether compensation for expropriation should be based on a projected stream of future profits was in respect of a company formed to undertake shrimp farming which was destroyed as a result of a counter-insurgency operation by government forces. An ICSID Tribunal refused to award the owner of shares in the destroyed company compensation for either goodwill or loss of future profits, as neither "could be reasonably established with a sufficient degree of certainty".[601]

922. The Tribunal found that in order for there to be goodwill, there must be a presence in the market for at least two or three years. This was the minimum period needed in order to establish continuing business connections. Also during that period expenses would be incurred in supporting management's efforts devoted to create and develop the marketing network of the company's products.

923. The possible existence of valuable "goodwill" becomes even more difficult to sustain with regard to a company, not only newly formed and with no record of profits, but also incurring losses and under-capitalized.

924. In *Asian Agricultural Products Ltd.*, the fact that the lost company had exported for the first time only two shipments of product to Japan before its farm was destroyed, did not sufficiently demonstrate in the Tribunal's opinion "a certain ability to earn revenues" in a manner that would justify considering it able to keep itself commercially viable as a source of reliable supply in the Japanese market.[602]

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598. *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, 8:2 ICSID Review – Foreign Investment Law Journal 3328 (1993) at paragrsaphs 187-8.

599. *Sola Tiles v. Government of the Islamic Republic of Iran*, 83 I.L.R. 460 (1987) at paragraph 64.

600. *Phelps Dodge Corp. and Overseas Private Investment Corp. v. Government of the Islamic Republic of Iran*, 10 Iran-U.S. C.T.R. 121 (1986) at paragraph 30.

601. *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, 6:2 ICSID Review - Foreign Investment Law Journal 526 (1990) at paragraph 106, and generally, paragraphs 87-108. See also P.D. Friedman and E. Wong, Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies, 6:2 ICSID Review - Foreign Investment Law Journal 400 (1991) at 419-421.

602. *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, 6:2 ICSID Review - Foreign Investment Law Journal 526 (1990) at paragraphs 102-105.

925. Furthermore, according to a well established rule of international law, the assessment of prospective profits required proof that:

> "they were reasonably anticipated; and that the profits anticipated were probable and not merely possible".[603]

926. The expert reports of Messrs. Butler, Zmijewski, and Dages collectively cast serious doubt on the Claimant's ability to be a going concern.

4. Appropriate method of valuation

927. For the purpose of answering the Claimant's contention that it is entitled to compensation in the sum of 90 million dollars (and without conceding that going concern value is an appropriate valuation criterion in this case), the Respondent has tendered the expert report of John C. Butler of Putnam Hayes and Bartlett, Inc. Mr. Butler was instructed to approach the valuation of COTERIN from the point of view of a properly informed potential purchaser. The Tribunal will see that he is critical of the highly optimistic (in some cases wholly unrealistic) assumptions used by AAA in purporting to assess the discounted cash flow value of the La Pedrera facility.

928. Mr. Butler's analysis, which is based on volume, price and cost assumptions that a potential purchaser would consider to be realistic, results in a potential discounted cash flow value that is approximately one eighth of the sum assessed by AAA, without taking into account the additional difficulties that arise from the fact that COTERIN lacks needed municipal permits and that social opposition continues to be a significant obstacle to viable operations, and number of permitting issues, such as the fact that COTERIN's federal authorization is for a period of only five years and the fact that COTERIN's State Land Use License is based on a federal authorization to develop a much smaller landfill operation than Metalclad now claims to be entitled to operate. As Mr. Butler explains, these are matters that a properly informed purchaser would take into account in deciding whether to make an offer to acquire COTERIN and the maximum price such purchaser would be willing to pay.

929. In addition to Mr. Butler's expert opinion, it is instructive to examine how Metalclad approached the acquisition of COTERIN in 1993. Of initial interest is a memorandum to Grant Kesler from Metalclad's in-house advisors which, upon discussing the fact that a partially permitted site was available at an asking price of 2 million dollars, proclaimed "THIS IS TOO EASY - THERE MUST BE SOMETHING WRONG !"[604].

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603. Marjorie Whiteman, *Damages in International Law*, volume II (1937), page 1837.

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Although apparently enthused by this opportunity, the authors of this memorandum, concluded there remarks by saying *"Remember, just because THEY have a permit to operate doesn't mean they will!".*

930. Also of interest is a memorandum from the same individuals to the vendors of COTERIN, Salvador and Guillermo Aldrett, wherein the potential terms of purchase are discussed. The discussion of discounted cash flow value results in numbers in the range projected by Mr. Butler. Moreover, it is based on a price assumption of 150 dollars per tonne (not 250 to 360 dollars per tonne as Metalclad later proclaimed to the market) and a volume assumption of 36,500 tonnes per annum (not 120,000 to 360,000 tonnes per annum as Metalclad soon began to predict in promotional material).[605]

931. Finally, it is instructive to note that Metalclad was only willing to pay 500,000 dollars of the 2.0 million dollar purchase price of COTERIN without having in hand the needed municipal construction permit (or a judgement from a court of competent jurisdiction stating that construction could proceed without such permits) and the express consent of the State government for construction of the landfill. This supports Mr. Butler's belief that a properly informed purchaser would only be willing to make a conditional offer to acquire COTERIN in the face of substantial social opposition and the need to acquire local permits and an operating permit limited to five years.

932. Mr. Butler has opined that, in his opinion a properly informed purchaser would not pay more than 3 million dollars for COTERIN in the circumstances that exist today (which pre-existed Metalclad's interest in the project), and there is a strong likelihood that no offer would be made. However, to assist the Tribunal he has given a range of discounted cash flow calculations and opinions as to fair market value based on different potential factual scenarios. The possibilities range from nil value to 10.8 million dollars.

Other Possible Valuation Criteria

933. The claimant has not adduced any evidence that would assist the Tribunal in assessing the quantum of its direct investment in COTERIN. The Memorial is replete with assertions which state or imply that the Claimant has invested 20 million dollars (or more) in acquiring and developing the La Pedrera facility. However, none of the Claimant's witnesses (including Mr. Kesler) testify to this alleged fact. The only place that information concerning the Claimant's expenditure appears is in a table in the AAA report which is comprised exclusively of information provided by Metalclad. A review of this

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table of alleged amounts investment in ECOPSA and COTERIN shows that approximately 6.2 million dollars was spent in Mexico before the second calendar quarter of 1993 when Metalclad entered into an option to acquire COTERIN.[606] It is plainly evident that the Claimant seeks to attribute to La Pedrera (and recover in this proceeding) costs associated with the abandoned Santa Maria del Rio project and other failed ventures in the Mexican waste management industry.

934. The Respondent's accounting expert, Kevin Dages of Chicago Partners, having reviewed all available information (including financial information provided during a visit to Metalclad's offices for this very purpose) has opined that the Claimant's direct expenses for acquisition and development of the La Pedrera landfill is generously stated 3.225 million dollars. This figure is much closer to the Claimant's own 6.4 million dollar projected acquisition and development cost (which included over 1.3 million dollars in cash that Metalclad has not been required to pay the vendors) for a fully equipped facility than it is the 20 million dollars and 25 million dollars figure that Mr. Kesler is fond of proclaiming in public statements as well as the pleadings herein.

935. The Claimant's oft-repeated contention that 1.5 million dollars has been spent on the environmental impact study, studies requested by the committee of UASLP professors and the environmental audit is also wanting for support in the evidence. The Claimant alleges (and the respondent admits) that the environmental impact study cost 500,000 pesos. The evidence of Dr. Ortega indicates that the environmental audit (and all associated studies) cost about 750,000 pesos. There is no evidence of any other expenditure. The total is less than 150,000 dollars.

936. The Respondent accordingly submits that the Tribunal should decline to make any finding as to the Claimant's expenditure (as an alternate means of ascertaining fair market value or as damages for a breach of any other provision of Chapter Eleven that the claimant asserts) in the absence of cogent evidence that demonstrates persuasively that specific sums have been expended to COTERIN's account in developing the La Pedrera facility.

937. Finally, there remains the Claimant's contention that it has suffered a decline in "market capitalization" in the sum of 23 million dollars, perhaps as support for its claim of 90 million dollar loss of fair market value or as an alternate theory of damages for other alleged breaches of Chapter Eleven. The purpose is not made clear by AAA or the Claimant's memorial. In addition to taking the position that it would be completely inappropriate to measure damages on this in an international law proceeding of this nature, it is clear that the Claimant's alleged loss rests on a fundamentally false premise. As discussed at length in Prof. Zmjewski's expert report, the Claimant's "market cap" was substantially based on incomplete information (if not false information) that was fed to the

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market by Metalclad. The main reason his market cap figure differs from Mr. Butler's assessment of COTERIN's fair market value is that Mr. Butler was able to assess realistically COTERIN's potential revenues whereas the markets were told repeatedly by Metalclad to expect revenues in the order of 40 million to 50 million dollars per annum.

V. REQUEST FOR RELIEF

938. For the reasons set forth above, the Respondent respectfully requests that the Tribunal make a finding that the Respondent has not violated Chapter Eleven of the NAFTA, and reject Claimant's demand for compensation.

939. Further, the Respondent requests that the Tribunal order the Claimant to pay all of the Respondent's costs, including legal and experts fees, incurred in defending this action. In the view of the Respondent, the Claimant has intentionally filed a claim that lacks any plausible legal or factual basis. Among other things, (i) the Claimant grounded its case on an assertion that it relied to its detriment on representations of federal primacy, although the evidence demonstrates that it was actually fully aware of the requirement to obtain a municipal construction permit, (ii) the Claimant has made outrageous and indiscrimate allegations of corruption, all of which are completely unsubstantiated, (iii) the Claimant did not instruct its own experts as to its true state of knowledge, and (iv) there is no credible evidence supporting its claimed expenditures at the landfill site and its assertion of damages of 90 million dollars.

940. The Respondent believes it is vital that the Tribunal not permit the absence from these proceedings of the disciplines normally imposed on litigants in domestic courts to encourage the bringing of groundless claims, especially because such cases will needlessly divert the attention and resources of the NAFTA governments.

Respectfully submitted,

Hugo Perezcano Diaz