INTERNATIONAL CENTRE FOR SETTLEMENT

OF INVESTMENT DISPUTES

ICSID CASE NO. ARB/10/23

TECO GUATEMALA HOLDINGS, LLC
CLAIMANT

REPUBLIC OF GUATEMALA
RESPONDENT

RESPONDENT'S
POST-HEARING BRIEF

10 JUNE 2013

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QUESTIONS FROM THE TRIBUNAL

The Respondent's Post-Hearing Brief is submitted in accordance with point 4 of the Procedural Order dated 22 March 2013 and the agreement of the Parties dated 29 May 2013. Attached hereto are 16 factual exhibits numbered R-234 to R-249, and five legal authorities numbered RL-33 to RL-39. In accordance with the Tribunal's request, the new factual, doctrinal, and legal exhibits that accompany this brief relate to specific questions asked by the Tribunal during the Hearing and in its letter dated 11 March 2013. Except where otherwise indicated, all capitalized terms not defined in this Brief have the same meaning they were given in the Memorial on Objections to Jurisdiction and Admissibility and Counter-Memorial and the Rejoinder submitted by the Republic of Guatemala (***Guatemala***) in this proceeding.[1] This Rejoinder has been written in Spanish and translated into English. Therefore, in the event of any discrepancy or ambiguity, Guatemala requests that TGH and the Tribunal refer to the original Spanish version.

I. INTRODUCTION

A. THE PURELY REGULATORY NATURE OF TGH'S CLAIM, AND ITS LACK OF CREDIBILITY AND FOUNDATION

1. The Hearing held between 21 January and 23 January 2013 and between 1 March and 5 March 2013 highlighted two fundamental issues in the present case: the purely regulatory nature of TGH's claim, and the lack of credibility and foundation of the claim.

2. In particular, the Hearing demonstrated the role of passive observer that Teco adopted at the time of its investment in EEGSA, omitting any material analysis of the regulatory framework or the company's prospects. Consistent with this initial distinterest, Teco (and later TGH) silently assumed the role of *silent partner* in EEGSA during the life of the investment without involving themselves in the business of the company, which remained under the control of Iberdrola, the majority shareholder and operator. In 2010, Iberdrola impelled TGH to sell its stake in Empresas Públicas de Medellín (***EPM***).

3. As was demonstrated at the Hearing, Teco's decision to invest in EEGSA was not based on any specific promise made by Guatemala. Mr. Gillette, who was Vice President of Regulatory Matters (and later Director of Finance) of Teco Energy LLC during the time of the

[1] Similarly, all emphasis included in citations has been added for purposes of this submission, unless noted otherwise.

privatization of EEGSA, explained the reasons for the company's decision to invest in EEGSA. His testimony was telling. As he himself confirmed during the Hearing, TGH did not conduct any real due diligence, either on the company or with regard to Guatemala's regulatory framework in the electricity sector.[2] Nor could Mr. Gillette identify a single person at TGH who had participated in any road show.[3] Mr. Gillette also confirmed that as Vice President of Regulatory Matters he had not requested any legal analysis regarding Guatemalan electricity regulations from either his internal or outside legal counsel,[4] nor had he reviewed any of the promotional material in the request for bids.[5]

4. After Mr. Gillette offered this testimony, Guatemala's next asked what Mr. Gillette and Teco *did* know about the company that they were buying in 1997.[6] Mr. Gillette responded that he never actually obtained detailed or written information, and that any information he did receive was obtained through "*casual inputs […] in an informal way*."[7] When asked specifically about the information that the Directors of TECO Energy received with respect to the regulatory framework, Mr. Gillette confirmed that the only thing that they were told was that it was a methodology similar that of the Chile, Argentina, and El Salvador regimes, and that the tariffs were based on an efficiently operated distribution company.[8]

5. Teco's ignorance regarding the situation at the time of the investment was also evidenced during the Hearing when Mr. Gillette affirmed that Teco invested with the "hope" of receiving a "significant" tariff increase in 2003.[9] However, the reality is that the witness

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2 Tr. (English), Day Two, 445:2-445-13, Gillette.

3 *Ibid*., 445:2-445-10.

4 *Ibid.*, 459:13-17 y 460:19-461:6.

5 *Ibid.*, 450:7-11.

6 *Ibid.*, 457:4-10.

7 *Ibid.*, 458:5-6.

8 *Ibid.*, 480:8-16:

> Q. So my understanding from this is that the Orly explanation given to the TECO Energy Board about the regulatory Framework, that it was a methodology similar to the Chilean, Argentina and El salvador regimes. And that the tariffs are based on an efficiently operated distribution company. That is the sum total of the briefing on tariffs in the regulatory framework?
> A. That is the written briefing.

9 *Ibid*., 489:8-17:

> Q. So your investment was based on the hope of a substantial tariff increase in 2003?
> A. Well, I wouldn't say a hope.
> Q. You just did.

himself recognized during the Hearing that Teco's expectation (as reflected in its business plan) was that the tariff would only increase by 3% in real terms in 2002, and by 2.1% in real terms in 2008.[10]

6. All of this is unsurprising.[11] As Mr. Gillette himself confirmed during the Hearing, TGH's true motivation for investing in EEGSA was the possibility of vertically integrating its electricity business in Guatemala,[12] as 90% of the electricity produced by Teco's power stations in Guatemala was ultimately sold to EEGSA.[13]

7. This issue is significant. The non-disputing state parties made clear that the protection offered by the CAFTA-DR minimum standard of treatment does not protect the investor's legitimate expectations. TGH's *complete lack* of expectations makes its claim entirely inadmissible. Thus, even if the CAFTA-DR did protect legitimate expectations, the evidence offered at the Hearing confirmed that TGH's investment expectations were not based on promises or representations made by Guatemala. In this context, it is no minor detail that TGH

A. I would characterize it more -- well, I'm sorry.
Q. You did say you just used the word "hope" so I was using the word back to you. If you want to correct it, that's fine.
A. Fair enough.

[10] *Ibid.*, 497:5-11:
Q. So would it be fair to assume that in terms of real adjustment, after inflation to the VAD calculation, that the expectation in this business plan that you presented to obtain financing was that tariffs would increase by 3 percent in real terms in 2002, and 2.1 percent in real terms in 2008?
A. Yes, it would appear that.

[11] Mr. Gillette's responses further confirm the falsity of the allegations of TGH in this process with respect to the statement that Teco "conducted an exhaustive due diligence process [...]" (Memorial, para. 59). The Tribunal will recall that when Guatemala requested the documentation for that due diligence in its request for documents (**Exhibit R-142**, Documentation A.2), TGH did not submit a single document, neither on the due diligence supposedly conducted when it invested in 2005, nor from 1998 when other companies from the group joined EEGSA.

[12] Tr. (English), Day Two, 442:4:8, Gillette:
Q. And that enabled you at the time when you were thinking about the investment, EEGSA would enable you to vertically integrate your power business in Guatemala?
A. Yeah. That's true.
See also Ibid., 485:17- 486:8.

[13] *Ibid.*, 440:13-441:10.
Q. And what percentage of power produced by Alborada and San Jose was bought by EEGSA?
A. A very high percentage. All of the capacity of both San Jose and Alborada is contracted to EEGSA in the contractually stated capacity. […].
But ultimately -- so I'm not a mathematician either, but well over 90 percent of the power produced –
A. Of the capacity; yes.
Q. -- was sold to EEGSA?
A. Yeah.

was incorporated in 2005 and, as acknowledged by Mr. Gillette, TGH could have no expectation before its creation.[14]

8. TGH's claim also suffers from a double deficit–it has no evidence to support its factual or its legal case. Additionally, TGH's claim suffers from simple opportunism. The manner in which TGH arrived at this arbitration is an example. After TGH submitted its trigger letter, it waited nearly two years to submit this international claim. It only submitted this claim after it had received two reasoned decisions from the Guatemalan Constitutional Court regarding the same matters that TGH introduced in this arbitration. In other words, TGH decided to make this an international dispute and bring it before this forum once it became dissatisfied with the decision of the national courts.[15] However, in a total contradiction, TGH has not presented a claim for denial of justice.

9. TGH's opportunistic behavior was also evidenced by the fact that just one day after it initiated this arbitration, TGH announced the sale of its stake in EEGSA to EPM, one of the most important public utilities companies in Latin America. TGH received US $185 million for its share in DECA II.[16] That is to say, TGH sold its stake for a sum of nearly US $200 million and reserved this arbitration for itself in search of a double recovery.

10. Finally, as highlighted during the Hearing, TGH's claim has been artificially over-valued. Let it be noted that after receiving more than US$ 100 million for its stake in EEGSA (as was confirmed in this arbitration by their own expert), TGH only reduced its original claim from US$ 285.6 million to US$ 243.6, i.e., by around 42 million dollars.[17] To have a sense of the disproportionate nature of this claim, suffice it to say that TGH valued its purported

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[14] *Ibid.*, 434:9-435-4.
> Q. Okay. So any references to TECO or any TECO entities in your Witness Statement in reference to events that predate 2005 are not referring to the Claimant in this case; correct?
> A. That's correct […]
> Q. […] My question was simply, did TECO Guatemala Holdings, the Claimant in this case, rely on any statements of the Guatemalan government or its advisers made in 1998?
> A. The answer is no.

[15] Tr. (English), Day One, 185:17-186:3, Respondent's Opening Statement.

[16] Rejoinder, para. 28; M Abdala and M Schoeters, **Appendix RER-4**, Table 1, row 4.

[17] Tr. (English), Day One, 193:5-6, Respondent's Opening Statement; Annual Report for Teco Energy Inc. (10K) **Exhibit C-324**, p. 19. It is not possible to determine the precise amount Teco received for the sale of its stake in EEGSA to EPM. M Abdala and M Schoeters, **Appendix RER-4**, Table 1, row 4. *See* paras. 320-323.

material damage in EEGSA at more than *double* the figure claimed by its partner and controlling shareholder, Iberdrola, in its arbitration.[18]

11. The lack of legitimacy and the disproportionate nature of TGH's monetary claim is unsurprising once EEGSA's conduct during the tariff review is examined. As shown during the Hearing, after Bates White presented a study implicating a 245% increase in the VAD, with a requested annuity of US$552 million a year,[19] the President of EEGSA showed up at the CNEE with an anonymous letter proposing an increase of 10% (i.e., an annuity of US$175 million) "outside the study," in blatant disregard for the regulatory regime that TGH now claims to defend. Mr. Pérez's "offer" showed that the tariff studies EEGSA had prepared were nothing more than a pressure tactic to lay the groundwork for a "negotiation" and seek to "agree" on a tariff outside the legal framework.

12. During the Hearing, TGH was incapable of providing <u>any</u> explanation for the inconsistency between the financial requirements presented in the tariff studies and Mr. Pérez's offer. Furthermore, during the Hearing, TGH attempted to put forth a novel argument, according to which Guatemala should not have disclosed the presentation of Mr. Pérez, since it represented a "settlement discussion."[20] This new attempt to conceal the illegitimate actions of EEGSA does not withstand scrutiny. There simply was no 'dispute' between the parties at that time, nor had Mr. Pérez reserved any rights. This explanation is also inconsistent with Mr. Gillette's statement during the Hearing that he "was not aware of the content of any discussions or proposals that were being made" by Mr. Pérez to the CNEE.

13. Finally, the unreasonableness of EEGSA and TGH's position in the 2008-2013 tariff review is evidenced by comparing them with the position of the same company –now controlled by EPM– in the tariff review currently underway. While EEGSA claimed a 245% increase in the VAD in its first tariff study dated 31 March 2008, the initial tariff study

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[18] While Iberdrola, with a 49% share in Deca II had lodged a 183 million-dollar claim in its arbitration, Teco, with a substantially lower share – 30% – requested a much larger figure: 243.6 million dollars.

[19] Tr. (English), Day One, 216:12-19, Respondent's Opening Statement.

[20] Tr. (English), Day One, 61:9-12, Claimant's Opening Statement.

performed by the EEGSA consultant in the 2013-2018 tariff review proposed a mere 15% increase.[21]

B. TGH'S SURPRISING SILENCE REGARDING THE POSITION OF THE NON-DISPUTING STATE PARTIES

14. Apart from the factual, technical, and regulatory matters that form part of any final hearing, the Hearing also involved a very important aspect of public international law: four of the state parties to CAFTA-DR, including the United States, had filed non-disputing party submissions shortly before the Hearing, in which they emphasized the extremely restrictive character of the protection offered in the CAFTA-DR treaty. The international minimum standard of treatment is the only standard invoked by the Claimant. In particular, the presentation of the United States made clear that said standard protects investors only against the denial of justice and manifestly arbitrary actions, and accords a wide margin of deference to the regulatory powers of domestic authorities.[22]

15. Despite the significance of this issue and in spite of the unequivocal position taken by the Government of the country of which TGH is a national, TGH's attorneys decided to ignore the presentations entirely. They did not even once utter the phrase "non-disputing party" during their opening statement. Even when the states decided to participate with oral presentations during the Hearing, TGH chose not to exercise its right to comment in response, even when the opportunity for rebuttal was expressly built into the Hearing schedule.

16. The only justification that TGH could have had for remaining silent was that it possessed no arguments with which to respond, and therefore preferred to ignore the question.

C. THE HEARING CONFIRMED TGH'S WITNESSES' LACK OF CREDIBILITY

17. Apart from the above examples that illustrate TGH's and EEGSA's lack of credibility, the Hearing also demonstrated the lack of credibility of several of TGH's witnesses involved directly in the tariff revision process. The following are just examples.

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[21] *See* para. 355 *et seq*.

[22] Non-Disputing Party Submission of the United States of America, 23 November 2012, paras. 6-7.

18. *First*, it was shown during the Hearing that, contrary to his testimony, Mr. Giacchino never acted "independently" through the tariff review process, but as an agent for EEGSA and TGH's interests. The following scenarios are telling:

- Though Mr. Giacchino stated at the Hearing that in his role as EEGSA's consultant during the tariff review he maintained an independent opinion, as required under article 1.5 of the Terms of Reference,[23] it was demonstrated during that the contract between Mr. Giacchino and EEGSA established that the CNEE's observations would be incorporated into the study provided these were "accepted be EEGSA." Such study was to be presented "to the satisfaction" of EEGSA.[24] Likewise, Mr. Giacchino's contractual obligation to EEGSA to "present, defend and in general pursue approval of the Tariff Study,"[25] even as a member of the Expert Commission,[26] was at odds with any independent opinion.

- In an attempt to defend his alleged "independence," Mr. Giacchino testified during the Hearing that he "changed [his] mind" with respect to several pronouncements while serving in the Expert Commission.[27] What Mr. Giacchino failed to mention to the Tribunal is that in all such discrepancies in which he "changed [his] mind," he simply aligned himself with the majority opinion on the discrepancy, which had already been announced by the other two experts. In other words, his change of opinion did not have any practical effect.[28]

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[23] Tr. (English), Day Five, 858:3-17, Giacchino.

[24] Contract between EEGSA and Bates White LLC for the performance of the 2008-2013 Tariff Study, **Exhibit R-55,** Clause Five, Obligations of the Consulting Firm.

[25] *Ibid.*, Number 12.

[26] As Giacchino himself has accepted, his obligation to defend the position of EEGSA before the CNEE extended both to his work during the preparatory phase of the tariff studies, as well as his work in the Expert Commission. Final Hearing Transcripts, ICSID Case No. ARB/09/5 (excerpts), **Exhibit R-202**, Tr., Day Two, 539:22-540:6, Giacchino.

> Q. Then, in your role – there was no separate contract, as if it existed – separate contracts that existed with Eng. Bastos. You, your role within the Expert Commission was regulated by the terms of this contract, is that correct?
>
> A. I suppose so. […]

[27] Tr. (English), Day Five, 930:12-13, Giacchino.

> […] and then in some cases I changed my mind on some things.

[28] *See* para. 180 below.

- The Hearing also revealed that, in his capacity as member of the Expert Commission, Mr. Giacchino did not just "pass along the decisions made by the Expert Commission" to his team of Bates White consultants without informing the CNEE. In addition, he transmitted extensive information to EEGSA itself prior to the official issuance of the pronouncement, without copying or informing the CNEE of this. The CNEE only learned of these unilateral communications during this arbitration.[29]

19. *Second*, the Hearing proved that Mr. Bastos is not credible. As the Tribunal will recall, Mr. Bastos attempted to explain how Bates White had implemented the Expert Commission's pronouncements in the 28 July study. However, during the Hearing, Bastos himself admitted that he "was unable to review [himself] the written report."[30] Yet according to him, he did review "each spreadsheet of the Excel models." But even that is untrue. He himself expressly acknowledged that he was unable to review these reports and models when he was questioned about the *Iberdrola* arbitration:

> At no time have I meant to say that I have reviewed the 137 Excel models and every step of calculation or the thousand-odd sheets constituting the final report, and I say this emphatically [...] For me it was impossible to confirm all of the steps of calculation of the model.[31]

20. *Third*, Mr. Calleja, Manager of Regulation at EEGSA during the 2008 tariff revision, made it clear that both he and EEGSA regarded Guatemala's regulatory scheme as optional and subject to the will of the company's Spanish operator (Iberdrola) and its partners, including TGH. In particular, Mr. Calleja revealed his peculiar reading of article 1.10 of the Terms of Reference, according to which the consultant could in practice rewrite the Terms of Reference at will.[32] The abuse on the part of EEGSA and Bates White with respect to article 1.10 was

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[29] *See* para. 182 below,

[30] Tr. (English), Day Four, 768:15-16, Bastos.

[31] Final Hearing Transcripts, ICSID Case No. ARB/09/5 (excerpts), **Exhibit R-140**; Day Two, 635:13-20, Bastos.

[32] Tr. (English), Day Two, 636:6-23, Calleja.

> Q: What you understand this article to be during the tariff review, according to your Statements, is that it gave the consultant the power to disregard the Terms of Reference approved by the CNEE if it had its own technical justifications and it didn't need authorization from the CNEE for that; correct?

evident, as Bates White resorted to this article to reject 85 of the 125 observations made by the CNEE in its study of EEGSA,[33] invoking the article to depart from the methodology no fewer than 423 times.[34]

21. The cross-examination of Mr. Calleja also brought to bear his conception of how EEGSA and the CNEE should be managed vis-à-vis the Expert Commission. Thus, for example, he "didn't attach any importance" to circulating a draft of the operating rules to Mr. Bastos behind the back of the CNEE, while indicating that the rules had already been approved.[35] Nor did he take into account that any agreement regarding these rules would need to be formalized with the CNEE because "[t]here are some things that we agreed [with the CNEE] there that aren't signed off on"[36] (which, moreover, is not true).

D. THE HEARING CONFIRMED THAT TGH'S EXPERTS WERE NEITHER INDEPENDENT NOR COMPETENT

22. It was also proven during the Hearing that TGH's experts lacked independence, whether based on their ties to TGH, their witnesses in the arbitration, their former partner in EEGSA (Iberdrola) or with EEGSA's new operator, EPM. Furthermore, the Hearing showed that they were not competent to provide an expert opinion on the matters in question.

23. The expert Mr. Barrera openly acknowledged during the Hearing that 26% of his combined professional experience was comprised of consulting work for Iberdrola.[37] Further, Mr. Barrera acknowledged that he was working for EPM on the 2013-2018 tariff review.[38] More worryingly, Mr. Barrera admitted that in the process of preparing his report—which endeavored to determine whether Mr. Giacchino had correctly incorporated all of the Expert Commission's pronouncements into the 28 July study[39]—he had consulted and interacted with

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A. Correct.

33 Rejoinder, para. 302. Colom, **Appendix RWS-1**, para. 108. Excerpts from Stage Reports in which Bates White invokes Articles 1.5 and 1.10 of the Terms of Reference, **Appendix-R-II**.

34 Counter-Memorial, para. 347.

35 Tr. (English), Day Two, 665:21-666:2, Calleja.

36 *Ibid.*, 667:19-20.

37 Tr. (English), Day Six, 1322:11-17, Barrera.

38 *Ibid.*, 1325:2-12.

39 Barrera, **Appendix CER-4**, Section 3.

Mr. Giacchino himself.[40] As revealed during the Hearing, Messrs. Barrera and Giacchino had known each other since 2002, when both worked for NERA Consulting (***NERA***), the consultant firm that advised EEGSA in the 2003-2008 tariff review.[41]

24. In terms of his suitability to testify on matters contained in his report, Mr. Barrera admitted that, as an economist, he was not qualified to given an opinion on the VNR, and that his opinion with regard to such questions was based on his "discussions" and "interactions" with Mr. Barrientos, the co-author of his report.[42] The Tribunal will recall that counsel for TGH was emphatic in insisting that only Mr. Barrera, not Mr. Barrientos, testify at the Hearing.[43] Also, in evaluating Mr. Barrera's testimony, the Tribunal should consider that, in contrast with Mr. Damonte—who participated in the 2003, 2008 and 2013 tariff reviews as a consultant for Deorsa and Deocsa distributors[44]—Mr. Barrera has no experience[45] in the Guatemalan regulatory framework.[46]

25. The expert Mr. Kaczmarek admitted during his cross-examination that he based his conclusion that the 28 July Bates White study "correctly incorporated all of the pronouncements"[47] simply on the statements of the author of this study, Mr. Giacchino:

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40 Tr. (English), Day Six, 1326:7-16, Barrera.

41 *Ibid*., 1325:18-1326:6.

42 *Ibid*., 1320:17-1321:1:

> Q. So, it would be fair to say that the opinion that you're going to give us today here [is] going to be on the basis of your understanding of Barrientos engineering knowledge?
>
> R. It's going to be based on many discussions that I have had with him, on basically interacting with him on mostly the stage C. [...]

43 Hearing Organization Proposal, point 7, submitted by the Respondent and the Claimant, email dated 2 November 2012 ("(iii) Identification of witnesses/experts and order of appearance 7. […] Claimant thus opposes Respondent's calling Mr. Barrientos to testify as to that same report. If Respondent does not agree to call only Dr. Barrera, Claimant seeks a decision from the Tribunal that where the primary author of an expert report indicates that he is competent to testify as to the entirety of the report, he alone should be examined on that report.[…]").

44 Tr. (English), Day Six, 1384:15-1385:1, Damonte.

45 Barrera, **Appendix CER-4**, curriculum vitae attached.

46 Finally, serious inconsistencies were shown during the Hearing in Dr. Barrera's testimony, which must also be taken into account by the Tribunal in judging his credibility. By way of example, despite having stated on direct examination that "EEGSA is a company that seems to spend a lot of money on capital," a few moments later, on cross-examination, he acknowledged never having reviewed the historic investments made by EEGSA: "No, we haven't looked at what actually has been invested." *See* Tr. (English), Day Six, 1310:3-5 y 1343:5-12, Barrera.

47 Kaczmarek, **Appendix CER-2**, paras. 13, 101, 125, 126.

> Q. […] [B]asically you take that [it] is correct because it's Giacchino opinion?
>
> A. Yes, that's correct. I understand that Guatemala contests that, but I've not offered any opinion because I haven't done any work to check whether or not all of the Expert Commission's findings were incorporated.[48]

26. More alarming is the fact that Mr. Kaczmarek only admitted to having based his conclusions on Mr. Giacchino's assertions *after* attempting to convince the Tribunal that his opinion was based on Mr. Barrera's report.[49] But as revealed during the Hearing, Mr. Barrera's expert report was submitted by TGH's counsel with the Rejoinder, i.e., several months after Mr. Kaczmarek would have issued his first expert report in this case:

> Q. Mr. Kaczmarek, you repeat in your First Report […] that the 28th July study incorporated the Expert Commission rulings […] more than six or seven times […] Before providing this opinion, did you personally analyze whether the study, in fact, incorporated the Expert Commission's recommendations?
>
> […]
>
> I certainly did not. It was not my scope of work to make sure that the changes were incorporated. That was on Mr. Barrera, and so I take it from him that they have been incorporated, not myself.
>
> Q. Mr. Kaczmarek, at the time you drafted or you presented your First Report, was the report of Mr. Barrera presented in this arbitration?
>
> A. No, it wasn't. In that case, it would have been Mr. Giacchino, who was saying it was incorporated.[50]

27. This clear admission not only reflects the lack of credibility of Mr. Kaczmarek, but on its own is sufficient to completely discount his valuation of the damages. As explained in Section V below, Mr. Kaczmarek relies on the VAD in the 28 July 2008 study calculated by Mr. Giacchino, which—as has now been confirmed—Mr. Kaczmarek did not review.

28. Finally, in considering the weight of the evidence proffered in this case, the Tribunal must also take into account that, unlike the damages experts for the Republic of Guatemala, Dr. Manuel Abdala and Mr. Marcelo Schoeters,[51] Mr. Kaczmarek has no experience in the

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48 Tr. (English), Day Six, 1521:2-8, Kaczmarek.

49 *Ibid.*, 1520:12-15.

50 *Ibid.*, 1519:13-1520:21.

51 M Abdala and M Schoeters, **Appendix RER-1**, pgs. 13-14.

electricity distribution sector, much less in the regulatory framework for electricity distribution in Guatemala.[52]

29. With regard to Professor Alegría, it became evident during the Hearing that he failed to evaluate a fundamental issue in his reports: that the CNEE's obligation to base its VAD determination on the distributor's tariff study was only included in the original draft LGE (Article 54). This reference was expressly eliminated from the approved version of the LGE.[53] LGE Article 60 establishes that the CNEE must approve a VAD that complies with objective criteria established under law, and not, as TGH asserts, a VAD based on the distributor's tariff study. Lastly, it is strange that while emphasizing the role that Mr. Bernstein played in drafting the LGE, Professor Alegría made no mention of the crucial role played by Guatemala's expert, Professor Aguilar, who served as the primary author of the LGE as acknowledged in the preamble to the law.[54]

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30. In fact, TGH has "fabricated" for this Tribunal a factual case, including a regulatory framework that does not exist in reality. TGH's case only exists in its pleadings, and consists of allegations of supposed legitimate expectations, arbitrary conduct, bad faith and political interference. TGH has not managed to prove any of these allegations. More importantly, as demonstrated in the Hearing, TGH and EEGSA are the parties who have acted arbitrarily, in bad faith and who have abused their political influence. It is sufficient to recall the text in TGH Board of Directors' presentation, which suggested resorting to political influence regarding the Guatemalan Judiciary to obtain a "favorable" result in a hypothetical court submission against the reformed Article 98 of the RLGE:[55]

> We have concluded that the challenge [of unconstitutionality] is feasible. We are already working on arguments; and <u>we suggest the participation of 3 politically powerful attorneys in order to obtain a favorable decision</u>.[56]

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52 Kaczmarek, **Appendix CER-2**, Appendix I.

53 Tr. (English), Day Five, 1195:16-1197:19, Alegría.

54 LGE, final draft, **Exhibit C-13**, preamble.

55 Tr. (English), Day One, 228:18-229:17, Respondent's Opening Statement.

56 2009 Management Presentation by DECA II, January 14, 2010, **Exhibit R-107**.

31. TGH's response to this point during the Hearing was simply that there is no cause for concern about an allegation of using of politically powerful attorneys, given that "*no actual court challenge was actually ever filed. So what they're really saying is that you had some impure motivations*."[57] Such habitual impure motivations behind EEGSA's conduct are of concern to Guatemala and should concern the Tribunal in its analysis of TGH's arguments in this arbitration.

32. The structure of this brief is as follows:

- Section II analyzes the reasons for which the Arbitral Tribunal does not have jurisdiction to consider the dispute that is the subject of the present arbitration.

- Section III describes how the Hearing confirmed Guatemala's version regarding the most important factual points that the Tribunal should consider in this case.

- Sections IV shows that the facts of this case did not result in any violation of the international minimum standard and therefore produce no consequences under the Treaty.

- Section V describes how the Hearing demonstrates that, in any event, TGH's claim for monetary damages is based on false premises and contains grave errors.

During the Hearing, the Tribunal directed questions toward the parties, some of which it was agreed would be addressed in the Post-Hearing Briefs. Additionally, the Tribunal's letter dated 11 March 2013 included a series of additional questions.[58] All questions are identified and addressed in the body of this brief where they are relevant to the various issues discussed. Page 4 of this brief includes an index of the questions for ease of reference.

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[57] Tr. (English), Day One, 347:21-348:1, Claimant's Opening Statement.

[58] Letter from the Tribunal to the Claimant dated 11 March 2013.

II. THE HEARING CONFIRMED THAT THE TRIBUNAL DOES NOT HAVE JURISDICTION

A. TGH MUST DEMONSTRATE THAT ITS CASE IS NOT MERELY A DOMESTIC LAW DISPUTE THAT HAS ALREADY BEEN DECIDED BY THE GUATEMALAN COURTS

33. TGH has invoked Article 10.16.1(a)(i)(A) of the Treaty to submit this dispute to the jurisdiction of this Tribunal.[59] According to this provision, this Tribunal has jurisdiction only if the claim relates to one of the investment protection standards set forth in the Treaty.

34. The importance of this requirement was established in the *Iberdrola* case, which is factually identical to the present one. In *Iberdrola*, the treaty restricted arbitration to "[a]ny dispute […] concerning matters governed by this Agreement [the BIT.]"[60] The tribunal concluded that the claim −which was identical to the present one− did not constitute "a real claim" of violation of the treaty, with the exception of the denial of justice claim that is absent in this case.[61] The tribunal therefore unanimously concluded that it had no jurisdiction, and ordered the claimant to cover all costs of the proceeding.

35. Contrary to TGH's erroneous assertions at the Hearing,[62] the *Iberdrola* case is not the only example of such conclusion. Another well-known example is *Azinian v. Mexico*. In that case, the tribunal examined whether the dispute was one "founded upon the violation of an obligation established in Section A"[63] (investment protections) of NAFTA, which is the exact same requirement contained in Article 10.16.1(a)(i)(A) of the Treaty. The tribunal concluded that it was not. Rather, the tribunal found that the "fundamental claim" was a domestic law claim: a "breach" of Mexican law by a public authority, which had already been decided by the domestic courts. The tribunal found that the claimant merely dressed the domestic law claim as an international one, just as TGH does here.[64] The Tribunal, after affirming that "*labelling is*

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59 Notice of Arbitration, para. 27.

60 Agreement between the Kingdom of Spain and the Republic of Guatemala for the Promotion and Reciprocal Protection of Investments, 9 December 2002, **Exhibit RL-18,** Article 11(1).

61 *Iberdrola Energía S.A. v. Republic of Guatemala* (ICSID No. ARB/09/5) Award, 17 August 2012, **Exhibit RL-32**, para. 368.

62 Tr. (English), Day One, 156:4-8, Claimant's Opening Statment.

63 *Robert Azinian et al. v. United Mexican States* (ICSID Case No. ARB(AF)/97/2) Award, 1 November 1999, **Exhibit RL-2** (English version), para. 82.

64 *Robert Azinian et al. v. United Mexican States* (ICSID Case No. ARB(AF)/97/2) Award, 1 November 1999, **Exhibit RL-2** (English version), para. 87.

[…] *no substitute for analysis*,"[65] explained that "NAFTA, does not, however, allow investors to seek international arbitration for mere contractual breaches,"[66] as this would otherwise "have elevated a multitude of *ordinary* transactions with public authorities into potential international disputes."[67] It also held that "[a] governmental authority surely cannot be faulted for acting in a manner validated by its courts *unless the courts themselves are disavowed at the international level*."[68]

36. This principle is well established. A mere legal breach by a regulatory body (which has not even occurred here), does not give rise to a violation of international law. The tribunal in *ADF v. United States* was clear in its finding that: "*something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1).*"[69] These are matters under the jurisdiction of domestic courts, over which the tribunal "*do*[es] *not sit as a court with appellate jurisdiction*."[70]

37. The tribunal in *Saluka v. Czech Republic* reached the same conclusion, holding that "*[t]he Treaty cannot be interpreted so as to penalise each and every breach by the Government of the rules or regulations to which it is subject and for which the investor may normally seek redress before the courts of the host State*."[71]

38. The issue is analogous in claims involving mere contractual breaches; it is widely accepted that such claims do not by themselves constitute violations of international Law.[72]

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65 *Ibid.*, para. 90.

66 *Robert Azinian et al. v. United Mexican States* (ICSID Case No. ARB(AF)/97/2) Award, 1 November 1999, **Exhibit RL-2** (English version), para. 87.

67 *Ibid*.

68 *Ibid*., para. 97.

69 *ADF Group Inc. v. United States of America* (ICSID Case No. ARB(AF)/00/1) Award, 9 January 2003, **Exhibit CL-4**, para. 190.

70 *Ibid*.

71 *Saluka Investments B.V. v. Czech Republic* (UNCITRAL Case) Partial Award, 17 March 2006, **Exhibit CL-42**, para. 442.

72 *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina* (ICSID Case No. ARB/97/3) Decision on Annulment, 3 July 2002, para. 96; *Robert Azinian et al. v. United Mexican States* (ICSID Case No. ARB(AF)/97/2) Award, 1 November 1999, **Exhibit RL-2**, paras. 82–84, 87, 96–97, 100; *Consortium RFCC v. Kingdom of Morocco* (ICSID Case No. ARB/00/6) Award, 2 December 2003, **Exhibit CL-60,** para. 48; *Saluka Investments B.V. v. Czech Republic* (UNCITRAL Case) Partial Award, 17 March 2006, **Exhibit CL-42**, para. 442; *Parkerings-Compagniet AS v. Lithuania* (ICSID Case No. ARB/05/8) Award, 11

Tribunals frequently reject these claims at the jurisdictional stage of the arbitration,[73] as was the case for the alleged regulatory breaches present in the *Iberdrola* and *Azinian* cases.

39. All of the above applies in this case. TGH must demonstrate that it has submitted a real dispute under the Treaty, rather than a mere dispute of Guatemalan law dressed as a Treaty claim.

B. TGH HAS SUBMITTED A MERE REGULATORY DISPUTE UNDER GUATEMALAN LAW

40. The Hearing left no doubt regarding the true issues in dispute, as those arose time and again throughout the testimony. These issues, without exception, related to disagreements over the interpretation and application of certain provisions of Guatemalan law, as explained below.

1. The nature and impact of the Terms of Reference for the 2008–2013 tariff review

41. One issue is whether EEGSA and Bates White could unilaterally deviate from the Terms of Reference when they deemed those to be inconsistent with the LGE or the RLGE. TGH's position is that it could do so, as Messrs. Calleja and Giacchino maintained vigorously during the Hearing.[74]

42. The CNEE's position is that, subject to judicial control, the CNEE has the last word regarding the Terms of Reference in light of its responsibilities as regulator to comply with and enforce the LGE and RLGE.[75] This is also inherent in its authority to establish the methodology and the Terms of Reference for the tariff reviews.[76] These powers were expressly

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September 2007, **Exhibit RL-10**, paras. 315–320, 345; *Helnan International Hotels A/S v. Arab Republic of Egypt* (ICSID Case No. ARB/05/19) Award, 3 July 2008, para. 108.

73 *Robert Azinian et al. v. United Mexican States* (ICSID Case No. ARB(AF)/97/2) Award, 1 November 1999, **Exhibit RL-2**, paras. 87, 92; *Iberdrola Energía S.A. v. Republic of Guatemala* (ICSID Case No. ARB/09/5) Award, 17 August 2012, **Exhibit RL-32**, para. 350. *See also SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13) Decision on Jurisdiction, 6 August 2003, paras. 156–162; *Generation Ukraine, Inc. v. Ukraine* (ICSID Case No. ARB/00/9) Award, 16 September 2003, **Exhibit RL-6,** paras. 8.12–8.14; *Joy Machinery Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/03/11) Decision on Jurisdiction, 6 August 2004, paras. 72, 82.

74 Tr. (English), Day Two, 636:6-13 and 650:13-651:1, Calleja; Tr. (English), Day Five, 849:8-12 y 851:14-18, Giacchino.

75 LGE, **Exhibit R-8,** Arts. 4(a); RLGE, **Exhibit R-36**, Art. 3.

76 LGE, **Exhibit R-8,** Arts. 4(c), 74 y 77; RLGE, **Exhibit R-36**, Art. 97.

set forth in point 1.10 of the Terms of Reference, which were the subject of much debate during the Hearing.

2. The nature of the Expert Commission's pronouncement and scope of its functions

43. This question is whether the Expert Commission's pronouncement is binding, and if so, whether that same Expert Commission was to review an amended VAD study to determine whether it incorporated that pronouncement, in order to ultimately approve the study.

44. The CNEE's position is that the pronouncement is advisory −not binding− and that the Expert Commission completes its functions once it issues the pronouncement. From that point on, it is the CNEE that decides whether it is possible to correct the tariff study, or whether that study is so unreliable that tariffs must be determined using the independent study commissioned by the CNEE.

45. This interpretation does not diminish the relevance of the Expert Commission. As discussed below,[77] the Expert Commission plays an important role, allowing the CNEE to make an informed and reasoned decision on the basis of expert opinions.

46. TGH's interpretation would result in the delegation of the authority of the regulator to enforce the law,[78] approve tariff studies,[79] approve the VAD,[80] and determine tariffs[81] to an unaccountable temporary body. This would not only contravene the electricity regulatory framework, but also Article 3 of Guatemala's Law on Administrative Disputes.[82]

47. Such a delegation of power cannot be established implicitly by the phrase "[t]he Expert Commission shall pronounce itself on the discrepancies" in Article 75 of the LGE, which is the only phrase in the law concerning the Expert Commission's authority. No country in the world delegates the determination of the VAD to an expert commission that exists temporarily and

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77 *See* Section II.C.1, below.

78 LGE, **Exhibit R-8,** Arts. 4(a); RLGE, **Exhibit R-36**, Art. 3.

79 RLGE, **Exhibit R-36**, Arts. 92, 98 and 99.

80 LGE, **Exhibit R-8,** Arts. 60, 61, 71 and 76; RLGE, **Exhibit R-36**, Arts. 82 and 83.

81 LGE, **Exhibit R-8,** Art. 4(c), 61, 71 and 76; RLGE, **Exhibit R-36**, Art. 99.

82 Law of Administrative Disputes, approved by Decree No. 119-96, 21 November 1996, **Exhibit C-425**, Art. 3; Tr. (English), Day Five, 1234:14-1235:2, Aguilar. *See* Section II.C.1, below.

that does not give explanations. TGH and its expert, Mr. Alegría, make reference to Chilean law to support their position. However, the panel of experts in Chile establishes the VNR (not the VAD), is a permanent body (not temporary), the law expressly regulates that entity, and establishes the binding nature of its decision.[83] Even if it were true, as Mr. Alegría claims, that Chilean law influenced the Guatemalan legislation,[84] it is clear that the Guatemalan legislators expressly decided not to incorporate the same expert commission model in the LGE.

3. The CNEE's obligation to rely solely and exclusively on the distributor's tariff study for tariff approval

48. According to TGH, the CNEE must always use the VAD proposed in the distributor's tariff study in order to calculate the tariff. Any other rule, in TGH's view, would render the distributor's study irrelevant. TGH relies on an implicit interpretation of LGE Articles 74 and 75 −the only articles that mention this study− in support of this view.

49. The CNEE's position is that the LGE does not require the CNEE to establish tariffs on the exclusive basis of the distributor's tariff study. In fact, as mentioned before, such obligation had been provided for in the draft law,[85] but was later removed during the legislative proceedings.[86] In particular, Article 54 of the draft provided that: "[t]he costs for the distribution activity approved by the Commission shall correspond to standard distribution costs of efficient companies, determined by a study commissioned by distributors." The underlined portion, however, was removed from the final text of Article 60 of the LGE. Therefore, the CNEE's obligation is to ensure that the approved VAD (the distribution costs) complies with objective criteria: "shall correspond to standard distribution costs of efficient companies." The approved law contains no obligation to ensure that the VAD approved is the one determined by the distributor's study.

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83 General Electricity Law (Chile), approved by Decree 4/20018, 2 May 2007, **Exhibit C-482**, Arts. 208–211.

84 Tr. (English), Day Five, 1203: 1-18, Alegría.

85 LGE, final draft, **Exhibit C-13**, Art. 54.

86 LGE, **Exhibit R-8,** Art. 60.

50. It is notable that neither TGH's counsel nor its Guatemalan law expert have made reference to this modification between the LGE's draft and its final text.[87] Nevertheless, Ms. Menaker, speaking on behalf of TGH, placed great emphasis on this issue during the Hearing:

> On that, the law is very clear. It says, the distributor's VAD must be set on the basis of the distributor's study.[88]

51. This is simply not true. The legislature expressly excluded this obligation. Even Professor Alegría −TGH's expert− admitted during the Hearing that the CNEE as regulator is empowered to decide whether the VAD complies with the LGE, including whether the distributor's study is objective and can be relied upon for that purpose.[89]

52. This completely invalidates TGH's argument that the 2007 reform of RLGE Article 98 allowed the CNEE for the first time to depart from the distributor's tariff study. However, the obligation to rely on the distributor's study never existed in the final text of the LGE. Therefore the reform of Article 98 cannot have had the effect charged by TGH.

53. Notably, immediately following LGE Article 75 (regarding the distributor's tariff study and the Expert Commission), Article 76 establishes that the CNEE "shall use the VAD […] to structure a set of tariffs." It does not require the CNEE to use the distributor's tariff study, but rather that it use the VAD, which is very different.

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87 Note the response of expert Alegría during the Hearing. (Tr. (English), Day Five, 1195:16-1197:10, Alegría):

> Q. Did you refer to this change in your report?
>
> A. No, I did not.
>
> Q. Don't you consider it important that there was that modification to the bill?
>
> [...]
>
> A. Once again, I was studying how to interpret the law rather than how the bill should have been interpreted. The bill is going to give me some information. It's going to shed some light as to how to interpret the final law that was captured.
>
> [...]
>
> Q. Of course. Then we need to see what was removed to understand what the intention was behind this. This is an important interpretive rule.
>
> A. Yes, it is an interpretive rule, but I shouldn't have to criticize whether Article 54 was transferred or not.

In short, expert Alegría, despite recognizing the importance of the draft LGE in the interpretation of the LGE itself, curiously did not find it appropriate to reference draft Article 54.

88 Tr. (English), Day One, 349:6-8, Claimant's Opening Statement.

89 Tr. (English), Day Five, 1180:16-1183:7 and 1207:7-1208:12, Alegría.

54. None of this detracts from the importance of the distributor's study. First, as repeatedly stated throughout the proceeding, the purpose of requiring such a study is that only the distributor has first-hand knowledge of its costs, which together with efficiency criteria, provide the basis for calculating the VAD. Secondly, it is reasonable to require the regulator to consider the distributor's position so that it makes an informed and reasoned decision.

55. The distributor's role, as established in LGE Articles 74 and 75, must be interpreted in the context of this framework. The distributor's role cannot result in a restriction of the responsibilities and powers delegated to the CNEE.

4. Technical and financial questions concerning calculation of the VAD

56. The main technical issue upon which TGH disagrees with the CNEE relates to the design of the construction units, and whether the Bates White or the Sigla study adopt the correct units. This was acknowledged by Mr. Barrera during the Hearing ("*I think that there are a number of reasons why the two VNRs are different, but mostly they have to do with the construction units*"[90]). Construction units are sets of materials configured in distinct ways to form each of the electrical components in the distribution network. The construction units chosen determine the optimal number of transformers, kilometers of power lines and types of lines, etc.

57. This issue is regulatory and technical in nature and, therefore, is the kind of issue that is delegated to the CNEE as regulator to decide. In fact, the Expert Commission favored the position of the CNEE with respect to most discrepancies on construction units.[91]

58. Another relevant technical issue concerns the inclusion of depreciation in the VAD calculation. The CNEE's position is that depreciation must always be included in this calculation. If TGH's position were adopted, the distributor would perpetually accrue earnings on portions of the capital base that it had already recovered, which would be equivalent to a bank charging interest on the part of a loan that had already been paid off. In any event, the formula for calculating the VAD, which included the 50% depreciation, was part of the Terms of Reference and was not challenged by EEGSA, unlike other aspects that were challenged.

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[90] Tr. (English), Day Six, 1466:4-7, Barrera.

[91] Report of the Expert Commission, 25 July 2008, **Exhibit R-87**, pp. 68-71, 79, 83-86, and 94-96.

5. The dispute is nothing but a regulatory disagreement

59. The CNEE's position on the issues above is not ridiculous, absurd, or unreasonable to the point that would justify an argument that there has been a fundamental change in the regulatory framework, arbitrariness, or abuse of power, which are the labels employed by TGH to justify its international claim. In all of these matters, the CNEE's position has a legal and/or technical and economic basis that is concrete and justified.

60. TGH disputes the CNEE's interpretation, but such disagreement does not constitute a violation by the Guatemalan State of the international minimum standard under the Treaty. In this context, Guatemala's obligation under international law was to make its courts available for TGH and EEGSA to challenge the CNEE's interpretation; there is no question that Guatemala did so. TGH has not accused Guatemala of denying justice.

C. THE GUATEMALAN COURTS HAVE ALREADY DECIDED THIS REGULATORY DISPUTE

61. These regulatory questions have already been decided by the courts of Guatemala. Notably, aside from its unsubstantiated assertions that the Constitutional Court decisions on this matter were "*politically motivated*," TGH devoted very little time to this issue during the Hearing.[92]

62. The Constitutional Court's decisions will not be reexamined here, as they have already been analyzed in previous submissions.[93] It must be noted, however, that the Constitutional Court did not rely on the amended RLGE Article 98 to establish the lawfulness of the CNEE's conduct. Nevertheless, TGH repeatedly and incorrectly alleged during the Hearing that "*the Constitutional Court here found that the CNEE had acted lawfully on the grounds that the amended RLGE Article 98 allowed the CNEE to set the VAD on the basis of its own study*."[94]

63. On the contrary, the Constitutional Court ruled on the basis of the CNEE's power as regulator to set tariffs and approve the VAD. This is clear from the following passages of the Court rulings:

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92 Tr. (English), Day One, 16:5, Claimant's Opening Statement.

93 For example, Rejoinder, paras. 48–50.

94 Tr. (English), Day One, 108:17-20, Claimant's Opening Statement, and for example also in *Ibid*., 130:20-131:3, 159:3-11, and 343:8-11.

Decision of 18 November 2009:[95]

> c) *Functions of the National Electricity Commission*
> Article 4 of the General Electricity Law created the National Electricity Commission as the regulatory body of the system, granting it the authority to: "Set transmission and distribution tariffs, subject to regulation pursuant to this law, as well as the methodology for calculating the same."
>
> […]
>
> to comply with its attribution in that regard. Consequently, as established by Article 4 section c) and Article 71 of the referenced law, tariffs are calculated by the National Electricity Commission, which must do so after it receives the opinion of the Expert Commission, which, as mentioned, fulfilled with [the submission of] such opinion its advisory function regarding the discretionary action of the competent authority to set tariff schedules. To understand that the members tasked with completing the expert study would have yet another duty, or that its opinion would be binding in nature, violates the provisions of Article 154, paragraph three, of the Constitution, which prohibits delegation of duties, except where it has
>
> [illegible seals]
>
> […]
>
> all its phases. This power of setting the tariff schedules held by the National Electricity Commission is a legitimate power granted by the General Electricity Law, whereby it performs a Government function, for whose exercise it is guided by Articles 60, 61, 71, and 73 of said law, which impose limits on any discretionary overstepping since they refer to verifiable concepts inasmuch as the tariffs "correspond to standard distribution costs of efficient companies," that they are structured "so that they promote the equal treatment of consumers and the economic efficiency of the sector."

Decision of 24 February 2010:[96]

> its regulations, and being within the established time limit, issued its opinion with regard to the discrepancies noted by the National Electricity Commission between the tariff study submitted by the petitioner, and the terms of reference previously set forth by the challenged authority. In fact, it is worthwhile to emphasize that there does not exist, either in the Law governing the matter or in its respective Regulations—the only rules within

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95 Decision of the Constitutional Court (Consolidated Case Files 1836-1846-2009) Appeal of Amparo Decision, 18 November 2009, **Exhibit R-105**, pp. 30–32.

96 Decision of the Constitutional Court (Case File 3831-2009) Amparo Appeal, 24 February 2010, **Exhibit R-110**, pp. 31–34.

the Guatemalan legal framework applicable to this case—any provision that would assign to the Expert Commission another function beyond that of issuing its opinion on the discrepancies mentioned above. By virtue of this, upon submission of its respective

[seal:]
[illegible] Constitutional Court, Rep. of Guatemala.

[seal:]
CONSTITUTIONAL COURT,
Rep. [of Guatemala]

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pronouncement, the Expert Commission completed the function that the Law on the matter and its respective Regulations entrusted to it for such purpose. Having completed its function, and not being a permanent Commission, but rather one of a temporary nature whose advisory function, by Law, was to assist in the determination of the tariffs by the authority in charge of this task, and there being no other involvement in the proceeding, by Law, no harm could be caused to the petitioner from the dissolution thereof, inasmuch as the actions by the challenged authority were in accordance with the provisions of the Law and the RLGE governing the matter.

[…]

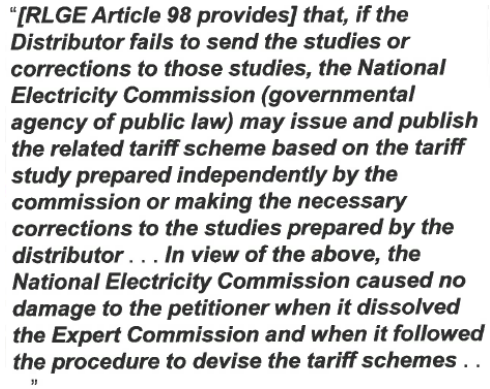
Subject to this, and based on the considerations set forth above, to assign the Expert Commission the task of resolving the present dispute between the petitioner and the challenged authority and recognize its competence to issue a binding decision, and empower it to approve the tariff studies.

[illegible seal]

as the Court could decide, would breach the principle of legality that is a feature of the Rule of Law, and moreover, would undermine the principle of public duty subject to the law, since, pursuant to the provisions of the General Electricity Law and its Regulations—the only applicable provisions within the Guatemalan legal framework—it is incumbent on the National Electricity Commission, as the sole entity responsible [on the matter], to set distribution tariffs and approve tariff studies, having to continue with the process

64. The only reference to Article 98 in the Constitutional Court decisions is in the decision dated 24 February 2010, but that article does not form the basis for the Court's decision. It is

notable how TGH distorted the text of the judgment at the Hearing, displaying the following slide supposedly quoting the judgment literally:[97]



65. The missing part marked by ellipses, which TGH omitted, is fundamental because it shows that the Court did not rely on Article 98. Rather, the Court stated as follows in the omitted passage:

> [T]he National Electricity Commission has not caused any harm to the petitioner by deciding to dissolve the Expert Commission and continuing with the procedure for setting the tariff schedules at issue, since that power—which is a state function—as stated previously, is a legitimate power vested in that entity by the General Electricity Law, pursuant to the provisions established to that effect by Articles 60, 61, 71 and 72 thereof.[98]

66. Thus, it is clear that the reform of Article 98 of the RLGE had no influence on the Court's decision. It is the LGE that establishes the CNEE's authority to determine a VAD that complies with the law and is to be used for setting the five-year tariffs.

67. In any event, this issue, which forms the fundamental basis of TGH's claim has already been decided by the Guatemalan courts, and TGH has not alleged that those decisions violate the Treaty or International Law.

Question from the Tribunal: Could TGH have filed an action in the Guatemalan courts?

68. At the Hearing, arbitrator von Wobeser asked whether TGH could have filed an action in the Guatemalan courts regarding the measures subject of this arbitration and if so, what the

[97] Slide 107 of TGH's opening argument at the Hearing, referring to the Decision of the Constitutional Court (Case File 3831-2009) Appeal for Constitutional Relief, 24 February 2010, **Exhibit R-110**, pp. 35–36.

[98] Decision of the Constitutional Court (Case File 3831-2009) Amparo Appeal, 24 February 2010, **Exhibit R-110**, p. 36.

procedure would have been.[99] We understand that this question inquires about the possibility of invoking the Treaty itself in Guatemalan courts. If this is the question, the answer is affirmative, since the Treaty is part of Guatemalan domestic law and is directly applicable. This could have been pursued through litigation before the Administrative Court, which is granted jurisdiction by the Political Constitution to decide cases involving administrative decisions, and cases involving actions taken by autonomous and decentralized entities of the State.[100] However, it should be noted that, to date, no foreign investor has ever invoked an investment protection treaty in Guatemalan courts.

69. In any event, had TGH brought a Treaty-based claim before, this would have been a mere pretense for the regulatory claim that EEGSA had already filed.

70. Lastly, it is worth clarifying that TGH did not have standing to file the claims that EEGSA brought in the local courts. EEGSA was the entity with standing. Thus, it was EEGSA that started –with the approval of the director appointed by TGH to the Board of Directors of EEGSA– the relevant actions giving rise to the Constitutional Court decisions.

D. TGH'S ONLY VALID CLAIM WOULD HAVE BEEN FOR DENIAL OF JUSTICE, WHICH TGH HAS NOT ALLEGED

71. At the Hearing, TGH objected again to Guatemala's position that the only valid claim in this case would have been for denial of justice. According to TGH, that would restrict the international minimum standard to denial of justice.[101]

72. That is incorrect. Guatemala does not dispute the fact that, in order to bring a valid international claim, the investor must first challenge State measures locally before elevating them to the international level as a denial of justice claim. This approach must be adopted for regulatory disputes of domestic law that have already been analyzed and decided by the local courts. The decisions cited above in section II.A and in previous pleadings demonstrate this. In

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[99] Tr. (English), Day Two, 414:4-21, von Wobeser.

[100] Article 221 of the Political Constitution of Guatemala, **Exhibit C-11**:

> "Administrative Court. Its function shall be to ensure compliance with the law by the public administration and it shall have powers to decide disputes over acts or decisions of the administration and the autonomous and decentralized entities of the State, and disputes derived from government contracts and concessions."

[101] Tr. (English), Day Two, 153:22-154:6, Claimant's Opening Statement.

the words of the tribunal in *Azinian*, "[a] governmental authority surely cannot be faulted for acting in a manner validated by its courts unless the courts themselves are disavowed at the international level."[102]

73. The reasoning behind this position is compelling. When the claimant's complaint is, as here, that a regulator incorrectly applied the domestic regulatory framework, the conduct of the courts examining the regulator's actions cannot be ignored. Otherwise, an essential part of the conduct of the State, i.e., the activity of its courts, would be disregarded. It is the courts that must resolve any dispute over the interpretation and application of domestic law. In this sort of dispute, Guatemala's obligation was merely to make sure that its courts were available and made a decision that could not give rise to any accusation of denial of justice. That is what it did, as demonstrated by the fact that TGH has not claimed denial of justice. Therefore, Guatemala has complied with its obligations under the Treaty.

E. THE *IBERDROLA* AWARD IS FULLY APPLICABLE

74. At the Hearing, TGH also alleged that the *Iberdrola* Award is not applicable because TGH has presented a better case than Iberdrola.[103] However, what matters, as explained in the *Iberdrola* Award, is the substance of the claim, not the manner in which it is dressed. The substance of TGH's claim is not different from *Iberdrola's*, since it is based on exactly the same facts. As the tribunal held in *Iberdrola*:

> As stated by the Tribunal and demonstrated by the record, beyond the characterization that the Claimant gave the disputed issues, the substance of these issues and, above all, of the disputes that the Claimant asks the Tribunal to rule on, regard Guatemalan law.[104]

75. The *Iberdrola* tribunal noted that the substance of the claim concerned the "extent of the distributor's participation in the VAD calculation […] and if the consultant had the power to diverge from the Terms of Reference," "[t]he correct formula for calculating the VAD," "[t]he correct interpretation of the rules concerning the contracting of tariff studies and whether

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[102] *Robert Azinian et al. v. United Mexican States* (ICSID Case No. ARB (AF)/97/2) Award, 1 November 1999, **Exhibit RL-2**, para. 97.

[103] Tr. (English), Day One, 156:9-157:20, Claimant's Opening Statement.

[104] *Iberdrola Energía S.A. v. Republic of Guatemala* (ICSID Case No. ARB/09/5) Award, 17 August 2012, **Exhibit RL-32**, para. 351.

those rules authorized the CNEE to commission its own tariff study, independent of the distributor's study," "[w]hether the pronouncement of the Expert Commission was binding," "[i]f there was an agreement between the CNEE and EEGSA on the operating rules of the Expert Commission," "[w]hether the unilateral decision of the CNEE to dissolve the Expert Commission was in accordance with the law," and "[i]f the conduct of the CNEE in rejecting the study of the Claimant's consultant and accepting that of Sigla was in accordance with the law."[105]

76. These are the same issues that TGH has raised here, which demonstrate that this dispute is purely regulatory and is outside the jurisdiction of this Tribunal. As was the case in *Iberdrola*, this Tribunal cannot "act as a regulatory body, an administrative agency and a court of instance" of Guatemala.[106] Therefore, the conclusions of the *Iberdrola* Award are fully applicable to this case:

> [A]n ICSID tribunal, constituted under the Treaty, cannot determine that it has jurisdiction to judge, under international law, the interpretation made by the State of its domestic legislation, simply because the investor does not agree with it or considers it arbitrary or in violation of the Treaty.
>
> It is not enough, therefore, for the Claimant to convince the Tribunal that its interpretation of the Guatemalan laws and of the technical and economic models is correct and that the interpretation adopted by the CNEE is wrong. Nor is it enough to label its own interpretation of the history of the LGE and RLGE as "legitimate expectations," nor is it enough to challenge the interpretations of the regulatory body of Guatemala or the decisions of its courts, to persuade the Tribunal that it must resolve the local law dispute as a violation of the Treaty. Neither is it enough to label the interpretation of the CNEE or of the courts as "arbitrary" for the Tribunal to conclude that there is a genuine claim that Guatemala violated the standard of fair and equitable treatment or that there was a real international dispute regarding an expropriation, because the Claimant considers that the financial criterion used by Bates White to calculate the VAD is correct and all the others, (including the VAD proposed by one of the EEGSA executives), erroneous. Or that the interpretations of the LGE and [RLGE], backed by the courts of Guatemala, are in violation of the Treaty because they do not coincide with those of Iberdrola. […]
>
> If the situation is as described in the preceding paragraphs and the interpretation of the regulatory body was supported by the local tribunals, in

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105 *Ibid,* para. 354.

106 *Ibid,* para. 354. (Emphasis added).

> order for this Tribunal to be able to resolve this dispute the Claimant should have demonstrated, beyond doubt, that the conduct of the courts violated the Treaty.[107]

F. A MINOR REGULATORY CHANGE IS NOT A MATTER FOR THIS TRIBUNAL

Question from the Tribunal: can the question of whether a minor regulatory change constitutes a violation of the international minimum standard be analyzed as a question of jurisdiction?[108]

77. As part of its jurisdictional analysis, the Tribunal must determine whether the dispute submitted by TGH to this arbitration is a dispute over matters regulated by the Treaty. This includes an assessment undertaken by the *Iberdrola* tribunal, of the essence or substance of the dispute at issue to determine whether there is a "real claim" of violation of the international minimum standard, "or that there was a real international dispute."[109]

78. This analysis applies to all aspects of the dispute, including allegations regarding changes to the regulatory framework, given that drastic changes could constitute a violation of the international minimum standard. The goal is to analyze whether such a change is manifestly arbitrary, disproportionate or unreasonable. However, at the jurisdictional level, what must be examined is whether the alleged existence of such a fundamental change is a mere label assigned by the claimant to try to add credibility to its claim. In other words, the existence and significance of a change must be examined at the jurisdictional level, because only certain types of reforms to the regulatory framework alter the basic premises of that framework to such an extent as to result in a violation of international law.

79. In this case, TGH has attempted to present the reform of Article 98 of the RLGE as a substantial alteration of the regulatory framework. However, upon careful examination, it becomes apparent that TGH has not challenged the reform of Article 98 *per se*, but rather it objects that the CNEE "arbitrarily invoked the modified version of Article 98 of the RLGE."[110] In other words, it has challenged the way in which the CNEE interpreted and applied Article 98, approving the study by the consultant firm Sigla after the pronouncement of the Expert

[107] *Ibid*, paras. 356, 367, 368, 371 (Emphasis added).

[108] Tr. (English), Day Two, 413:8-22, von Wobeser.

[109] *Iberdrola Energía S.A. v. Republic of Guatemala* (ICSID Case No. ARB/09/5) Award, 17 August 2012, **Exhibit RL-34**, para. 371.

[110] Reply, para. 117.

Commission. According to TGH, the CNEE is required to rely on the distributor's study in all circumstances; Article 98 could not grant the CNEE the power to approve another study. The question, therefore, is whether the LGE requires the CNEE to always set the tariffs based on the distributor's study. As explained above, this is not so, as the Constitutional Court has recognized.[111] In sum, TGH's complaint does not concern a real regulatory change; this is an issue that the Tribunal must decide at the jurisdictional level.

G. CONCLUSION: THE TRIBUNAL DOES NOT HAVE JURISDICTION

80. In short, the dispute submitted by TGH does not fall within the Tribunal's jurisdiction. The essence of the dispute relates to disagreements between EEGSA and TGH, on one side, and the CNEE, on the other, regarding the interpretation and application of the regulatory framework, including questions of procedure and technical and financial questions concerning EEGSA's 2008 tariff review. The allegations of arbitrariness and the destruction of the regulatory framework are mere labels, which are easily unmasked by minimal analysis as explained in the *Iberdrola* Award. For instance, there is nothing in the regulation that demonstrates that the pronouncement of the Expert Commission is binding (as is the case with the Chilean legislation), or that it is for the Expert Commission to approve the VAD calculation instead of the CNEE which is the regulator, or that the CNEE must adopt the VAD in the distributor's study (which was expressly deleted from the text of the draft LGE). Even if the CNEE were wrong with respect to these issues (which it was not), such questions were to be decided by the local courts, as they have. Guatemala was only required to ensure that there was no denial of justice in such proceedings, and TGH has not alleged that such denial of justice has taken place. Thus, there was neither arbitrariness in those proceedings nor manifest arbitrariness on behalf of the CNEE.

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[111] *See* Section II.B.A.

III. THE HEARING CONFIRMED THE VERSION OF FACTS AND THE INTERPRETATION OF THE REGULATION PRESENTED BY GUATEMALA IN THIS PROCEEDING

A. EEGSA AND BATES WHITE TRIED TO IGNORE OR REDEFINE THE TERMS OF REFERENCE AT THEIR DISCRETION

1. The Hearing confirmed that the power to set the Terms of Reference belongs exclusively to the CNEE, and that once they have been fixed, they are of mandatory application

81. Guatemala has emphasized throughout this proceeding the tariff review functions assigned to the CNEE pursuant to the regulatory framework. LGE Article 4(c) clearly establishes that it is the CNEE that must ensure "compliance with and enforcement of this law and its regulations." Therefore, in each tariff review, the approved VAD must comply with the principles and policies established by the LGE and RLGE. As accepted by TGH's legal expert, Mr. Alegría, it is precisely the CNEE that is called upon to ensure the law is obeyed.[112]

82. In that context, one of the responsibilities that the law assigns solely and exclusively to the CNEE is to define the "methodology" for calculating the tariffs, which occurs through the issuance of the Terms of Reference for the tariff review.[113] The importance of this function is reflected in the three direct mentions that the LGE makes in its Articles 4(c), 74 and 77.[114] Mr. Calleja, who was Manager of Regulation of EEGSA from 2001 to 2008, confirmed the existence of this authority during the Hearing:

> Q. Is it correct to say that the CNEE under the electricity law defines the methodology for the tariff studies?
> A. Yes.

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[112] Tr. (English), Day Five, 1182:20-22, Alegría.

[113] Counter-Memorial, para. 57; LGE, **Exhibit R-8**, Arts. 4(c) and 61, RLGE, **Exhibit R-36**, Article 29.

[114] LGE, **Exhibit R-8**, Article 4(c):

> The Commission shall have […] the following functions:
>
> (c) Defining the transmission and distribution tariffs subject to regulation in accordance with this law, as well as the methodology for calculation of the same.

Ibid., Article 74:

> The Terms of Reference of the study(ies) of the VAD shall be drawn up by the Commission […]

Ibid., Article 77:

> The methodology for determination of the tariffs shall be revised by the Commission every (5) years […].

> Q. Is it correct that none of these articles of the law that I have read have been modified since the law was issued?
> A. Sorry. Yes.[115]

83. Mr. Giacchino, who served as a consultant to EEGSA during the 2003 and 2008 tariff review, also acknowledged that the CNEE holds this authority.[116]

84. As is logical, the LGE affords the CNEE the discretion to issue the Terms of Reference, but requires that those comport with the efficiency principles set forth in the LGE. Thus, if the distributor deems that the Terms of Reference do not meet the criteria under the LGE or the RLGE, it may appeal them administratively and judicially.[117] Once decided judicially, the Terms of Reference are fixed and may not be modified. Distributors frequently exercise that right to appeal. Mr. Calleja confirmed that EEGSA filed appeals against the Terms of Reference issued by the CNEE in both the 2003 and 2008 tariff reviews.[118] As Mr. Calleja explained, once those motions are decided, the Terms of Reference are firm and must apply "in their totality":

> Q. Well, once those local appeals were decided against the Terms of Reference, you agree that the Terms of Reference were then firm, that they could not be subject to new objections or -- and that you would withdraw your appeals against those terms?
> A. Well, if Terms of Reference do not have -- are not subject to appeal, and the deadlines pass, then they are firm, but that's a very legal question.
> Q. And do you agree that they are mandatory?
> A. Yes, all of them.[119]

85. Thus, during the Hearing, TGH's witnesses confirmed (i) the sole and exclusive role of the CNEE in determining the methodology for calculating the tariffs;[120] and (ii) that the distributor has only one opportunity to dispute the Terms of Reference—and must do so before the courts. Once established, the Terms of Reference must be applied, unless the CNEE itself orders or authorizes their modification.

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115 Tr. (English), Day Two, 625:8-15, Calleja.

116 Tr. (English), Day Five, 837:6-838:6, Giacchino.

117 RLGE, **Exhibit R-36**, Article 149.

118 Tr. (English), Day Two, 631:18-20, Calleja.

119 *Ibid*., 634:8-17.

120 Something that, moreover, had already been clarified by Guatemala's Constitutional Court. *See* Decision of the Constitutional Court, 18 November 2009, **Exhibit R-105,** p. 31.

2. The Hearing confirmed that article 1.10 of the Terms of Reference reserved the powers of the CNEE to issue the methodology

86. As evidenced during the Hearing, revised article 1.10 of the Terms of Reference reserved to the CNEE the power to define the methodology for the tariff study.

87. As mentioned above, in May of 2007, EEGSA judicially challenged the first Terms of Reference for the 2008-2013 tariff review. Curiously, EEGSA challenged a large number of provisions that it had accepted in the previous tariff review.[121] Nevertheless, in view of the *amparo* achieved by EEGSA, the CNEE decided to review the Terms of Reference so as not to interrupt the tariff review process.[122] As a result of that review, the CNEE decided to incorporate certain changes requested by EEGSA, insofar as these did not affect principles of the LGE or the exclusive powers of the CNEE.[123] One of the provisions included in the revised Terms of Reference was article 1.10.

88. During the Hearing, TGH presented a distorted interpretation of article 1.10 in line with the interpretation adopted by EEGSA and its consultant during the tariff review. Under such interpretation, the article would have allowed the consultant to unilaterally deviate from the Terms of Reference at his discretion, with no need to obtain advance approval from the CNEE. Such interpretation contradicts the allocation of powers under the LGE. It also contradicts the terms of article 1.10 itself, as the validity of that provision is subject to the LGE and the RLGE. Finally, it contracts the history of the negotiation of article 1.10. It is worth comparing the version of article 1.10 proposed by EEGSA with the version ultimately approved by the CNEE:

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[121] Counter-Memorial, paras. 300-01, Rejoinder, para. 282.

[122] Otherwise, with the provisional constitutional relief suspending the effects of the Terms of Reference, the review process would be put on hold until the courts and even the Constitutional Court issued a decision on the merits of the matter, which could take several months, and the CNEE would be unable to determine the new tariff schedule until then. *See* Colom, **Appendix RWS-1**, para. 66.

[123] Tr. (English), Day Five, 1104:10-1105:8, Colom.

Article 1.10 of the Terms of Reference	
Proposed by EEGSA[124]	Approved Text[125]
These Terms of Reference set forth general guidelines to be followed by the distributor and the consultant in each of the Stages and/or studies described and defined. Consequently, the consultant may vary, in a justified manner, the methodologies presented in each of the studies to be performed, based on its knowledge and experience.	These Terms of Reference set forth the guidelines to be followed when carrying out the Study, and for each one of its described and defined Stages and/or studies. If there are changes in the methodologies set forth in the Study Reports, which must be fully justified, CNEE shall make such observations regarding the changes as it deems necessary, confirming that they are consistent with the guidelines for the Study.

89. The comparison shows the much more restrictive scope that the CNEE stipulated for article 1.10.[126] In particular, it is clear that the CNEE would review the consultant's changes and would have to verify that those changes were consistent with the "guidelines" for the Study. In this context, it is worth clarifying a point that generated some debate during the Hearing. As Mr. Calleja acknowledged during his cross-examination:[127] the reference to "the guidelines for the Study" in article 1.10 refers to the approved Terms of Reference.[128]

90. That is, under article 1.10, the consultant's proposed changes to the methodology had to be consistent with the Terms of Reference and the regulatory framework. Mr. Colom confirmed this understanding in his response to a question from the President of the Tribunal, in which he reiterated the exceptional character that was anticipated for article 1.10 and emphasized the fact that the article obliged the CNEE to "verify the consistency" between the Terms of Reference and any methodological change proposed by the consultant.[129]

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[124] Letter from Miguel Francisco Calleja to José Toledo Ordóñez, 11 May 2007, **Exhibit C-108**, p. 5.

[125] Addendum to the Terms of Reference for the Performance of the Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A., Resolution CNEE-124-2007, 11 October 2007, **Exhibit R-44**, Article 1.10.

[126] Rejoinder, para. 299.

[127] Tr. (English), Day Two, 645:16-21, Calleja.

[128] *See* the text at the start of Article 1.10 "These [Terms of Reference] set forth the guidelines to follow in preparation of the Study"—meaning that any variation must be consistent with the Terms of Reference approved by the CNEE, Exhibit R-53.

[129] Tr. (English), Day Five, 1148:12-1151:14, Colom.

91. During the Hearing, Mr. Calleja and Mr. Giacchino provided peculiar responses when questioned about the CNEE's obligation under article 1.10 to "verify" the consultant's changes to the Terms of Reference. In their responses, Mr. Calleja and Mr. Giacchino limited themselves to a partial reading of article 1.10, deliberately ignoring such obligation.[130] Eventually, after various evasive responses (including to questions from the President of the Tribunal himself),[131] Mr. Calleja accepted that it was the CNEE that was supposed to "verify" that the provisions were consistent with the Terms of Reference:

> Q. But that last part [of article 1.10] is the one which I'm not sure about. Besides making observations, [the CNEE] verifies the consistency with the guidelines of the study. Who does that? I know that CNEE makes observations because we see that from the text. But in the last part, you're also reading it.
> A. No, I'm not trying to interpret anything from here. I'm saying, in the observations it verifies the consistency with the guidelines of the study.
> Q. The CNEE?
> A. Yes.
> Q. Thank you.[132]

92. Ultimately, it is clear that this article contains no *carte blanche* allowing EEGSA to unilaterally depart from the Terms of Reference, as EEGSA, Bates White and TGH sought to make this Tribunal believe. The text of article 1.10 clearly establishes that the CNEE has the obligation —in line with its sole and exclusive power to define the methodology—to approve any change to the Terms of Reference. If EEGSA had opposed that formulation, then it should have appealed the Terms of Reference on this point in court (which it did not do). Absent such an appeal, the application of the Terms of Reference became "compulsory."

3. The Hearing confirmed that EEGSA and Bates White decided to ignore the Terms of Reference in their preparation of the tariff study

93. Despite this specific purpose of article 1.10 of the Terms of Reference, EEGSA and Bates White abused this provision during the tariff review process. In effect, and as Mr. Calleja

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130 Tr. (English), Day Five, 845:4-845:13, Giacchino and Tr. (English), Day Two, 647:22-648:20, Calleja.

131 Tr. (English), Day Two, 641:13-643:9, Calleja.

132 *Ibid.*, 648:21-649:10.

confirmed during the Hearing, EEGSA interpreted article 1.10 as a tool for ignoring the approved Terms of Reference. In the words of Mr. Calleja:[133]

> Q. […] What you understand [article 1.10] to be during the tariff review, according to your Statements, is that it gave the consultant the power to disregard the Terms of Reference approved by the CNEE if it had its own technical justifications and it didn't need authorization from the CNEE for that; correct?
>
> A. Correct.

94. Nor did Mr. Giacchino leave any doubt as to Bates White's interpretation of article 1.10:

> Q. [Y]ou've told me that when you reviewed this, in your view, you were permitted by 1.10 to change the methodology in accordance with 1.10. I just wanted to get your understanding.
>
> A. Well, my understanding, yes, it could be changed, and that's in the Terms of Reference, 1.10.[134]

95. Ultimately, during the Hearing, the parties responsible for the tariff study acknowledged their conscious decision to use article 1.10 as a tool to unilaterally change the finalized Terms of Reference. In so doing, they disregarded the Terms of Reference that were approved by the CNEE—the regulator with exclusive authority to issue them. As a result of the deviations by Bates White, the study was impossible to audit and presented a highly overvalued VNR and VAD (see Section III.B.2 below).

B. THE BATES WHITE STUDY WAS NOT RELIABLE

1. Mr. Giacchino was not an independent consultant for EEGSA

96. EEGSA's selection of Mr. Giacchino to conduct its tariff study was not accidental. Mr. Giacchino was in charge of the tariff study for EEGSA in the prior tariff review of 2003, through his prior firm NERA.[135] Mr. Giacchino had also worked for the Iberdrola group (operator of EEGSA) in the tariff review of its subsidiary companies, Companhía de Electricidade do Estado da Bahia (Brazil) in 2003 and Electricidad de la Paz (Bolivia) in 2002

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133 *Ibid.*, 636:6-13.

134 Tr. (English), Day Five, 855:1-6, Giacchino.

135 Rejoinder, para. 277.

and 2004. During the Hearing, Mr. Giacchino confirmed his repeated commercial involvement with Iberdrola over the five years prior to the EEGSA tariff review in 2007.[136]

97. Article 1.5 of the Terms of Reference expressly required the consultant to exercise independence of judgment from the distributor.[137] This was an important point, and typical in these types of documents, as Mr. Giacchino accepted during his cross-examination:

> Q. […] Now, there was a concern here in [article 1.5 of] the Terms of Reference, it appears, that they wanted to ensure that when you were preparing this study, that you would not take directions from EEGSA but that you would exercise independence of criteria from the Distributor because that's what this [section of the Terms of Reference] is about, "Contratación de la Consultura", the contracting of the consultant; agreed?
>
> A. Yes, this is very typical of many Terms of Reference when a consultant is hired to do a Tariff Review. You know, when a consultant is hired, the Terms of Reference will make mention to that independence of criteria.[138]

98. Mr. Giacchino boasted of that supposed independence during his cross-examination.[139] However, despite the fact that the Terms of Reference were already in effect at the time when Bates White was hired, the contract between Bates White and EEGSA included certain obligations that openly violated the independence requirement provided for in article 1.5.[140] For example, clause Five (6) of the Bates White-EEGSA contract established that any modifications to the tariff study that were requested by CNEE were subject to the prior approval of EEGSA.[141] When questioned about this at the Hearing, Mr. Giacchino was unable

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136 Tr. (English), Day Five, 834:15-837:5, Giacchino.

137 Terms of Reference for the Performance of the Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A., CNEE Resolution 124-2007, January 2008, **Exhibit R-53**, point 1.5:

> 1.5 CONTRACTING OF THE CONSULTANT
>
> […]
>
> The Consultant must have independence of judgment in preparing the Study. Notwithstanding its technical responsibility, the Distributor must assume full responsibility for the information that he delivers and processes, and for the Study that he delivers to the CNEE, provided that no written objection is submitted.

138 Tr. (English), Day Five, 858:5-17, Giacchino.

139 *Ibid*., 856: 7-15 and 857:6-22.

140 Terms of Reference for the Performance of the Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A., CNEE Resolution 124-2007, January 2008, **Exhibit R-53**, point 1.5.

141 Clause Five, section 6, of the contract between EEGSA and Bates White establishes the consultant's obligation: "To make the corrections and/or additions requested by the CNEE and accepted by EEGSA, considering the time available, in each one of the reports and even after the final report is submitted until each one of the reports, as well as the Final report, is finalized to the satisfaction of the Distributor with the

to explain convincingly how that clause could be consistent with his professed independence of judgment and the "typical" requirement that article 1.5 of the Terms of Reference imposed to that effect. [142]

99. That was not the only irregularity in the EEGSA-Bates White contract. That contract also provided that Mr. Giacchino would be EEGSA's representative on any Expert Commission formed in connection with the tariff review. In exchange for his participation, Mr. Giacchino would receive a "premium" on top of his hourly consulting rate.[143] Thus, from the very start of the relationship, Bates White and Mr. Giacchino knew that, if the tariff study generated discrepancies that were submitted to an Expert Commission, there would be an additional economic benefit in the process.

100. The consequence of the lack of independence by EEGSA's consultant was, as explained in the following section, a tariff study of questionable reliability and an inefficient VAD.

2. The Bates White VNR and VAD were grossly overvalued

a. Guatemalan regulation is based on a price cap system that seeks to incentivize efficiency

101. As Mr. Damonte explained in his direct examination, and as has not been disputed by TGH, Guatemala's regulatory framework is a price cap system.[144] Under this system, the distributor is granted a maximum and efficient price, which it receives over a five-year period. In Guatemala, following the Chilean model, that maximum price is calculated on the basis of a model company.[145] The purpose of the model company is to simulate a competitive market and

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professional agreement of the Consultant." Contract between EEGSA and Bates White LLC for the performance of the 2008-2013 Tariff Study, 23 January 2008, **Exhibit R-55**, p. 3, Clause Five, section 6.

142 Tr. (English), Day Five, 917:8-15, Giacchino.

143 Contract between EEGSA and Bates White LLC for the performance of the 2008-2013 Tariff Study, 23 January 2008. **Exhibit R-55**, p. 18, Section 9.3c ("Fee for participation").

144 Tr. (English), Day Six, 1386:7-10, Damonte. *See also* direct questioning slide of Damonte, slide 2.

145 LGE, **Exhibit R-8, Article 60:**

> […] The costs for the distribution activity approved by the Commission shall correspond to standard distribution costs of efficient companies.

Ibid., **Article 61:**

> The tariffs to users of the Final Distribution Service shall be determined by the Commission by adding the power and energy acquisition cost components, freely agreed upon among

thereby incentivize efficiency.[146] If the distributor manages to be more efficient than the model company, that efficiency is converted into additional profits for it during the tariff period. Those efficiencies must then be passed on to the users in the next tariff period.[147] As Mr. Damonte correctly explained, when properly applied, this is a system where everyone benefits: a "win-win."[148]

102. In order for the Guatemalan regulatory system to function and benefit both the distributor and the user, certain basic rules need to be respected:

- The service must be provided at a minimum cost;[149]
- The model company is fictitious but must be plausible;[150]
- The costs of the model company may not be higher than those of the actual company;[151] and
- The quality of the service provided by the model company must be equivalent to the service provided by the actual company. If the model company was designed to provide a service that is superior in quality to that of the actual company, the user would be paying for a service that he will not receive and the distributor would be receiving undue profits for investments that it will not make.[152] As was clarified at the Hearing by TGH's expert, Mr. Barrera, the regulatory framework in Guatemala does not remunerate the distributor in order to improve the quality of the service to the customer but rather it makes sure that it is provided according to commercial, product and technical service quality indicators at the lowest possible cost.[153] As clarified by Mr. Damonte,

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generators and distributors, and referenced to the inlet to the distribution network with the components of efficient costs of distribution to which the preceding article refers.

During the Hearing, the Tribunal asked where it was established that the operating costs had to take into account the calculation of the return. Tr. (English), Day One, 290:18-291:4, Mourre.

146 Tr. (English), Day Six, 1386:11-19, Damonte.

147 *Ibid*., 1386:11-1387:4.

148 *Ibid*., 1387:5-8.

149 Tr. (English), Day Six, 1291:17-18, Barrera.

150 Tr. (English), Day Six, 1386:20-1387:8, Damonte.

151 *Ibid*., 1387:21-1388:19.

152 *Ibid*.

153 Tr. (English), Day Six, 1458:21-1459:14, Barrera:

> "[t]he improvement of quality is only acceptable under the VNR if it is at a lower cost."[154]

103. As explained in detail in Section III.B.2.b below, Bates White did not follow the regulatory efficiency criteria when designing its model company.

b. The capital base of the model company must be efficient and valued at the VNR

104. In order to calculate the VAD, which is the annual fee paid by the distributor to cover its efficient costs necessary to provide the service, the first step is to determine the capital base and value it at the VNR.

105. As explained at the Hearing, the first step to determining the capital base is to construct—pursuant to the methodology established in the Terms of Reference—an efficient company that can meet the demand in the area in which the distributor operates. Thus, the most efficient materials (e.g. copper versus aluminum cables) are selected at the best market price. Those materials are then used to make the most efficient construction units (e.g. aerial lines versus underground lines) and, finally, it is determined how many construction units are needed to provide the service. As Mr. Damonte described at the Hearing, first you select the efficient types of "bricks," then the efficient type of "house" and, finally, you construct the most efficient "neighborhood."[155]

106. The efficiency of the construction units is assessed over the long term by comparing the initial capital, the maintenance costs, and the replacement costs for all the available alternatives that could provide the quality of service offered by the actual company. As Mr. Damonte explained in response to a question from arbitrator Park:

> THE WITNESS: (Dr. Barrera) […] So, what is the function? Same level of quality. Yes, you don't really put customer's valuation of quality in your analysis. You leave that out. You say, okay, it should provide the same sort of quality.
>
> ARBITRATOR PARK: You're telling me that you agree with that, the customer satisfaction does not matter?
>
> THE WITNESS: (Dr. Barrera) Well, some countries may do that. Guatemala doesn't do that.

[154] Tr. (English), Day Six, 1398:10-11, Damonte.

[155] Tr. (English), Day Six, 1400:10-1402:20, Damonte.

> MR. DAMONTE: The VNR should be assessed for a good that will replace the function of the original good at the same level of quality at the lowest cost available. What you just mentioned about the underground line, as you said, the underground line has lower cost of maintenance, but the initial cost is much higher. So, what do we do? We take the whole life of that good that we are going to assess, the whole life, and we determine the current value of the operation throughout the life. That is to say, we simulate how many times it could get damaged, so the work, the maintenance work, losses, and we include that as total cost at present value. Then we analyze the second alternative. What is it? What is the section option? Well, an aerial line. The aerial line has an initial lower cost, but the operational and maintenance costs are higher. What if there is an accident, there is a crash against the post, the post collapses and we need to replace it? We estimate all that, we estimate the losses and then we estimate again the current value of the second option. […] [W]e look at the lowest figure and we choose that one. Undoubtedly, the three options are different from the point of view of the community, the underground wire is nicer, you cannot see it, but you cannot take that into account.[156]

107. The capital base, designed with efficient and optimal construction units valued at the market price, constitutes the VNR. This and only this is the VNR. Such an asset-valuation system is commonly used in other sectors as a system to adjustment for inflation or replacement.[157] Its purpose is to keep the value of the capital base up-to-date and thereby ensure that the investor can (i) make the new investments at market value - in other words, at the replacement value,[158] (ii) confront operating costs and investment costs at up-to-date values, and (iii) receive a profit (amortization of capital and return) in line with up-to-date values.

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[156] *Ibid*., 1456:19-1458:11. This long-term logic of efficiency also applies to the case of the cables with respect to which the President of the Tribunal asked to what extent it was efficient or convenient to invest in thicker cables, which are more costly, to compensate for energy losses (Tr. (English), Day One, 98:14-17). In fact, the relation between the cost of investing in networks ("thicker cables") is directly proportional to the cost of lost energy ("losses"), that is, if the cost of lost energy in the network is high, it is convenient to install "thicker" cables. However, to determine "to what extent [it is] convenient to invest in more expensive cables in view of the price of electricity to compensate for [energy] losses" depends on many variables, including the characteristics of each distributor, as well as the placement (Km. of network) and amount of user demand. For this reason, it is not possible to give a value of general application; rather, it must be calculated in each specific case.

[157] *Ibid*., 1390:4-18.

[158] *Ibid*., 1400:4-8:

> It is important to take into account that the new investments will take into account the new replacement value, and that is the smart way to replace the asset. And this is consistent. The new investments will be made at the New Replacement Value.

c. ***The capital base in the Bates White study was grossly overvalued and was not reliable***

108. Far from following the methodology established in the Terms of Reference and building an efficient company as the regulation required, Bates White ignored those terms and presented an overvalued and unreliable VNR.

109. A large problem identified in the Bates White VNR was the inclusion of over US$400 million in underground networks.[159] As explained at the Hearing, the inclusion of the underground lines was contrary to the provisions of LGE Article 52, which establishes that the service must be provided with aerial lines. If underground lines were required, they had to be paid for by the beneficiaries of the service.[160] During the Hearing, Mr. Giacchino made various attempts to justify their inclusion. First, he stated that their inclusion had been requested by the municipalities. However, in his cross-examination, he was incapable of: (a) identifying any document recording such a request;[161] (b) naming any single municipality in particular; (c) naming the individual from EEGSA who had supposedly told him about the request; or (d) providing details on the alleged meeting between the municipalities and EEGSA at which the request was purportedly made.[162]

110. Mr. Giacchino also admitted that he knew that EEGSA had no investment plan to construct underground lines throughout the entire service area. When pressed about this issue in his cross-examination, he tried to explain that the costs would be reflected in the tariffs once the investments were made:

> [Y]ou're going to include that cost in the tariffs, then you need to have some sort of investment plan on when the investments will be done, and then the tariffs could be modified to reflect that.[163]

111. That is completely false. The reality is that once included in the VNR, the underground networks' overestimated value becomes the basis for calculating the VAD –in other words, EEGSA was remunerated for the investment costs of underground lines which were never

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159 Tr. (English), Day Five, 876:20-877:6, Giacchino.

160 *Ibid.*, 891:19-22.

161 *Ibid.*, 872:17-876:11.

162 *Ibid.*, 873:7-14, 875:14-876:10.

163 *Ibid.*, 873:16-19.

constructed. In fact, none of the studies submitted by Bates White included a provision excluding those amounts relating to the underground networks from the general tariff.

112. When asked by arbitrator von Wobeser about why the models were not "[updated] automatically" to exclude the underground networks from the VNR,[164] Mr. Giacchino answered that "I still had hopes […] that there were going to be meetings with the CNEE."[165] This excuse lacks all credibility given that the ban on including underground networks was not only plainly established in the LGE but, in addition, the CNEE had already clearly objected to that inclusion on at least three occasions.[166]

113. The overvaluation of the VNR due to the inclusion of underground networks was not, however, limited to the inclusion of those networks, but also to the prices that Bates White purported to charge the users for them. As Mr. Damonte explained during the Hearing, the price per kilometer of underground network requested by Bates White was double that requested by the other foreign distributors, Deorsa and Deocsa.[167]

114. Besides the underground networks, the Bates White study had many other significant faults, including, among others, a model that was not auditable and failed to present the international reference prices necessary to check the efficiency of the prices sought by the distributor.[168] In these circumstances, it was impossible to determine whether the VNR was optimal, as required by the regulation.

115. These examples not only demonstrate that the VNR calculated by EEGSA was not optimal, but also Bates White's lack of good faith in calculating the VNR.[169]

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[164] Tr. (English), Day Five, 895:11-16, von Wobeser.

[165] Tr. (English), Day Five, 896:2-4, Giacchino.

[166] Letter from the CNEE to L. Mate, 14 March 2008, **Exhibit C-169**, p. 3; CNEE Resolution 63-2008, **Exhibit R-63**, point C.3.2; CNEE Resolution 96-2008, **Exhibit R-71**.

[167] Tr. (English), Day Six, 1410:18-21, Damonte. Mario C. Damonte: "Analysis of Bates White 5-5-2008 and Recalculation of VNR and VAD based on the pronouncement of the Expert Commission," presented in *Iberdrola Energía, S.A .v. Republic of Guatemala*, ICSID Case No. ARB/09/05, **Exhibit R-190**, para. 328.

[168] Tr. (English), Day Six, 1410:3-14, Damonte.

[169] According to Mr. Damonte, the four most conspicuous cases of overestimation of the VNR are: 1) the number of outlets per transformer substation, 2) the replacement of large amounts of the existing aerial network with underground networks laid in "ducts," 3) the use of service connections with lengths and gauges greater than necessary, the unit costs of which are significantly higher than the optimum costs, and 4) voltage regulators.

d. ***Bates White's attempt to calculate the VAD including a profit on the gross value of the capital base is contrary to all regulatory and financial norms and resulted in a highly overvalued VAD***

116. Once the model company's optimal capital base valued to the VNR has been calculated, it is used to calculate the VAD; i.e. the annual income received by the investor for providing the service. The VAD includes (i) operating and maintenance costs; (ii) costs of losses recognized by the regulation, and lastly (iii) the investor's compensation or the cost of capital.[170] In turn, the cost of capital is made up of two elements: the depreciation[171] of the invested capital (called "*return of investment*" by the TGH experts) and the return or profit on the capital made available to the service (called "*return on investment*" by the TGH experts).[172]

117. Under the Guatemalan regulation, the cost of capital is calculated by multiplying the capital base by the FRC (capital recovery factor). As Mr. Damonte demonstrated at the Hearing, the FRC is broken down as follows:[173]

The four clearest cases of overestimation of the VNR			
Case	Description	Items	Overestimation (Millions USD)
1	Quantity of Feeders for each CT	MV Network Length	17.0
		CT	41.0
		MV Network Length	
		MV Equipment	
		Sub-Total	**58.0**
2	Underground Network	Network Length	89.0
		Optimal Technology Change	26.0
		Sub-Total	**115.0**
3	Supply Cables	Length of supply cables	53.7
		Conductor Size Change	
		Sub-Total	**53.7**
4	Voltage Regulators	Change in the Quantity	21.7
Total Four Cases			**248.4**

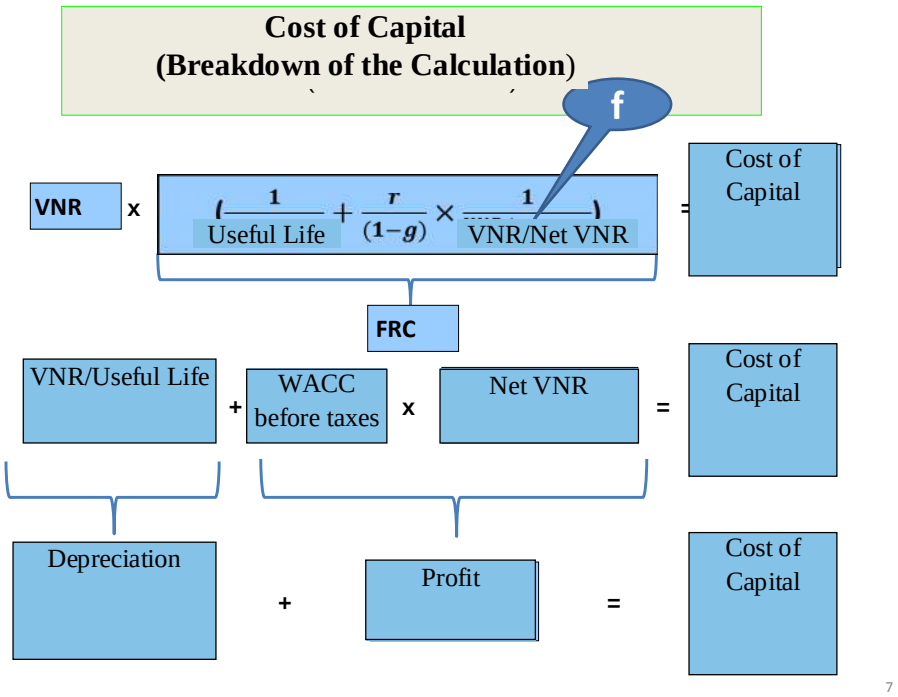
Damonte, **Appendix RER-2**, paragraphs 139-153.

170 *See* slide of Direct Examination of Mario Damonte, slide 6.

171 Depreciation and amortization are usually considered synonyms for the purposes of regulation.

172 Kaczmarek, **Appendix CER-2**, paras. 55, 71; Tr. (English), Day Six, 1403:21-1404:2, Damonte.

173 Slide of Direct Examination of Mario Damonte, slide 7.



Question from the Tribunal: Is the FRC equivalent to the WACC?

118. During the Hearing, the President of the Tribunal asked if the FRC was equivalent to the WACC.[174] The WACC is part of the FRC, but it is not the FRC. More specifically, the WACC is the cost of capital rate before tax [r/(1-g)] by which the VNR net of accumulated depreciation is multiplied for the purposes of calculating the investor's return (profit).[175]

119. According to the Guatemalan regulation, and as had also been applied in the 2003-2008 tariff review, the CNEE established in the Terms of Reference that the return would be calculated on a depreciated capital basis.[176] Contrary to what was alleged by TGH at the Hearing, this concept was not "improper."[177] The most irrefutable proof of this is that despite having judicially appealed the previous version of the Terms of Reference,[178] neither EEGSA

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174 Tr. (English), Day One, 164:15-20, Mourre.

175 Tr. (English), Day Six, 1405:5-18, Damonte.

176 Terms of Reference for the Performance of the Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A., CNEE Resolution -124-2007, January 2008, **Exhibit R-53**, Article 8.3:

> To evaluate the total cost to be recognized with respect to the capital, the criterion to be used is to recognize **a profit on the net value** of the immobilized capital in the service assets (VNR less accumulated depreciation) **plus a current amortization proportional to the gross value (VNR)**.

177 Tr. (English), Day One, 57:5-7.

178 Counter-Memorial, paras. 300-301; Rejoinder, para. 282.

nor TGH objected to this element in the final Terms of Reference. If it were true, as TGH alleges, that the FRC in the Terms of Reference substantially affected EEGSA, it is clear that EEGSA would have judicially appealed them. As discussed above and accepted by Mr. Calleja, since they were not challenged, the Terms of Reference became final and were of mandatory application.

120. Instead of complying with the Terms of Reference, EEGSA, through its consultant Mr. Giacchino, decided to allege that the "2" found in the formula in the Terms of Reference was a "typographical error"[179] and conveniently calculated EEGSA's return on the value of the gross capital base; i.e. without taking into account the depreciation already received by EEGSA in the past. This analysis, as explained in the following sections, defies basic principles of financial economy, the Guatemalan regulatory framework and the prior practice of EEGSA and the CNEE.

e. The LGE and RLGE establish that depreciation must be taken into account when calculating the investor's return

121. Guatemala has explained in detail during this arbitration proceeding that calculating the return on a gross capital base is contrary to the basic principles of financial economy and the Guatemalan regulation.[180] In light of the Tribunal's concerns during the Hearing and the confusion created by TGH in that regard, we reiterate the most relevant regulatory bases for determining this issue.

Question from the Tribunal: Where is it established that depreciation must be taken into account for calculating the return?

122. At the Hearing, the Tribunal expressly asked where it was established in the regulation that depreciation must be taken into account for calculating the return.[181] First, depreciation is implicitly mentioned in LGE Article 73 within the concept of "constant annuity of the cost of capital":

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[179] Bates White, Value-Added for Distribution Study for EEGSA: Stage D Report: Annuity of the Investment, 29 February 2008, revised on 31 March 2008, corrected on 5 May 2008, **Exhibit R-69**, p. 11.

[180] Counter-Memorial, paras. 28, 398-399; Rejoinder 255 and 310-320.

[181] Tr. (English), Day One, 290:18–291:4, Mourre.

> The cost of capital per unit of power shall be calculated as the ***constant annuity***[182] ***of the cost of capital*** corresponding to the New Replacement Value of an economically designed distribution network. The annuity shall be calculated on the basis of the typical useful life of distribution facilities and the discount rate that is used in the calculation of the tariffs.[183]

123. It is a basic principle of financial economics that the "cost of capital" includes:[184]

- **depreciation** (*return of investment*), which is the return of a part of the investor's initial investment that is made every year throughout the useful life of the assets. The sum of the amounts paid for a given asset during the term of its useful life must be equal to 100% of that asset's initial value.[185] Thus, at the end of its useful life, the investment has been completely returned to the investor;[186] and

- **profit** (*return on investment*), which is the gain on the capital not yet returned. This gain is only paid on the capital base net of depreciation already returned to the investor.

124. This is a concept universally accepted by authors specializing in the field.[187]

125. Second, Article 73 establishes that:

> "The annuity [of the costs of capital] shall be calculated on the basis of the ***typical useful life*** of distribution facilities."

126. The only purpose of considering the useful life of the assets is to determine the period in which the assets "depreciate."[188] By establishing that the typical useful life of the assets must be taken into account to calculate the cost of capital, the law therefore requires that the depreciation of those goods be taken into account.[189]

127. Lastly, it should be mentioned that RLGE Article 83 establishes that depreciation will not be recognized as a cost in the VAD:

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182 The constant annuity provides a constant amount to the investor each year (profit on the net capital and return of the invested capital) over the course of the tariff review period.

183 LGE, **Exhibit R-8**, Article.

184 Kaczmarek, **Appendix CER-2**, paras. 55, 71; Tr. (English), Day Six, 1403:21-1404:2.

185 Damonte Rejoinder, **Appendix RER-5**, para. 47.

186 Kaczmarek, **Appendix CER-2**, para. 82.

187 AE Kahn, The Economics of Regulation, Principles and Institutions (1996) Vol. 1, **Exhibit R-7**, p. 32; Rejoinder, para. 314. Tr. (English), Day Six, 1406:22-1407:5, Damonte; Rejoinder, paras. 312-320; Tr. (English), Day Five, 1016:21-1018:21, Moller.

188 Tr. (English), Day Six, ,1408:1-1408-17, Damonte.

189 *Ibid*., 1408:1-1746:1-22.

> Article 83.- Unrecognized Costs. The following shall not be included as supply costs for the calculation of the Base Tariffs: financial costs, equipment ***depreciation,*** costs related to generation assets owned by the Distributor, costs associated with public lighting installations, loads due to excess demand over the demand contracted, established in the Specific Regulations of the Wholesale Market Administrator, any payment that is in addition to the capacity agreed in the capacity purchase contracts and other costs that, in the opinion of the Commission, are excessive or do not correspond to the exercise of the activity.[190]

128. This article was a source of great confusion during the Hearing given that Mr. Barrera attempted to argue for the first time, during his direct examination, that this article provided a regulatory basis to justify Bates White's exclusion of accumulated depreciation in calculating EEGSA's profit.[191] This is incorrect.

129. As Mr. Damonte explained at the Hearing, the reason the RLGE establishes that depreciation will not be recognized within the operating costs—as is regularly done under accounting rules—is because those costs have already been included in the cost of capital as provided by LGE Article 73.[192] The same thing also happens with the financial costs mentioned in Article 83: it is not that financial costs are not recognized in the tariff, but that they are paid as part of the cost of capital and not as an operating cost of supply.

130. On the basis of the foregoing, it is clear that accumulated depreciation must be taken into account to calculate the investor's profit and that the novel interpretation of Article 83 offered by the expert Mr. Barrera is baseless.

f. ***The Guatemalan model was influenced by the Chilean model in which the profit is calculated on the depreciated capital base***

131. Aside from the Guatemalan regulatory norms, it is important to recall that, as has been explained by Guatemala and the TGH witnesses during the proceedings,[193] Guatemala's

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190 RLGE, **Exhibit R-36**, Article 83.

191 Tr. (English), Day Six, 1295:12-15, Barrera.

192 Tr. (English), Day Six, 1408:6-16, Damonte.

193 Tr. (English), Day Five, 1203:1-6 and 1207:16-20, Alegría; Tr. (English), Day Six, 1299:22-1300:2, Barrera; Tr. (English), Day Six, 1293:6-15, Damonte; Tr. (English), Day Four, 791:8-11, Bastos.

regulatory regime was strongly influenced by that of Chile. The Chilean regime calculates the investor's return on a capital base net of depreciation.[194]

132. In view of this conclusive evidence, during the Hearing, the expert Mr. Barrera, in an attempt to justify his theory that in Guatemala the return is paid on the gross capital base, went so far as to say that the Guatemalan regulatory framework was "different" from the Chilean framework given that in Guatemala, the law does not allow the payment of depreciation. In his own words:

> So, Guatemala is different from Chile in that [in] Guatemala the law explicitly says, contrary to what I have understood and what I heard in this case, depreciation is not paid for, and the law says don't pay depreciation.[195]

133. Not only did Mr. Barrera himself acknowledge in this statement that this was not his previous understanding, but he also admitted in response to a question from the President that his theory was not even consistent with the Expert Commission's pronouncement:

> Barrera: No. Because in Guatemala, you don't pay depreciation […].
>
> President Mourre: That's not what the Expert Commission said.
>
> Barrera: No. That is true […].[196]

134. Similarly, Mr. Barrera also attempted to argue that in Chile, the cost of capital was calculated like a mortgage, but that this was not the case in Guatemala.[197] This is false and can be demonstrated with evidence submitted by TGH in this case. In his report, the expert Mr. Kaczmarek himself used the example of the mortgage to illustrate the system applied in 2003 in Guatemala:

> With respect to the capital costs, we understand that the CNEE proposed in note 407 under the terms of reference, that the FRC be calculated using a formula representing a constant payment, self-amortizing bond. This formula is akin to the payment formula used to calculate a constant mortgage payment where the constant payment includes a changing mix of loan principal repayments and interest payments over time. In this payment formula, the portion of the payment applied to reduce the loan balance (i.e.,

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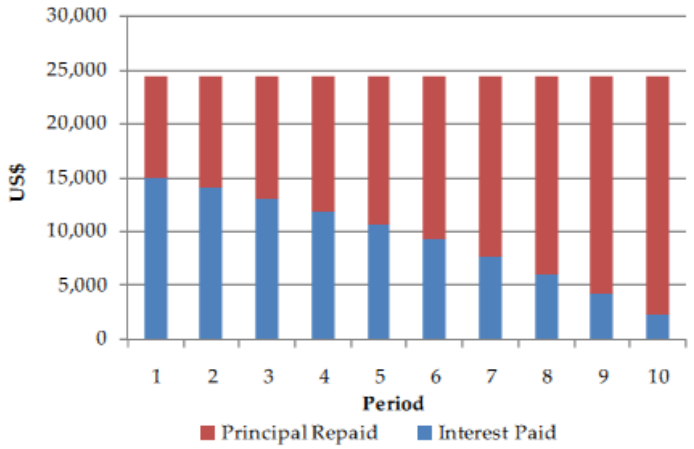
194 Damonte Rejoinder, **Appendix RER-5**, paras. 49-50.

195 Tr. (English), Day Six, 1330:13-17, Barrera.

196 Tr. (English), Day Six, 1332:18-1333:1, Barrera.

197 *Ibid*., 1328:15-1330:12.

> the return of capital portion) increases over the life of the mortgage while the portion of the payment utilized to satisfy the interest expense (i.e., the return on capital portion) decreases over the life of the mortgage. Figure 8 below is a graphical depiction of a hypothetical constant US$ 24,000 payment and the changing portions of the payment utilized to repay the loan balance and interest.[198]
>
> **Figure 8 – Example of a Constant Payment, Self-Amortizing Bond**
>
> 
>

135. Asked again about this inconsistency on cross-examination, Mr. Barrera had no other choice than to admit that in 2003, the mortgage formula was used to calculate EEGSA's return, but that in his opinion, it should not have been applied:

> Barrera: […] What I said is that, in 2003, the mortgage formula was used. What I understand is that the NERA team said that the mortgage formula was not the one to be used in Guatemala for the reasons that I am telling you […]
>
> Q. Can we agree that that is your opinion … [but that it] was actually the formula applied [in 2003]?
> […]
>
> Barrera: I understand that EEGSA and the CNEE agreed on applying the mortgage formula.[199]

136. Mr. Barrera's admission that the mortgage-type formula was used in 2003 proves that depreciation is in fact taken into account to calculate the investor's return as Mr. Kaczmarek explained in his report:

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[198] Kaczmarek, **Appendix CER-2,** para. 89.

[199] Tr. (English), Day Six, 1335:3-1336:2, Barrera. *See also*, Tr. (English), Day Five, 962:3-10, Giacchino.

> [T]he portion of the payment applied to reduce the loan balance (i.e., the return of capital portion) increases over the life of the mortgage while the portion of the payment utilized to satisfy the interest expense (i.e., the return on capital portion) decreases over the life of the mortgage.[200]

137. This clear admission that the mortgage formula was applied in 2003 to calculate EEGSA's return and depreciation leaves no doubt that the Guatemalan regulatory framework required the calculation of the return on a capital base net of depreciation.

g. EEGSA will not reinvest the entire amount received as amortization of capital, as Mr. Barrera attempted to allege

138. Among his novel approaches to justifying his former colleague Mr. Giacchino's attempt to calculate EEGSA's return on the gross capital base, Mr. Barrera argued, without any support, that given that the investor will automatically reinvest the amounts received for depreciation (*return of investment*) into the service, the capital base should have remained constant as though it were new.[201] In his own words:

> The VNR method assumes that as the assets comprising the regulatory asset base depreciate, they are simultaneously replaced. In other words, the VNR method assumes that the assets are always new.[202]

139. When questioned on cross-examination, Mr. Barrera admitted, however, that he never reviewed the amounts of depreciation received by EEGSA or the investments it made.[203] Despite Mr. Barrera's failure to undertake this exercise, it is important to stress that in reality, EEGSA did not make such investments. By way of example, while in the 28 July study, EEGSA requested US$51.4 million in depreciation (*return of investments*),[204] EEGSA's historical average investments never exceeded US$20 million, as shown in the following chart:[205]

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200 Kaczmarek, **Appendix CER-2,** para. 89.

201 Barrera, **Appendix CER-4**, para. 29.

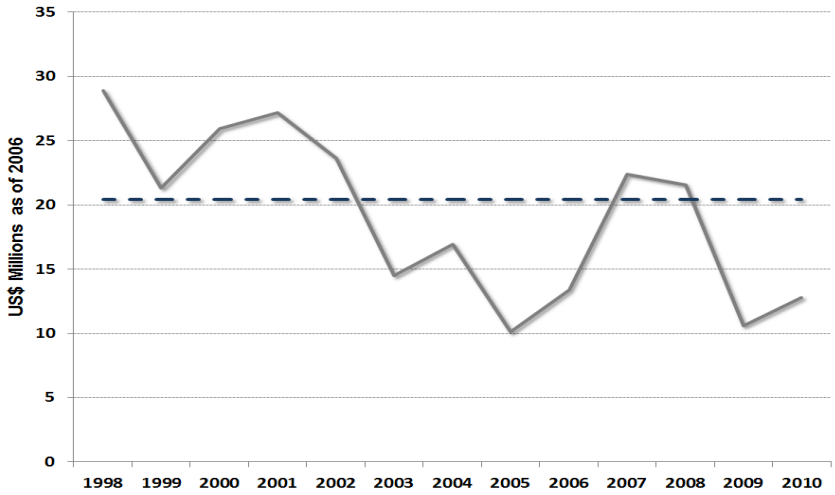
202 *Ibid*. *See also* Tr. (English), Day Six, 1337:10-1338:11, Barrera.

203 Tr. (English), Day Six, 1343:11-12, Barrera:

> No we haven't looked at what actually has been invested.

204 **Exhibit C-258**, p. 55. As **Appendix R-VI** (Calculation of the Internal Rate of Return for Distribuidora de Electricidad de Occidente, S.A. and Distribuidora de Electricidad de Oriente, S.A.), we will provide a copy of this exhibit explaining each of its components.

205 M Abdala and M Schoeters, **RER-1**, p. 28, image 1 (1999-2013); Second NCI Model (NavigantSecondReportModel_24May2012xlsm).



140. In view of this evidence, Mr. Barrera had no choice but to admit that EEGSA did not reinvest those amounts, and thus any difference recognized in the tariff actually became an additional return for EEGSA:

> Barrera: […] It is not really what happens in reality. […] It's just a financial formula to make sure that you get the VNR back at the end of the asset's life.
>
> Q. And on the basis of this financial theoretical formula, you would agree with me that the resulting reality is that the company gets at least three times more of what it's replacing, right?
>
> Barrera: Based on the statement you are making here.
>
> Q. Based on this statement.
>
> Barrera: OK […][206]

141. With this admission, Mr. Barrera's attempts to justify his calculation of the return based on the gross VNR in Bates White's studies were completely undermined.

h. ***EEGSA could have submitted evidence of the level of depreciation to be applied in the FRC***

142. During this arbitration, TGH has constantly complained of the supposed "arbitrariness" of the CNEE in applying a depreciation of 50% to calculate EEGSA's return.[207] In his cross-examination, Mr. Moller clearly explained that the decision to adopt a 50% depreciation was

[206] Tr. (English), Day Six, 1345:4-16, Barrera.

[207] Reply, paras. 310-311. Tr. (English), Day One, 57:5-7, Claimant's Opening Statement.

not a capricious or arbitrary decision by the CNEE. On the contrary, it was suggested by the external consultant hired by the CNEE, Mr. Riubrugent, and was accepted by the CNEE's Board of Directors.[208]

143. During the Hearing, counsel for TGH alleged that this arbitrariness was proven by the fact that the CNEE directors did not know exactly what the 2 meant and asked Mr. Riubrugent about it by email. What TGH does not explain is how this exchange could reflect bad faith or arbitrariness. Mr. Riubrugent was the external technical consultant hired by the CNEE and this type of exchange was completely normal within the framework of a technical discussion of this complexity. Moreover, the consultation by the CNEE directors actually reflects their will to understand the meaning of the 2 in the FRC[209] and evidences that there was no intent whatsoever on the part of the CNEE to prejudice EEGSA. As is plainly seen in the emails between Mr. Riubrugent and the CNEE directors, Mr. Riubrugent legitimately believed that 50% depreciation was appropriate for mature companies.[210] This was a valid opinion and in no way arbitrary, as Mr. Bastos verified when confirming the validity of this formula for mature companies:

> This formula that the National Energy Commission was applying answers to a company that is not growing. It's used mainly in Australia, and I think in New Zealand as well […]The formula used was correct […].[211]

144. The lack of arbitrariness or bad faith on the part of the CNEE against EEGSA is also evidenced by the fact that this formula applied to all distributors in Guatemala and not just EEGSA. That said, as the Tribunal rightly indicated during the Hearing, it is true that there was a likelihood that the sole amortization level was not the correct one for all the distributors to which it was applied.[212] In this case, the proper thing would have been for EEGSA to justify the appropriate level, for example, by providing the accounting depreciation level. That accounting value is perfectly acceptable, as Mr. Bastos acknowledged at the Hearing:

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[208] Tr. (English), Day Five, 1020:4-1021:3, Moller.

[209] *Ibid*., 1021:8-15:

> It's a very complex issue in terms of speciality, economics, what have you, on this part. And I wasn't familiar with this. I understood that Mr. Colom was not familiar with this, and we asked for an explanation of what that really represented, what was it, what was its effect, and that's where I was given an explanation of what I have tried to explain to you.

[210] Email chain between M. Peláez and J. Riubrugent, 9 January 2008, **Exhibit C-567**.

[211] Tr. (English), Day Four, 792:20-795:2, Bastos.

[212] Tr. (English), Day Six, 1479:8-17, Mourre.

> In general, when depreciation criteria are used, one uses an accounting bases, historical bases, and then one sees real depreciation.[213]

145. However, EEGSA never provided any alternative information, but rather opted to interpret the "2" in the Terms of Reference as a "typographical error" and insist that it be granted a return on its gross capital base. The fact that the other two distributors also controlled by foreign shareholders, Deorsa and Deocsa, have provided that information[214] shows the opportunism and lack of seriousness of EEGSA and its consultant firm during the tariff process. In the case of these companies, the depreciation level was set at 42% (rather than 50%) after they submitted the relevant information.[215]

146. However, at the Hearing, counsel for TGH tried to demonstrate that the CNEE possessed EEGSA's financial statements and therefore could have adapted the formula to EEGSA's "actual" depreciation level.[216] First, as Mr. Moller explained, it was up to EEGSA to provide the information and proper justification for suggesting changes to the Terms of Reference:[217]

> The procedure established in the Terms of Reference is that the distributing company, which is the one that has all the information, is under an obligation to present that information to the Commission, and it's not for the Commission to be seeking an alternative means or elsewhere basic information that the Distributor has.[218]

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213 Tr. (English), Day Four, 792:18-20, Bastos.

214 Tr. (English), Day Five, 1016:11-21, Moller:

> MR. MOLLER HERNÁNDEZ: So the Distributor, DEORSA, DEOCSA [sic] presented the field information, and the amount that was amortized was 42 percent instead of 50 percent.
>
> PRESIDENT MOURRE: Based on what? Based on the life of the assets?
>
> MR. MOLLER HERNÁNDEZ: That is what I understood based on that explanation.
>
> PRESIDENT MOURRE: And in your opinion, that is consistent with the VNR concept, correct?
>
> MR. MOLLER HERNÁNDEZ: Well, it is consistent.

215 Tr. (English), Day Six, 1418:1-13, Damonte:

> "In the case of DEOCSA and DEORSA, we provided the Financial Statements of the DEOSCA and DEORSA, and we showed the CNEE that the ratio that we had was 42 percent. They said they studied that and they accepted that, and we decided [the f] was 1,73."

216 Tr. (English), Day Five, 1029:19-1030:6, Moller.

217 Terms of Reference for the Performance of the Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A., CNEE Resolution 124-2007, January 2008, **Exhibit R-53**, Article 1.10.

218 Tr. (English), Day Five, 1034:5-12, Moller.

147. Second, as explained in Section III.D.2 below, during the tariff review, EEGSA categorically refused to provide its financial statements to the CNEE. This refusal is telling of EEGSA's lack of transparency and collaboration during the tariff review process.

148. The result of calculating the VAD on an overvalued capital base and an FRC that calculated EEGSA's return on the gross value of that capital base was a highly overvalued VAD not suitable for determining the tariffs for the 2008-2013 period.

3. Mr. Pérez's offer confirmed the unreliability of the Bates White study and EEGSA's disregard for the LGE

149. One of the surprising events that has come to light in this arbitration is Mr. Pérez's visit to the CNEE shortly after the tariff review began, to present what he himself called a "discount offer," which would apply "outside the study" without regard for the tariff review process established in the LGE. Guatemala has explained how Mr. Pérez's proposal exposed EEGSA's lack of transparency, as well as the lack of credibility of its tariff studies.[219]

150. The treatment that TGH has given Mr. Pérez's proposal is a clear example of double standards of conduct. TGH attempted to play down this incident, indicating in its opening statement that Mr. Pérez's proposal was "*a settlement discussion, nothing more and nothing less.*"[220] In other words, according to TGH, Mr. Pérez went to the CNEE to resolve a dispute that existed between EEGSA and the CNEE. That is false. Mr. Pérez's proposal was not a "*settlement agreement*" as TGH is attempting to persuade this Tribunal. The proposal was made on 22 April 2008, when the CNEE did not even have EEGSA's final study (which was only submitted on 28 July 2008). Put another way, at the time the proposal was made, there was no dispute that could have been "*settled*" as TGH claims.

151. It is not very difficult to establish that Mr. Pérez's proposal amounted to an irregular maneuver. The best proof of this is the fact that EEGSA and TGH did everything possible to ensure that no trace of that proposal remained. Note that, except from the mouths of its attorneys and witnesses (and only because Guatemala raised the issue in the *Iberdrola* case),[221]

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[219] Rejoinder, para. 343.

[220] Tr. (English), Day One, 60:21-22, Claimant's Opening Statement.

[221] The existence of Mr. Pérez's proposal first came up in the *Iberdrola* ICSID arbitration filed by that company against Guatemala in 2009. Guatemala denounced this irregular proposal in its Counter-Memorial, since

TGH has not submitted a single piece of contemporaneous evidence that discusses this proposal and, in particular, the reasonableness of offering a discount in the VAD of over 90%! There are no minutes of board of directors' or shareholders' meetings, nor letters, nor internal emails, nor a statement from Mr. Pérez. Nothing. The only thing that exists is Mr. Pérez's PowerPoint presentation, which was submitted by Guatemala in the *Iberdrola* case.[222]

152. As will be recalled, the proposal was made at an in-person meeting with no pre-established agenda, with a single-copy of the document, without any email of introduction or follow-up, on paper with no letterhead and without mentioning the actual names of the people and companies involved. It is fitting to recall the justification for this attempted by Mr. Maté at the *Iberdrola* Hearing, which needs no further comment:

> Q. Is there any reason why this document did not show the letterhead of EEGSA or Iberdrola?
>
> A. Absolutely none. Well, because blank paper was used to print it.
>
> Q. Blank paper was used to print it.
>
> A. Yes. That was what was in the printer and it printed [itself]. But there was no reason for it. [...].
>
> Q. Could you indicate where in this document there is a reference to EEGSA, that the word EEGSA is used, in the 15 pages [...] of this presentation? [...] Where is EEGSA mentioned?
>
> A. Well, strangely, now that you mention it, I actually don't know where [...].[223]

153. TGH's opening statement attempted to defend the supposed legality of the proposal, which is obviously indefensible *per se*. But even more important than the form of this proposal is its substance. The figures requested by EEGSA in its tariff studies contrasted sharply with

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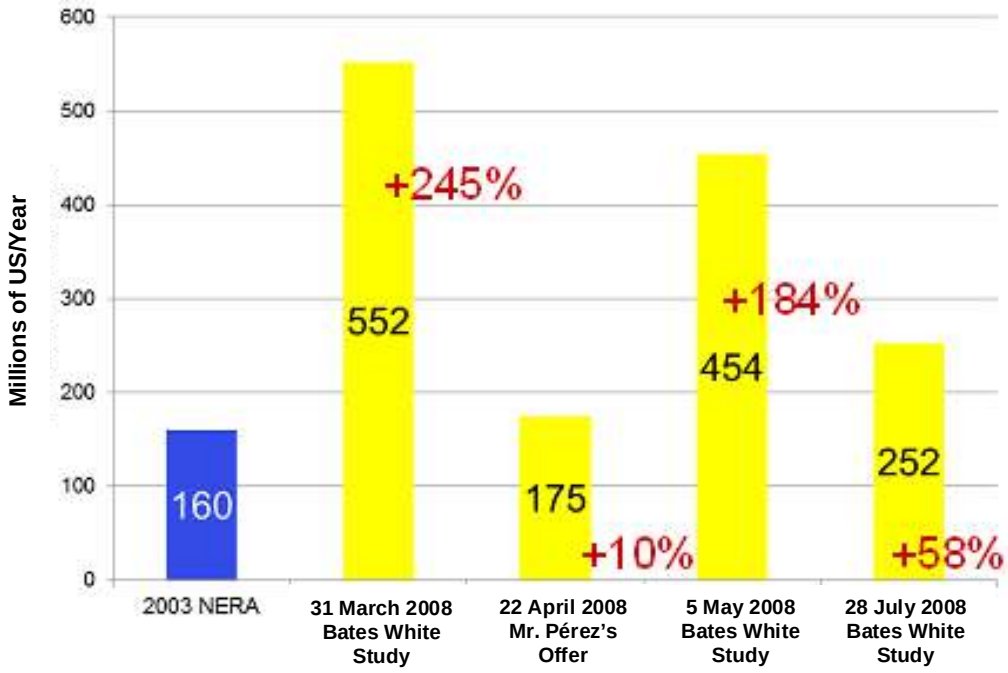
Iberdrola had omitted any reference to it in its Memorial. With the experience of the *Iberdrola* case as background, TGH anticipated this and referred to Mr. Pérez's proposal in its Memorial, appending the same copy of the presentation introduced by Guatemala in the *Iberdrola* case.

[222] Presentation on Income Requirements of the 22 April 2008 Tariff Study, **Exhibit R-65**; p. 2. Bates White, Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A. corrected on 5 May, **Exhibit R-69**, p. 3.

[223] Final Hearing Transcripts, ICSID Case No. ARB/09/5 (excerpts), **Exhibit R-202**, Tr., Day Two, 373:17-374:14, Maté.

the values that Mr. Pérez was requesting in his "offer." The following comparison is more than telling:

Increases in the VAD proposed by EEGSA



154. At no time in these proceedings did TGH attempt to explain why EEGSA offered a discount of this magnitude when the review process had just begun (April 2008). The President of the Tribunal asked Mr. Callahan this question:

> Did you have a discussion in order to prepare this and to determine the economic basis which allowed you to determine that an increase of 10 percent would be acceptable?[225]

155. However, Mr. Callahan said he knew nothing in that regard.[226] In fact, when Mr. Maté answered this question during his cross-examination in the *Iberdrola* case, he expressly acknowledged that the company's actual tariff expectations were close to Mr. Pérez's proposal, and therefore lightyears away from the amounts requested in the tariff studies prepared by Bates White:

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[224] Presentation on Income Requirements of the 22 April 2008 Tariff Study, **Exhibit R-65**; p. 2. Bates White, Value-Added for Distribution Study for Empresa Eléctrica de Guatemala, S.A. corrected on 5 May, **Exhibit R-69**, p. 3.

[225] Tr. (English), Day Two, 557:19-558:1, Callahan.

[226] Tr. (English), Day One, 558:2-3, Callahan.

> Q. An increase of 10 percent was sufficient for [EEGSA] to maintain, I imagine, the economic return that it had hoped to achieve from this investment.
>
> [...]
>
> A. Well, EEGSA considered at that moment that the return it wished to achieve or accepted it would achieve at that time was the 10 percent. But that was at that time. And that is what was offered [to EEGSA].[227]

156. Ultimately, Mr. Perez's proposal exposed EEGSA's lack of transparency. Even more importantly, Mr. Pérez's proposal also revealed the lack of credibility of the studies submitted by EEGSA to the point that, as confirmed by its own President during the meeting in question, not even EEGSA itself trusted in the work that was being of its consultant.[228]

C. THE EXPERT COMMISSION IS TECHNICAL, NON-BINDING BODY FOR THE CNEE

1. The Hearing confirmed that the Expert Commission is an "expert" body whose role is to give a non-binding technical opinion

157. The Hearing served to clarify the nature and scope of the Expert Commission's functions. As is known, Article 75—the only article of the LGE that refers to the Expert Commission—states that an Expert Commission must be created to pronounce itself on the discrepancies that persist between the parties once the CNEE had made its comments on the distributor's tariff study.[229] As is clearly seen from this article, the only function that the Expert Commission has is to "pronounce itself" ["*pronunciarse*"] on the discrepancies.

158. The Guatemalan Judiciary Act establishes that laws must be interpreted first with reference to the text and then to their context.[230] With regard to the literal interpretation, Guatemalan law refers to the dictionary of the Royal Spanish Academy (***RAE***).[231] TGH and

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[227] Final Hearing Transcripts, ICSID Case No. ARB/09/5 (excerpts), **Exhibit R-202**; Tr., Day Two, 393:22-394:9, Maté.

[228] Rejoinder, para. 343.

[229] LGE, **Exhibit R-8**, Article 75. In addition, two articles of the RLGE refer to the Expert Commission. Article 98 regulates the cost of hiring the third member, and Article 98 bis (which did not apply in the EEGSA tariff review) regulates certain aspects of the procedure and the deadlines for assembling the Expert Commission. *See* RLGE, **Exhibit R-36** and Government Resolution No. 145-2008 adding a new Article 98 bis to the RLGE dated 19 May 2008, **Exhibit R-72**.

[230] Rejoinder, para. 282 *et seq*.

[231] Memorial, para. 213.

its expert Mr. Alegría have presented definitions of this verb to the Tribunal that would seem to assign it a binding nature.[232] However, as Mr. Alegría himself acknowledged during the Hearing, the "itself" that follows the verb "shall pronounce" in the text of Article 75 turns this verb into a reflexive verb.[233] And the only purely reflexive meaning of the verb pronounce (oneself) offered by the RAE dictionary is "to declare or express oneself for or against somebody or something,"[234] a definition that obviously does not assign a binding nature to the term.

159. But in any event, the analysis cannot be limited to a dictionary definition. The contextual interpretation rule means that the word "pronounce itself" must be interpreted in conjunction with the word "expert," given that the one pronouncing itself according to Article 75 is an expert commission. This is an analysis as basic as it is fundamental: the adjective "expert" obviously derives from the noun "expert" and according to the RAE dictionary, this word means "person who, possessing certain scientific, artistic and technical or practical knowledge, reports, under oath, to the judge on contentious issues as they relate to their special knowledge or experience."[235] Thus, the scope of the "pronouncement" becomes clear, given that the power granted by the LGE to the Expert Commission is that of issuing an expert opinion to inform the decision of the pertinent administrative bodies (CNEE and then MEM) and possibly even judicial bodies. This integrative analysis of the text of Article 75—which, as Mr. Alegría acknowledged during the Hearing, he consciously decided to ignore[236]—destroys TGH's theory with respect to the scope of the Expert Commission's pronouncement.

160. Moreover, this interpretation of the scope of Article 75 is consistent with the rule of Article 4 of the Guatemalan Law of Administrative Disputes, which expressly precludes assigning a binding nature to the decisions of auxiliary bodies, as analyzed in the following paragraphs.

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[232] Tr. (English), Day Five, 1171:6-1172:18, Alegría.

[233] *Ibid*., 1209:5-9. On the reasons why the purely reflexive meaning should be accepted *see* Reply, paras. 535-540 and Rejoinder, para. 143 *et seq*.

[234] Dictionary of the Royal Spanish Academy, **Exhibit C-50**.

[235] Dictionary of the Royal Spanish Academy, **Exhibit R-153**.

[236] Tr. (English), Day Five, 1209:18-1210:9, Alegría.

Question from the Tribunal: The relevance of the Law of Administrative Disputes as to the binding nature of the Expert Commission's pronouncement [237]

161. During the Hearing, there was a discussion with respect to the scope of the Expert Commission's pronouncement in light of the authority established in Article 3 of the Law of Administrative Disputes (***LCA***). The Tribunal consulted the parties with respect to the impact that this article could have on the present dispute. Article 3 of the LCA establishes:

> Article 3. Form. Administrative resolutions shall be issued by the competent authority, citing the legal or regulatory provisions on which they are based. Treating opinions that have been issued by a technical or legal advisory body as resolutions is prohibited […][238]

162. First, it should be noted that the rule in LCA Article 3 is aimed directly at regulating acts of administrative entities such as the CNEE. The rule is not aimed at judicial authorities, but rather at entities of the public administration. And in fact, the CNEE is an administrative entity that—in the words of LCA Article 3—acts as "competent authority" by issuing "administrative resolutions," which produce legal effects.[239]

163. The prohibition set forth in LCA Article 3 against an administrative entity adopting as a resolution any opinion issued by a technical or legal advisory body is directly applicable to the Expert Commission in LGE Article 75. Such pronouncement cannot bind the CNEE under any circumstances nor can it produce any legal effects. As indicated above, the Expert Commission is a "technical advisory body" that consists of experts and pronounces itself through an "opinion" which, in the case of Article 75, is called a pronouncement.[240]

164. As Mr. Aguilar explained in his expert reports in these proceedings, the purpose of LCA Article 3 is to distinguish the functions assigned to the administrative authority (the CNEE) from those belonging to technical or legal advisory bodies such as the Expert

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[237] Letter of the Tribunal to the Claimant and Respondent dated 11 March 2013, p. 2.

[238] Decree Number 119-96, Law of Administrative Disputes, 20 December 1996, **Exhibit C-425**, Article 3.

[239] LGE, **Exhibit R-8**, Article 5:

> The Commission's resolutions shall be adopted by a majority of its members, who shall perform their duties with absolute independence of judgment and under their sole responsibility.

[240] Clearly the Expert Commission does not pronounce itself through a "resolution" because resolutions fall exclusively to "administrative bodies" – the Expert Commission does not share this nature.

Commission, whose opinions cannot be deemed a resolution of the matter in question.[241] Legal commentary on LCA Article 3 confirms this understanding. Guatemalan Administrative Law essayist Professor Jorge Mario Castillo González discusses the prohibition on treating expert opinions as resolutions established in Article 3 of the LCA in the following extract:

> [The] prohibition established in the Law of Administrative Disputes must properly apply in the administrative field. […] The expert opinion does not replace the resolution due to one simple fact: the opinion comes from the legal or technical advisor or consultant, and the resolution comes from the executive official. The expert report is an opinion and the resolution is a decision.[242]

165. The Constitutional Court has incorporated this interpretation of LCA Article 3 into its analysis of the scope of the powers of the CNEE and the Expert Commission in the context of Article 75:

> Expertise, in the form of wisdom, practice, experience or ability in a science and art, has traditionally served as an aid used by authorities when making a decision regarding a certain matter. […] It follows that [the authority] is not obliged to abide by the expert opinion; particularly when, in any reasonable case, it has the power to resolve the matter; thereby forming its own judgment based on the facts or information gained from exercising competence and other aspects that contribute to a determination of the facts. […] Expecting the Expert Commission to decide a conflict and recognizing its competence to issue a binding decision breaches the principle of legality [….] [L]imited strictly by the LGE, the power to approve tariff schemes pertains to the CNEE and in no way, either directly or indirectly, to an expert commission, whose nature has been considered.[243]

166. In conclusion, the text of the LGE follows the rule established in LCA Article 3, preserving the powers of the CNEE and delimiting the task of the Expert Commission to issuing its pronouncement, given that "[n]either the [LGE] nor the RLGE mentioned above contain any provisions indicating any roles of the Expert Commission other than to issue an opinion, which was fulfilled by submitting it."[244] Thus, it is clear that the CNEE at all times

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241 Tr. (English), Day Five, 1234:14-1235:3, Aguilar. Mr. Aguilar discusses the rule of LCA Article 3 in his two expert reports in Mr. Aguilar, **Appendix RER-3**, paras. 10(j), 50, 51, 67 and 71; Aguilar, **Appendix RER-6**, paras. 1(e) and 40.

242 J. M. Castillo Gonzalez, "*Derecho Administrativo Teoría General y Procesal* [Administrative Law, General and Procedural Theory]" (19th edition, 2009), Guatemala, **RL-34**,commentary on pp. 649-650.

243 Decision of the Constitutional Court, 18 November 2009, **Exhibit R-105**, pp. 26 and 29.

244 *Ibid*., p. 25.

maintains the authority and the obligation to adopt the final decision regarding tariffs, without the pronouncement of the Expert Commission imposing any limitation in that regard.

2. The proposed operating rules were contrary to the regulation and never approved by the parties

167. The Hearing confirmed the absurdity of TGH's arguments regarding the alleged agreement between the CNEE and EEGSA on operating rules for the Expert Commission. Not only did the LGE not envisage any additional task for the Expert Commission following the pronouncement, but there was also never any agreement between the CNEE and EEGSA in this regard. In fact, the Hearing made it clear that the treatment of the operating rules between the parties never went beyond the discussion stage.

168. The reasons are simple: rule 12 proposed by EEGSA stipulated that once the Expert Commission issued its pronouncement, the consultant for the distributor would correct the tariff study and send it to the Expert Commission. The Commission would then review it and confirm whether, in its opinion, said study faithfully reflected its pronouncement.[245] As Mr. Colom explained at the Hearing, the CNEE could not approve a rule that involved the delegation of CNEE's authority.[246]

169. The reality is that the CNEE and EEGSA never approved the operating rules.[247] TGH cannot expect Guatemala to prove a negative fact, i.e. that the rules were not agreed upon, but the following admission, made by Mr. Calleja during the Hearing, removes all possible doubt:

> Q. I have a very specific question for you. Can you tell me if there is any document that has been signed between CNEE and EEGSA where the two parties agree on the Operating Rules?
> A. Excuse me?
> Q. Is there any written document signed by the CNEE and EEGSA where the two parties agree on the Operating Rules?
> A. Is there such a document between EEGSA and the Commission?
> Q. Between CNEE and EEGSA.
> A. Well, no.[248]

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[245] Article 75 of the LGE provides that the "Expert Commission shall pronounce itself on the discrepancies within a period of 60 days counted from its appointment." Clearly, just once. LGE, **Exhibit R-8**, Article 75.

[246] Tr. (English), Day Five, 1114:8-15, Colom.

[247] As Mr Colom indicated at the Hearing, a "verbal" agreement did exist between CNEE and EEGSA regarding merely procedural rules, but this was never formalized. Tr. (English), Day Five, 1121:3-7, Colom.

[248] Tr. (English), Day Two, 666:14-667:3, Calleja.

170. During the Hearing, well-aware of the lack of grounds for its position, TGH and its witnesses resorted to the argument of a "verbal agreement" between the CNEE and EEGSA with regard to the operating rules.[249] However, such a position is implausible. First, it is false that any verbal agreement regarding rule 12 existed. Second, EEGSA and TGH are well-aware that as an administrative agency, the CNEE never makes any decisions that are not approved by formal resolution. Not only was there no CNEE resolution reflecting any such agreement, but the official documents issued by the agency in relation to the Expert Commission contradict TGH's theory.

171. Thus, the Notarized Act of Appointment of the Expert Commission,[250] which Mr. Calleja confirmed during the Hearing "determines the task of the Expert Commission"[251] contains no mention of any such rules. According to Mr. Colom:

> […] [The operation rules] never ever [became applicable]. Well, the only way in which they could have been applied is through a resolution and through a written document by the CNEE. [It] was very clear in the Notarial Letter of Appointment of the Expert Commission […] that the role that the EC had was in line with Article 75 of the law. But we never agreed to anything else, and it was never our understanding.[252]

172. It is important to highlight the fact that despite the absence of any agreement with the CNEE, Mr. Calleja forwarded to Mr. Bastos—without informing or copying the CNEE—an email containing the working draft circulated by Mr. Quijivix on 28 May.[253] When asked why he failed to copy Mr. Quijivix or the CNEE on his email, Mr. Calleja responded "maybe it was an oversight to not have sent [the email with the rules] to Melvin [Quijivix], but we were in a rush"[254] and that "[he] didn't attach any importance to it."[255] It is clear that the email in question, which the CNEE had nothing to do with, cannot serve as a basis for TGH's position that there was an agreement regarding rule 12.

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[249] *Ibid*., 666:15-667:3..

[250] Notarized Act of Appointment of the Expert Commission, 6 June 2008, **Exhibit R-80.**

[251] Tr. (English), Day Two, 670:20-22, Calleja:

> Q, Do you agree that in Section 1 it determines the task of the Expert Commission?
> A. Yes.

[252] Tr. (English), Day Five, 1119:7-19, Colom.

[253] Email from M. Calleja to C. Bastos, 2 June 2008, **Exhibit C-220**.

[254] Tr. (English), Day Two, 617:13-14, Calleja.

[255] Tr. (English), Day Two, 665:21, Calleja.

173. Lastly, it should be noted that while Mr. Calleja confirmed his understanding that the draft rules volleyed between the parties prior to 28 May were merely "working documents,"[256] he maintained that the 28 May draft reflected an agreement between the CNEE and EEGSA. However, Mr. Calleja did not explain why such similar "drafts" should be treated differently.

174. As illustrated in the table below, all the versions of the rules that were circulated by Mr. Quijivix indicated in the heading and/or in the Subject line that they were "PROPOSED." The 28 May draft is indistinguishable from its predecessors.

Document	**Date**	**Text in the email subject line**	**Heading of the list of rules under discussion**
Email from Mr. Melvin Quijivix to Mr. Miguel Calleja (D-217) attaching new version of the rules under discussion (D-218)	21 May 2008	PROPOSED RULES FOR THE EXPERT COMMISSION	PROPOSED OPERATING RULES FOR THE RUNNING OF THE EXPERT COMMISSION
Email from Mr. Melvin Quijivix to Mr. Miguel Calleja (D-219) attaching new version of the rules under discussion (D-220)	23 May 2008	EC RULES	PROPOSED OPERATING RULES FOR THE RUNNING OF THE EXPERT COMMISSION
Email from Mr. Melvin Quijivix to Mr. Miguel Calleja attaching new version of the rules under discussion (D-112)	28 May 2008	PROPOSED OPERATING RULES FOR THE EXPERT COMMISSION	PROPOSED OPERATING RULES FOR THE RUNNING OF THE EXPERT COMMISSION

175. Thus, it is clear that rule 12 was never accepted by the CNEE.

D. THE EXPERT COMMISSION CONFIRMED THAT THE BATES WHITE STUDY HAD SERIOUS DEFICIENCIES AND WAS INCOMPATIBLE WITH THE REGULATORY FRAMEWORK

1. The Expert Commission pronounced that the CNEE was correct in more than 50% of the cases

176. Even if the Expert Commission's pronouncement were binding, it is significant that the experts confirmed that the CNEE was correct in more than 50% of its comments, meaning the

[256] *Ibid*., 698:14-15.

study failed to comply with the Terms of Reference in the majority of cases. As Mr. Moller explained during the Hearing:[257]

> In this case, I don't remember exactly. It was 60 or 65 instances of failing to abide by the Terms of Reference, and the Experts said that there were 30 or 35, more than 52 percent of the positions put forth by the Regulator. The Experts said, in effect, the consultant did not abide by the Terms of Reference. Indeed, by simply not abiding by one point, that would have sufficed to say you did not correct the study properly, and it was more: 30, 35, more or less, 52, 53 percent.[258]

177. It is worth clarifying that the discrepancies settled in favor of the CNEE included, among others, discrepancies related to underground networks, the lack of reference prices and the non-traceability of the models.[259] The fact that more than eight months after the tariff review began, and after several rounds of comments, the Expert Commission pronounced that EEGSA was wrong in over half the cases, confirmed the CNEE's apprehension regarding the use of EEGSA's tariff study to determine tariffs.

178. TGH claims that EEGSA was correct in many of the discrepancies and that therefore its deviations from the Terms of Reference were justified.[260] This is not a convincing basis for the validity of the 5 May study, especially because Mr. Giacchino's participation on the Expert Commission detracted from the validity of that body. This is reinforced by examining the various "hats" worn by Mr. Giacchino throughout the tariff review process, including during his participation in the Expert Commission.

179. Mr. Giacchino had stated in his testimony that "when [he] was nominated on the Experts Committee, [he] acted independently,"[261] that he "still kept [his] independence"[262] and

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257 Counter-Memorial, para. 390; Rejoinder, para. 440.

258 Tr. (English), Day Five, 1036:6-15, Moller.

259 Report of the Expert Commission, 25 July 2008, **Exhibit R-87**, pp. 15-17, 33-36 and 82-83. Tr. (English), Day Five, 893:2-9, Mourre; Tr. (English), Day Five, 934:4-10, Giacchino; Rejoinder, para. 161.

260 Reply, paras. 129-132 and 182 *et seq*.

261 Tr. (English), Day Five, 927:4-12, Giacchino:

> Q. You didn't think--my question is: Did you think that in your role as on the Expert Commission that you were expanding upon defending and, in general, watching out for the approval of the Tariff Study?
>
> A. No, when I reviewed the Contract, I wasn't thinking about the Experts Committee. And when I was nominated on the Experts Committee, I acted independently.

262 *Ibid*., 936:7-12:

that "once [he] became a member of the Expert Commission, [he] maintained [his] independence."[263] However, Mr. Giacchino was unable to explain how this could be compatible with his obligation under the contract with EEGSA to "present, defend and in general pursue approval of the Tariff Study,"[264] even from within the Expert Commission.

180. In other words, Mr. Giacchino could not have made an impartial decision in his role as member of the Expert Commission. The mere inclusion of these obligations is inconsistent with the alleged understanding of EEGSA, TGH and Mr. Giacchino himself regarding any "independence" of the Expert Commission. But the lack of independence on the part of Mr. Giacchino whilst he was on the Expert Commission became clear in a concrete way. By way of example, when attempting to defend his alleged "independence," Mr. Giacchino stated at the Hearing that, in his capacity as member of the Expert Commission, he had "changed [his] mind" on some occasions when reviewing the pronouncements.[265] What Mr. Giacchino neglected to inform the Tribunal is that in all the discrepancies in which he supposedly "changed [his] mind" what he actually did was align himself with the majority opinion that had already been announced by the other two experts with regard to the discrepancy in question. In

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> Q. When you sent the report to your co-experts, you were wearing your hat as a consultant; correct?
>
> A. I sent the report to the CNEE first, I think, and then I sent it to the--CNEE and EEGSA, and then I sent it to the other two members of the Expert Committee, but I wasn't wearing hats or anything like that I still kept my independence of criteria.

[263] Final Hearing Transcripts, ICSID Case No. ARB/09/5 (excerpts), **Exhibit R-202**, Tr., Day Two, 534:4-18, Giacchino:

> Q. Do you consider that, in your role within the Expert Commission, you were acting as an independent and impartial person within the Expert Commission?
>
> A. Once I became a member of the Expert Commission, I maintained my independence. One can see that for the same decisions, there are decisions where Bates White proposed one thing that was different from what I then decided by unanimity or sometimes by majority with the other members of the Expert Commission.
>
> Q. You therefore consider yourself to be independent with regards to the dispute that you had to analyze.
>
> A. Yes. I maintained my independence with regards to the analysis of each dispute.

[264] Contract between EEGSA and Bates White LLC for the performance of the 2008-2013 Tariff Study for Empresa Eléctrica de Guatemala, Sociedad Anónima EEGSA – Bates White LLC, Clause Five, Number 12, Obligations of the Consulting Firm, **Exhibit R-55**. As Mr. Giacchino stated during the Hearing, this initial agreement was the only document signed with EEGSA governing his participation on the Expert Commission. *See* Tr. (English), Day Five, 927:17-20, Giacchino.

[265] Tr. (English), Day Five, 930:12-13, Giacchino:

> "[…] and then in some cases I changed my mind on some things".

other words, his change of opinion did not result in any practical effect. This was acknowledged by Mr. Giacchino during the *Iberdrola* Hearing:

> Q. The figure of the 16 occasions when you ruled against your own study, is the figure that you are including in your statement. Is that correct?
> A. Yes that is correct.
> Q. OK. […]. In any of those occasions was your vote necessary or Essentials for settling a dispute in favour of the CNEE? That is to say that your vote made the difference, that is – there already had been – that is you constituted a majority against your own study.
> R. No, on those 16 occasions we are talking about unanimous decisions, that is to say, there were already two members, not including me, who were deciding in favor of the CNEE, and I simply also voted – that is, I voted the same way as they did. It can be said that there were already two votes.[266]

181. It also became clear at the Hearing that Mr. Giacchino decided to give his Bates White team advance notice of the Expert Commission's pronouncements before they were issued and without informing the CNEE—a clear example of his abuse of the authority granted to him by the parties. This was unequivocally confirmed by Mr. Bastos:

> A. [D]uring the period that we were working on that, Bates White corrected the report by the consultant based on the conclusions that we had reached.
> Q. But, I'm sorry, Mr. Bastos, I understood that there was no communications between Mr. Giacchino and other people during his role as an expert. I understood that as part of the mandate there shouldn't be any communication, but now I understand that there was communication between Mr. Giacchino and EEGSA's consultant?.
> A. He was conveying the decisions made by the Expert Commission.[267]

182. Mr. Giacchino not only gave Bates White and EEGSA advance notice of the pronouncements without notifying the CNEE,[268] but there were also, as he acknowledged

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[266] Final Hearing Transcripts, ICSID Case No. ARB/09/5 No. ARB/09/5 (excerpts), **Exhibit R-202**, Day Two, 549:3-549:21, Giacchino (emphasis added).

[267] Tr. (English), Day Four, 762:4-16, Bastos (emphasis added).

[268] Tr. (English), Day Five, 1147:16-1148:9, Colom:

> Q. Mr. Colom, in these proceedings we have heard that Mr. Giacchino as an Expert of the Expert Commission informed of the future appointments of the members of the Commission to his consulting firm, Bates White. Do you know if you or any other person with CNEE was copied in those communications between Mr. Giacchino and Bates White?
> A. No. We didn't know that.

during the Hearing, unilateral contacts between the Expert Commission (through Bates White) and EEGSA, of which the CNEE was never informed:

> Q. […] [C]an you say definitively that when those decisions of the Comisión Pericial, the Expert Commission, were being passed to Bates White, that Bates White never once during that period requested information from EEGSA?
> A. No, they requested information such as the cost of some rents for buildings and issues like that, that the Experts Committee requested to include that information as part of the tariff proposal, and Bates White did not have it, so they had to contact one person that was within the area in Guatemala that had that information. So, they requested that specific information and got it.[269]

183. It is clear that under these circumstances, the Expert Commission's pronouncements in favor of the EEGSA tariff study do nothing to change CNEE's conclusion that it could not use that study to set tariffs.

2. The Expert Commission exceeded its mandate

184. Beyond agreeing with the CNEE on most discrepancies, the Expert Commission also exceeded its authority. As Guatemala has stated in these proceedings, the mandate of the Expert Commission, as provided for in its constituent documents, was to verify that the Bates White study complied with the Terms of Reference.[270] Nevertheless, the Expert Commission did not have the authority to modify the methodology established in the Terms of Reference since, as has already been stated, under the LGE, the CNEE has sole authority to determine such methodology.[271] Despite this fact, the Expert Commission exceeded its authority and, as acknowledged by Mr. Giacchino himself,[272] modified the FRC methodology that was set forth

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> Q. And Mr. Giacchino also told us that his consulting firm contacted EEGSA in connection with this same appointments before they were officially made. My question is whether you have any information about any copy received by CNEE of those Communications.

269 Tr. (English), Day Five, 935:5-935:18, Giacchino.

270 Counter-Memorial, paras. 207, 359 and 373; Rejoinder paras. 425 and 431.

271 LGE, **Exhibit R-8**, Article 4(c).

272 Tr. (English), Day Five, 958:18-959:5, Giacchino:

> PRESIDENT MOURRE: And my question is: changing Factor 2, is that a variation in methodology?
>
> THE WITNESS: There was a variation in the methodology because the premises were changed, so the Factor 2 is the result of a method, and within that method to get there, Mr. Riubrugent was taking certain premises, certain assumptions. So, if you changed the assumptions, you get the different result. So, the change in the methodology there was to change the assumptions.

in the Terms of Reference, pronouncing itself that the assets would not depreciate over their entire useful life, but rather only during the tariff period.[273]

Question from the Tribunal: Is the FRC formula proposed by the Expert Commission in compliance with the regulatory framework?

185. During the Hearing, the Tribunal asked whether the FRC formula proposed by the Expert Commission complied with the regulatory framework.[274] The answer is no. Not only was the Expert Commission's proposed modification of the FRC formula a clear case of an abuse of its authority, but in addition, it did not comply with the LGE or RLGE. The FRC proposed by the Expert Commission accumulates depreciation over the five-year period of the tariff study, but then readjusts the depreciation back to zero.[275] Thus, the Expert Commission's FRC implies an average depreciation of 8.3% despite the fact that the assets have been in operation for more than fifteen years and the investor has already recovered a portion of its investment in the form of depreciation payments over five years.[276]

186. As Mr. Damonte explained during the Hearing, by taking an implicit depreciation value of only 8.3%, this formula generates excess remuneration for EEGSA of approximately 19%:

> What I said is that the Capital Recovery Factor estimated or the formula stated by the Expert Commission is incorrect, and I can prove it from the financial point of view. I can prove that it is incorrect, it is wrong, there are mistakes. It does not fulfill the financial validity requirement. It has 19 percent overvaluation or overestimation of the current present value. […] The formula by the Experts Committee shows 19 percent as the current value that is incorrect. The result is that this is as if the VNR was 19 percent higher.[277]

187. Moreover, this methodology violates LGE Article 73, which provides that "annuity" is to be calculated "on the basis of the typical useful life of distribution facilities."[278] The useful

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[273] LGE, **Exhibit R-8**, Article 73:

"the ***annuity shall be calculated on the basis of the typical useful life of distribution facilities***."

[274] Tr. (English), Day Two, 401:20-22, Mourre.

[275] Damonte Rejoinder, **Appendix RER-5**, para. 186.

[276] Tr. (English), Day Six, 1459:9-12, Damonte.

[277] Damonte Rejoinder, **Appendix RER-5**, para. 189 and Table 20; M Abdala and M Schoeters, **Appendix RER-1**, paras. 67-71 and Table IV; M Abdala and M Schoeters, **Appendix RER-4**, paras. 29-30**.** Tr. (English), Day Six, 1454:10-1455:4.

[278] LGE, **Exhibit R-8**, Article 73: "The cost of capital per unit of power shall be calculated as the constant annuity of cost of capital corresponding to the New Replacement Value of an economically measured

life of distribution assets, depending on the asset in question, is approximately 25 to 30 years, so an FRC that only depreciates over the five-year tariff period, as the Expert Commission intended, could hardly be approved. The consequence of applying the Expert Commission's FRC would be that the distributor is remunerated for the cost of replacing all the assets every five years, when in reality, it is only doing so every 25 or 30 years.

188. For reference purposes, it is fitting to recall that in the 2003-2008 tariff review, the depreciation percentage used was 30% and the real depreciation value of EEGSA's asset base, according to its financial statements, was 43.5%.[279] It should be noted that the Expert Commission failed to provide any explanation for the enormous difference in the values between its proposed formula and the latter figures. Even though EEGSA flatly refused to provide its financial statements to CNEE during the tariff revision,[280] the Expert Commission relied on them at the time it issued its pronouncement.[281] Mr. Bastos himself admitted during the Hearing that "when depreciation criteria are used, one uses an accounting basis, […] and real depreciation [should be used]."[282]

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189. Based on all of the foregoing, it is clear that the 5 May Bates White study could not be used to set tariffs for the 2008-2013 period.

E. THE 28 JULY STUDY FAILED TO COMPLY WITH THE PRONOUNCEMENTS OF THE EXPERT COMMISSION

190. TGH argues that while the 5 May study could not be used to set the tariffs, the CNEE ought to have used its "corrected" study of 28 July. As has already been explained, the regulatory framework contained no provision that would allow the consultant firm to correct the study and submit it for the "approval" of the Expert Commission. The only scenarios

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distribution network. The annuity shall be calculated on the basis of the typical useful life of distribution facilities and the annual updating rate that is used in the calculation of the tariffs. The operating and maintenance cost shall be that of an efficiently managed benchmark distribution network." (Emphasis added.)

279 Tr. (English), Day Six, 1418:18-1419:17; Direct Examination of Mario Damonte, Slide 17.

280 Letter from Carlos Colom Bickford to Luis Maté, 30 October 2007, **Exhibit R-236;** Letter from Miguel Calleja to Carlos Colom Bickford, 6 November 2007, **Exhibit R-237,** pp. 1-2.

281 Emails between M. Peláez and J. Riubrugent, various dates, **Exhibit C-496**.

282 Tr. (English), Day Four, 792:18-20, Bastos.

provided for under the law were (1) that the Expert Commission would "pronounce itself" on the discrepancies; and (2) that the CNEE would (i) modify the distributor's study so that it would comply with the Expert Commission's pronouncements, or (ii) reject the study and establish the rates based on its consultant's study.[283]

191. But aside from this legal question, the 28 July Bates White study could not serve as the basis for setting the tariffs because, as explained below, it failed to incorporate all the Expert Commission's pronouncements, and also contained the FRC proposed by the Expert Commission that, as explained above, was technically incorrect.

1. The 28 July Bates White study failed to incorporate all of the Expert Commission's pronouncements and continued to result in an overstated VNR and VAD

192. To demonstrate that the 28 July study failed to incorporate all of the pronouncements issued by the Expert Commission and produced overinflated results, Guatemala asked Mr. Damonte to conduct the same exercise as Mr. Giacchino (incorporating the pronouncements into the 5 May study). Based on said instructions, Mr. Damonte proceeded to incorporate all the possible and economically relevant pronouncements.[284] The value Mr. Damonte obtained was US$ 629 million in VNR, rather than the US$ 1,053 million calculated by Bates White:[285]

193. With respect to the VAD, even using the FRC proposed by the Expert Commission, which contained serious technical errors discussed above, contained serious technical errors, the value estimated by Mr. Damonte was US$ 184 million per year, contrasted with the US$ 261 million per year calculated by Bates White.[286] This substantial difference between the VNRs and VADs shows the extreme inflation of values in the Bates White study.

194. During the Hearing, counsel for TGH asked Mr. Damonte why he failed to incorporate all the pronouncements just as they had been issued.[287] The reason Mr. Damonte was unable to

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283 RLGE, **Exhibit R-36**, Article 98.

284 Tr. (English), Day Six, 1413:12-1414:1, Damonte.

285 Direct Examination of Mario Damonte, slide 12. Damonte, **Appendix RER-2**, para. 173; Damonte Rejoinder, **Appendix RER-5**, paras. 195-196, 271.

286 Direct examination of Mario Damonte, slide 14. Damonte, **Appendix RER-2**, para. 171, Table 5; Damonte Rejoinder, **Appendix RER-5**, para. 195, Table.

287 Tr. (English), Day Six, 1462:3-20, Damonte.

incorporate all the pronouncements was because in many cases the Expert Commission had indicated that more information was needed,[288] or that EEGSA needed to justify that the option selected was the most efficient.[289] Moreover, as Mr. Damonte explained at the Hearing, he was unable to conduct an optimization audit of the model as it was not an auditable model. However, as Mr. Damonte rightly explained, incorporating these pronouncements would regardless only have served to bring the VNR and VAD down lower than the values he calculated.[290] In this context, Mr. Damonte's report is, in any event, conservative, as evidenced by, for example, the fact that the values calculated by Mr. Damonte are even higher than the proposal made by Mr. Pérez a few months earlier, which was US$ 175 million.

195. At the Hearing, counsel for TGH also questioned the fact that Mr. Damonte failed to analyze and give his opinion with regard to the 28 July study directly.[291] The reason for this as explained by Mr. Damonte at the Hearing, was that such an exercise would have been extremely complicated:

> And I did this in certain cases. Well, it was much, much more complex. Well, imagine, you take the study of July 28. I'm going to check if the $3 million of arbitrations that were put into question by the CE are or not included in the VAD, which is the ultimate thing that you want to reach. So, I looked at the spreadsheet. It takes me to another spreadsheet. The name is changed. The figures change, instead of saying 3 million it is changed to a monthly value, it adds interests as if it was paid in installments, it gives a different value, and it calls it a different name, and it's called gerencia de ingresos, and from that value it takes me to another spreadsheet and multiplies it by 12, it's $700,000 a year, and that figure is included as professional services or things like that. And it's very, very complicated. It took me four to five hours to just look at that figure, so the study of July 28 was not prepared to make revisions easy for the auditor. It was to make revisions more difficult for the auditor. So, I took the May 5th study, and I changed the results and it took me five minutes. And I encountered the same problems of being able to audit. They say that the models are linked. You have the names of the links. But you have to look for the files. It's not that you have one single book and everything is integrated. No. In order for us to be able to review all of this, we had to integrate all of the spreadsheets

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288 Report of the Expert Commission, 25 July 2008, **Exhibit R-87**, page B.1.a ("Reference Prices"), F.1 ("Costs of the Proposed Operations"), F.3 ("Costos Directos") and F.6 ("Costs of non-electric and tangible assets").

289 *Ibid*., Discrepancy B.2 ("Labor"), pp. 48-49 and Discrepancy B.3 ("Vehicles and Setup"), p. 51.

290 Damonte, **Appendix RER-5**, para. 242.

291 Tr. (English), Day Six, 1447:8-1448:6, Damonte.

> into one to be able to follow up all the hyperlinks. We're talking about hundreds of different models and spreadsheets and what not.[292]

196. It should be noted that as Mr. Damonte explained during the Hearing, even if he had undertaken a review of the 28 July study in comparison with the Expert Commission's pronouncement, the result "should have been exactly the same"[293] as the review he actually conducted.

2. Mr. Bastos' approval has no effect on this conclusion since as he acknowledged at the Hearing, he did not review the 28 July Bates White study to verify that it was consistent with the Expert Commission's pronouncement

197. Mr. Bastos was presented by TGH in this arbitration to explain how Bates White had incorporated the pronouncements of the Expert Commission into its study of 28 July 2008. According to Mr. Bastos, he gave his so-called "approval" of the study after a series of meetings held between 30 and 31 July 2008 with Mr. Giacchino and his team. The meetings took place at the Bates White offices in Washington, DC, where Mr. Bastos had traveled, with all expenses paid by Bates White (that is, EEGSA).[294]

198. Ignoring the legal irrelevance of such "approval," it would have been impossible within this short time frame to do much more than "validate" the affirmations of Mr. Giacchino and his team regarding their changes.[295] For example, whereas Mr. Bastos spent barely two days reviewing the study, Mr. Barrera acknowledged at the Hearing that his review of the incorporation of the pronouncements took him and his team approximately a month and a half.[296] Proper verification of some of the pronouncements alone would have taken several days.[297]

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[292] *Ibid*., 1414:7-1415:15.

[293] Tr. (English), Day Six, 1414:6-8, Damonte.

[294] Tr. (English), Day Four, 765:14-16 and 766:12-13, Bastos.

[295] *Ibid*., 764:16-765:5 and 767:7- 768:12.

[296] Tr. (English), Day Six, 1361:18-19, Barrera.

[297] One example is sufficient for illustrating the scope of Mr. Bastos' approval. Expert Commission Pronouncement No. B.1.a requested the submission of international reference prices so as to be able to verify that the prices included in the Bates White model were the most efficient. To verify that the 28 July Bates White model actually included efficient prices, Mr. Bastos ought to have printed a PDF file (that allegedly contained the 498 prices that were needed) and checked the prices contained in the database one by one and compared them to those included in the Bates White model to determine whether or not the prices chosen

199. During his cross-examination, Mr. Bastos confirmed the superficial nature of said *approval*. Mr. Bastos began by admitting that he had not reviewed the written report containing the substance of the tariff study:

> Q. How many pages did the Bates White report have, the one dated June 28th?
> A. Well, that was a very thick binder, similar to the one that I have here in front of me. I do not remember the number of pages, but I did not review written documents. I focused on the computer models.
> Q. So, you're saying that you did not review any written reports?
> A. No, I was unable to review the written report.[298]

200. According to Mr. Bastos, his failure to review the study itself did not affect the quality of his review, since according to him he reviewed "each one of the Excel model spreadsheets":

> Q. So, when you reviewed the Bates White's revised study, were you able to determine that all of the steps were corroborated and that the models could be traceable?
> A. Yes, I did corroborate that. After the report was submitted, I was in Washington for two days--I don't remember the date exactly, but I was there at the offices of the consultant, and I was looking at how each one of those decisions made by the Commission was incorporated into the computational models. I verified specifically in each one of the Excel model spreadsheets which had been the cells that had been changed and how the models had been affected.[299]

201. However, it is untrue that Mr. Bastos reviewed the spreadsheets for the models. When questioned regarding this matter during the *Iberdrola* arbitration, Mr. Bastos admitted that he had not been able to review said spreadsheets and models:

> At no time did I attempt to say that I have been able to review the 137 Excel models and all of the steps in their calculation or the thousand and so pages that constitute the final report, and I am saying this clearly […] the model itself prevent me from following in detail all the steps in the calculations that were performed.[300]

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were the most efficient. Moreover, he would have to do this without having access to an electronic database like the one the Expert Commission had requested. (*See* Rejoinder, para. 161).

298 Tr. (English), Day Four, 768:7-16, Bastos.

299 *Ibid*., 732:8-21.

300 Transcript for the final hearing of ICSID Case No. ARB/09/5 (extracts), **Exhibit R-140**; Tr., Day Two, 635:13-20, Bastos.

202. Even Mr. Giacchino himself acknowledged that Mr. Bastos ought to have at least read the most important parts of the report.[301] But he failed to do so. If he had, he might have noticed, for example, that the 28 July Bates White study referred to five pronouncements as having been issued in EEGSA's favor when in reality they had been in the CNEE's favor.[302] Further evidence of the superficial nature of his review is that Mr. Bastos was unable to explain why EEGSA's 28 July study continued to request over US$ 3 million in "arbitration fees" for a non-existent arbitration, even after the Expert Commission pronounced against the inclusion of such fees in the VNR.[303]

203. In summary, it is clear that any review undertaken by Mr. Bastos during his brief stay in Washington DC was minimal. In the two days of Mr. Bastos' "review," he could do no more than confirm what Mr. Giacchino *told him* he had done. It is clear that such an *expedited* approval by Mr. Bastos could not serve to approve the study for tariff purposes.

3. Mr. Barrera's report also has no effect on this conclusion since it was based on the information provided by Mr. Giacchino and his "own" interpretation of the pronouncements of the Expert Commission

204. Recognizing the weakness of Mr. Bastos' *expedited* approval and Mr. Giacchino's "self-approval" of the 28 July study, TGH decided to hire Mr. Barrera as an expert to certify that all of the Expert Commission's pronouncements were incorporated into the 28 July study. For the reasons outlined below, Mr. Barrera's evidence not only confirms that the 28 July study did not incorporate all of the pronouncements, but also shows that the CNEE had no way of corroborating whether in fact it had.

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[301] Tr. (English), Day Five, 948:7-15, Giacchino:

> Q. And the caveat was the one that you see here that begins, "The extension and complexity of the model in itself have prevented me following in detail all of the calculation steps that have taken place."
> A. Yes. There is over 200 files total, so he didn't go through all the 200 files.
> Q. Okay.
> A. He only went through the modifications to the model.

[302] Counter-Memorial, para. 431.

[303] Tr. (English), Day Four, 777:14-16, Bastos.

> A. My answer is that I don't know why these three millions are here. I don't know why they were kept here.

205. First, as Mr. Barrera openly admitted in his report[304] and verbally confirmed at the Hearing, in order to reach his conclusion that "the 28 July 2008 Bates White study fully implemented the EC Report decisions,"[305] Mr. Barrera consulted with Mr. Giacchino himself,[306] whom, moreover, he has known for more than 10 years.[307] In light of these circumstances, Mr. Barrera's express opinion loses all credibility.

206. Second, Mr. Barrera himself admitted in his report—and confirmed at the Hearing—that certain pronouncements of the Expert Commission had not been incorporated into the 28 July study. For example, Mr. Barrera admitted that not all of the international reference prices required by the Expert Commission had been included.[308] Although he attempted to justify this by pointing to some explanations for missing prices, he admitted that an explanation was not provided in all cases. In such cases, Mr. Barrera's excuse was that these prices were not used in the study.[309] As was established at the Hearing, the CNEE would have had to undertake an extremely complicated exercise to identify and confirm which prices had not been used.[310]

207. Third, Mr. Barrera also acknowledged at the Hearing that he did not verify the traceability of the entire model, as required by the Expert Commission in its pronouncement on Discrepancy 1.[311] The only thing he supposedly verified was the traceability of the changes that Bates White made in the 28 July study.[312] It is worth clarifying, however, that Mr. Bastos, the President of the Expert Commission, confirmed during the Hearing that Discrepancy 1 required the entire model to be traceable and not just the most recent modifications, as Mr. Bastos claimed:

> What the Commission determined or decided in connection with this discrepancy is that all of these steps had to be corroborated and that the

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304 Barrera, **Appendix CER-4**, para. 69.

305 *Ibid*., para. 65.

306 Tr. (English), Day Six, 1326:7-1326:16, Barrera.

307 Tr. (English), Day Six, 1325:18-1326:6, Barrera.

308 *Ibid*., 1363:9-15. Barrera, **Appendix CER-4**, para. 79.

309 Tr. (English), Day Six, 1363:16-1364:-6, Barrera. Barrera, **Appendix CER-4**, para. 79.

310 Tr. (English), Day Six, 1364:11-1365:15, Barrera. Barrera, **Appendix CER-4**, note on page 47.

311 Report of the Expert Commission, 25 July 2008, **Exhibit R-87**, Discrepancy 1.

312 Tr. (English), Day Six, 1351:14-1352:1 and 1360:8-14, Barrera.

> models could be traceable; that is to say, that the process could be followed from the data to the results.[313]

208. The requirement that the entire study be traceable is to allow the CNEE and any interested third party to audit the entire tariff study. The "partial" traceability suggested by Mr. Barrera was not sufficient for the CNEE. It is worth recalling that as a public authority responsible for setting the tariffs for the Guatemalan citizens, the CNEE had a duty to verify that the components of the study were consistent with the regulatory framework. It is therefore clear that the limited review conducted by Mr. Barrera is insufficient to claim that the 28 July study reflected all of the Expert Commission's pronouncements.

209. Moreover, Mr. Barrera's opinion that the 28 July VNR was reasonable was not based on a complete analysis of the study, but rather an analysis of the latest modifications, as he confirmed in his response to a question asked by arbitrator von Wobeser:

> Arbitrator von Wobeser: […] You only saw whether the recommendations were included or not. They were combinations of the CE?
> Barrera: Yes, exactly. We did not conduct a review of the May model.
> Arbitrator von Wobeser: When you say that they are reasonable, you reached the conclusion that they were reasonable. Based on what?
> Barrera: On the basis of what the CE was requesting.
> Arbitrator von Wobeser: So, they're reasonable because they included the recommendations, not because of the results obtained?
> Barrera: Yes, that's correct.[314]

210. As explained in greater detail below (Section III.F), contrary to what Mr. Barrera says, the 28 July VNR and the VAD values were not reasonable.

211. Lastly, it is worth pointing out that Mr. Barrera worked on models that had undergone modifications after 28 July 2008, the date that the study was delivered to the CNEE. In fact, fifteen percent of all the files contained in the model reviewed by Mr. Barrera had file modification dates that were after 28 July.[315] Mr. Barrera acknowledged at the Hearing that he did not check the dates or notice the modifications made to the models on which he worked.[316]

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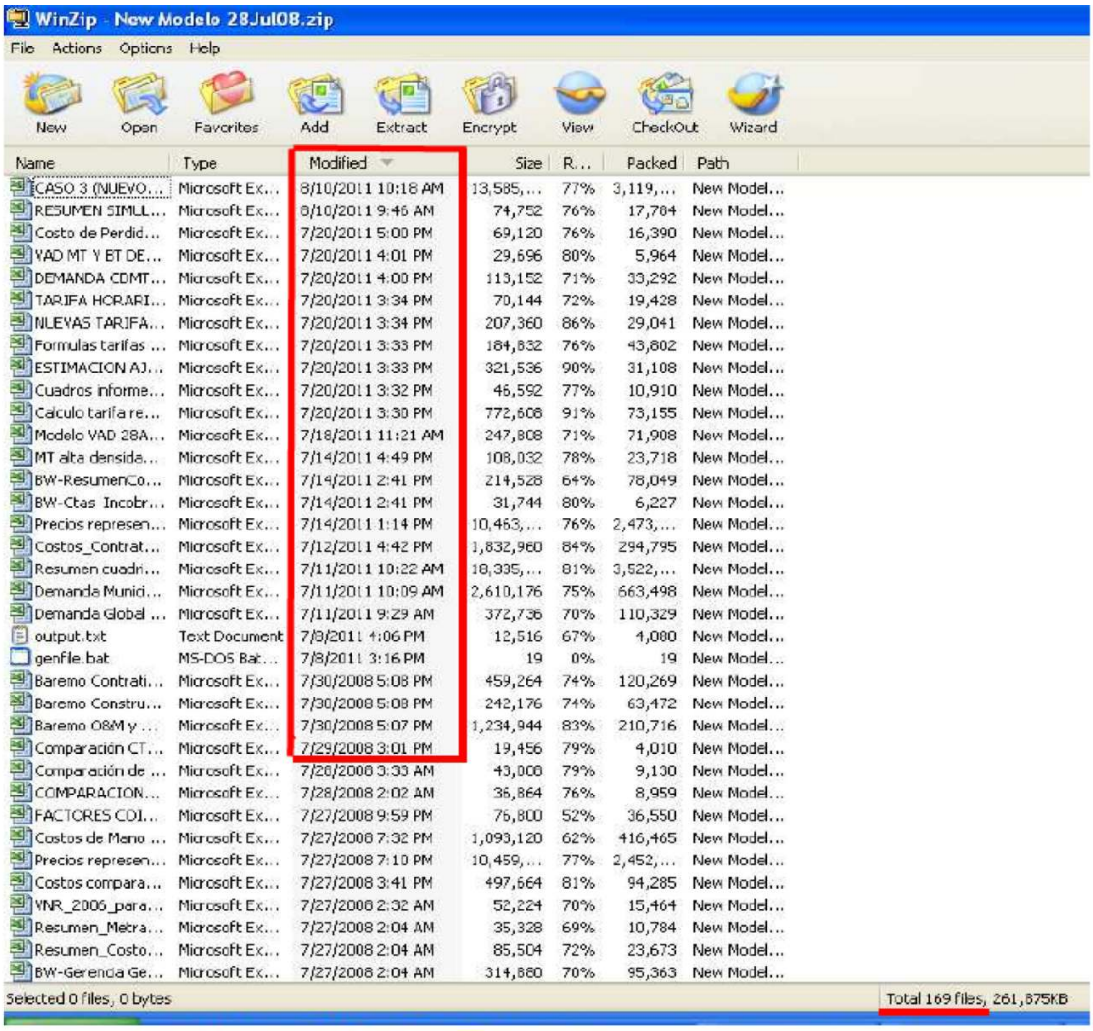
313 Tr. (English), Day Four, 731:21-732:3, Bastos.

314 Tr. (English), Day Six, 1376:9-1377-1, Barrera.

315 *See* Bates White Study of 28 July 2008, **Exhibit C-564**. When the files are organized by modification date, it is clear that the following files have modification dates later than 8 July 2008: CASO 3 (NUEVOS



212. In light of this evidence, Mr. Barrera tried to justify the file modification dates by saying that although he had not analyzed the matter, and was not a systems expert, he believed it was possible for a file's modification date to change without the content of the file actually having changed.[317] However, that is not the case here. While the model reviewed by Mr.

FACTORES, EQUIVALENCIA Y PRECIOS.xls; RESUMEN SIMULACIONES.XLS; Costo de Perdidas Estudio Tarifario.xls; VAD MT Y BT DEF 010508; DEMANDA CDMT Y CDBT 2006-2007-DEF CPercial.xls; TARIFA HORARIA; NUEVAS TARIFAS revmayo2008 DEF.xls; Formulas tarifas 120308 amarillo mod 010508.xls; ESTIMACION AJUSTES TRIMESTRALES AGOSTO.xls; Cuadros informe de tarifas010508.xls; Calculo tarifa reconexiones.xls; Modelo VAD 28Abr08.xls; MT alta densidad.xls; BW-ResumenComercial_v4.xls; BW-Ctas Incobrables v2.XLS; Precios representativos 05May08.xls; Resumen cuadriculas 21Mar08.xls; Demanda Municipios 20080221.xls; Demanda Global 25Jan08.xls; Baremo Contratisa – Informe final – 28.07.08.xls; Baremo Construccion y Montaje – Informe Final – 28.07.08.xls; Baremos O&M y Comercial para Informe Final 28.7.08.xls; and Comparación CT en esquina.xls.

316 Tr. (English), Day Six, 1368:10-1369:19, Barrera.

317 *Ibid.*, 1375:10-14.

Barrera (Exhibit C-564) contained 169 files,[318] the document provided to the CNEE (Exhibit R-182) contained only 163 files.[319]

213. It is therefore clear that this was not a matter of merely "opening and closing the files" as Mr. Barrera tried to claim, but rather of incorporating additional documentation into the model.

214. The foregoing are only some examples (highlighted during the limited time available at the Hearing) but they alone are sufficient to confirm that Mr. Barrera's opinion that the 28 July study "completely" incorporated the pronouncements of the Expert Commission is neither correct nor reliable.

4. Mr. Kaczmarek's report also has no effect on this conclusion since it was based on the information provided by Mr. Giacchino

215. TGH attempted to bolster its case by asking Mr. Kaczmarek to confirm that the 28 July study incorporated all the Expert Commission's pronouncements. Thus, Mr. Kaczmarek on several occasions explained that "*Bates White incorporated in its 28 July 2008 report the Expert Commission's rulings on the discrepancies*."[320] However, as has already been stated, Mr. Kaczmarek admitted during cross-examination that he had not performed any analysis whatsoever of the 28 July study and had based this confirmation on the word of the author of the report himself, Mr. Giacchino.[321] He did so despite criticism from Guatemala's experts throughout the proceedings, namely his "blind" use of the 28 July study and the Expert Commission's FRC.[322]

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[318] Model accompanying the revised Bates White Study of 28 July 2008, **Exhibit C-564**; slide 11, examination of Mr. Barrera.

[319] Bates White, Value-Added for Distribution Tariff Study (Chart) of 28 July 2008, **Exhibit R-182**; slide 12, examination of Mr. Barrera.

[320] Kaczmarek, **Appendix CER-2**, para. 126. *See also* paras. 13, 101, 113, 125.

[321] Tr. (English), Day Six, 1521:2-1521:8, Kaczmarek:

> Q. […] [B]asically you take that [it] is correct because it's Giacchino opinion?
>
> A. Yes, that's correct. I understand that Guatemala contests that, but I've not offered any opinion because I haven't done any work to check whether or not all of the Expert Commission's findings were incorporated.

[322] M Abdala and M Schoeters, **Exhibit RER-1**, paras. 4(b) and 48; M Abdala and M Schoeters, **Exhibit RER-4**, para. 6.

216. In conclusion, it is clear that the 28 July study did not contain all of the Expert Commission's pronouncements. The study was neither reliable nor auditable and reflected extremely overstated VNR and VAD values. TGH's efforts to obscure this reality with expert opinions drafted for purposes of this arbitration are not enough to reverse this conclusion.

F. UNLIKE THE TARIFFS PROPOSED BY EEGSA, THE TARIFFS SET BY THE CNEE WERE REASONABLE

1. Sigla's tariffs were reasonable and consistent with regional trends

217. When the CNEE received confirmation from the Expert Commission that the 5 May study failed to respect the Terms of Reference with regard to more than 50% of the discrepancies, the CNEE had only two options under the regulations: correct the 5 May study if possible or use the study conducted by the independent consultant Sigla.[323] As has been shown, the first option was not viable. According to the Expert Commission's pronouncement, the 5 May study was not auditable and to conduct an audit and make the appropriate changes would have taken at least a couple of months.[324] It is worth remembering that during the Hearing, Mr. Barrera admitted to having worked with a group of four people for a month and a half, and with the help and guidance of Mr. Giacchino,[325] in his attempt to incorporate the pronouncements.

218. Under such circumstances, the CNEE had no choice but to resort to the parallel study conducted by the consultant firm Sigla. It is worth recalling that the purpose of the CNEE's independent study was to serve as an escape valve to prevent distributors from pushing the regulator against the wall and forcing it to approve the only available study despite its incompliance with the regulatory framework. This is not new to the regulations. As Mr. Aguilar correctly explained, the CNEE's authority to conduct its own study was incorporated into Article 5 of the LGE from the beginning:

> As a consequence, the issue here is that a tariff scheme was approved and the legal opinion that is supporting that approval is based on a study that is what has always been stated in the law so as to guarantee the objectivity of

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323 Tr. (English), Day Five, 1055:15-1056:6, Moller.

324 Damonte, **Appendix RER-2**, footnote 63.

325 Tr. (English), Day Six, 1361:1-1362-13, Barrera.

> the tariffs. The Commission should always refer to the study. The study could be requested to another Party or could be the one developed mandatorily by the Distributor. It is very important to mention that everyone has looked at article 74 and 75, but no one paid attention to article 5. Article 5, that is the origin of the law, gives the powers to the National Commission on Electricity to request its own studies.[326]

219. Specifically, Article 5 provides:[327]

> [...] The Commission may commission professional advice, opinions and expert reports needed for the discharge of its functions. […].

220. In light of this clear legal provision, any argument put forth by TGH with regard to any alleged arbitrariness on the part of the CNEE in using its own consultant's study must be rejected.

221. The arguments of alleged arbitrariness are also discredited by the fact that Sigla was not an *ad hoc* consultant to the CNEE, but was selected from the pool of consultants that could also have been hired by the distributors.[328] In fact, EEGSA had previously hired Sigla in the 2003-2008 tariff review, and EEGSA itself acknowledged it had been "very satisfied" with Sigla's work.[329] Moreover, the Sigla study was conducted on the basis of the Terms of Reference and the available information provided by EEGSA. Just as it did with the Bates White study, the CNEE provided comments to Sigla's stage studies.[330] Lastly, Sigla also drafted similar studies for Deorsa and Deocsa (it was not necessary to use these for purposes of setting their tariffs), which demonstrates the transparency and consistency of the CNEE's actions. The fact is that in more than 40 tariff reviews,[331] this was the only time discrepancies arose with the distributor that could not be settled, making it necessary for the CNEE to use the study drafted by the independent consultant.

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326 Tr. (English), Day Five, 1255:20-1256:11, Aguilar.

327 LGE, **Exhibit R-8**, Article 5.

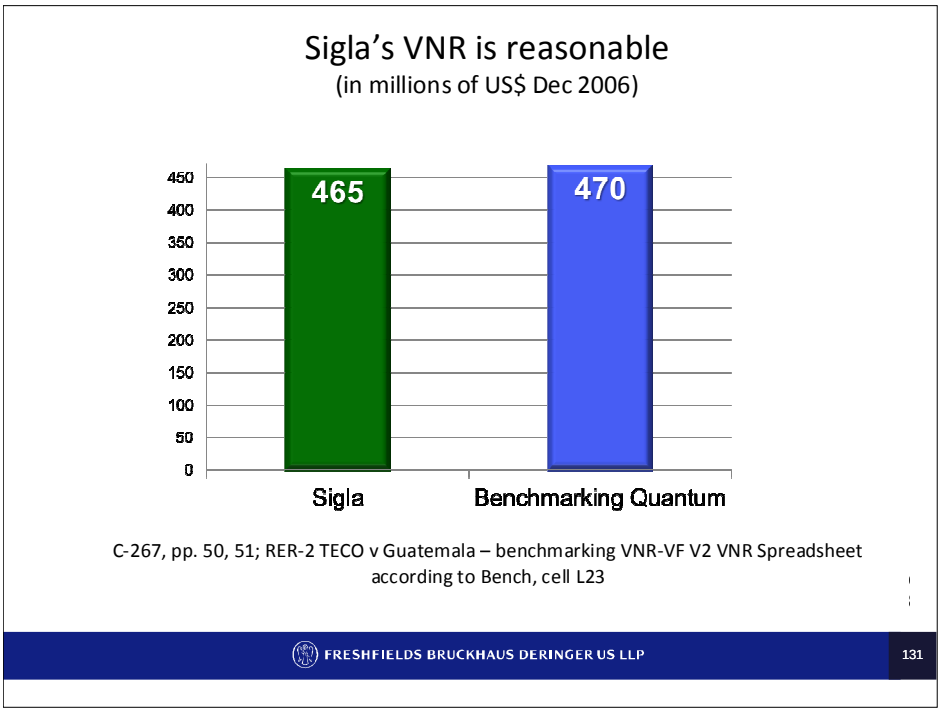
328 Tr. (English), Day Five, 1056:2-6, Moller.

329 Sigla S.A. – Electrotek S.A, Technical Offer to Participate in the Supervision of Load Characterization Studies (ECC) and the Components of the Value-Added for Distribution (EVAD), 15 October 2007, **Exhibit R-45**, pp. 46-47, (attaching letter from Miguel Francisco Calleja, Planning and Control Manager, to Luis Sbertoli, President of Sigla, 13 October 2005).

330 Tr. (English), Day Five, 1143:14-20, Colom.

331 Tr. (English), Day One, 201:8-12, Respondent's Opening Statement.

222. Regardless of the legality of the Sigla study, its values were reasonable. Sigla's VNR is consistent with other VNRs in the region, as evidenced by the benchmarking study drafted by Mr. Damonte comparing the VNRs of more than 60 companies in the region:[332]



223. Moreover, the tariffs set by the CNEE based on the Sigla tariff study were reasonable in light of the tariffs set at CAESS in El Salvador, which was the company that Guatemala used as a reference when setting its first EEGSA tariffs, these tariffs being those upon which Teco based its projections:[333]

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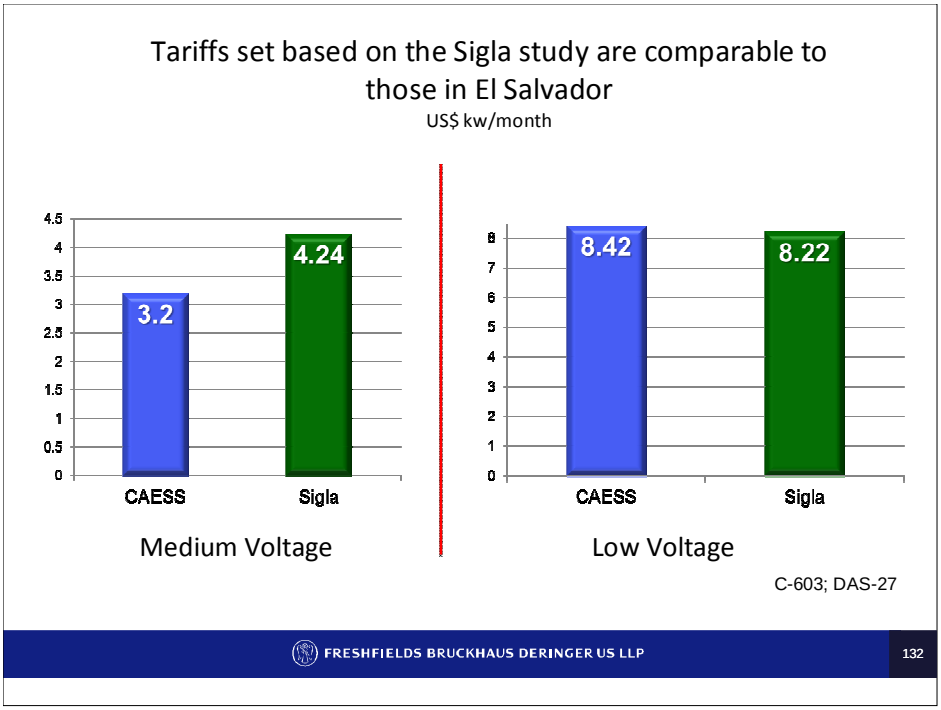
[332] Respondent's Opening Statement, slide 130. Damonte, **Appendix RER-2**, para. 255.

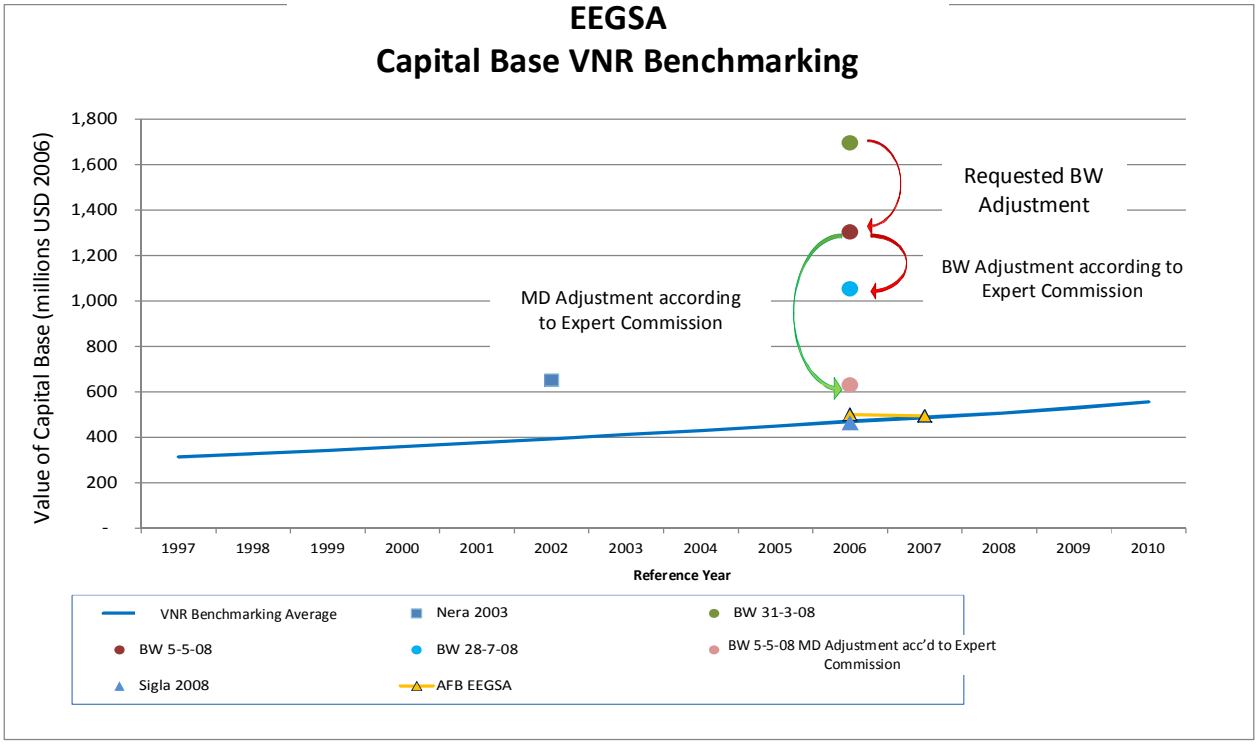
[333] Respondent's Opening Statement, slide 131; Tr. (English), Day One, 328:17-329:14, Respondent's Opening Statement; Rejoinder, para. 464.



2. The tariffs proposed by EEGSA in the 28 July study were excessive

224. Unlike the VNR and VAD values proposed by Sigla, the VNR and VAD values proposed by Bates White were excessive and far removed from values in the region. As Mr. Damonte's benchmarking study shows, Bates White's VNR of 28 July was 124% higher than the regional average:[334]

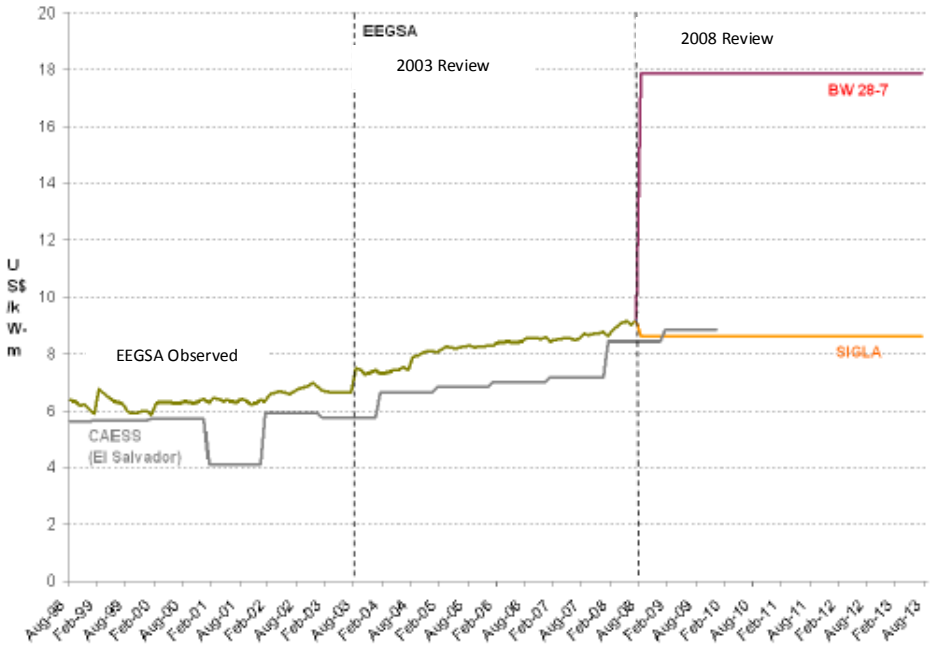
[334] Damonte, **Appendix RER-2**, Figure 5.



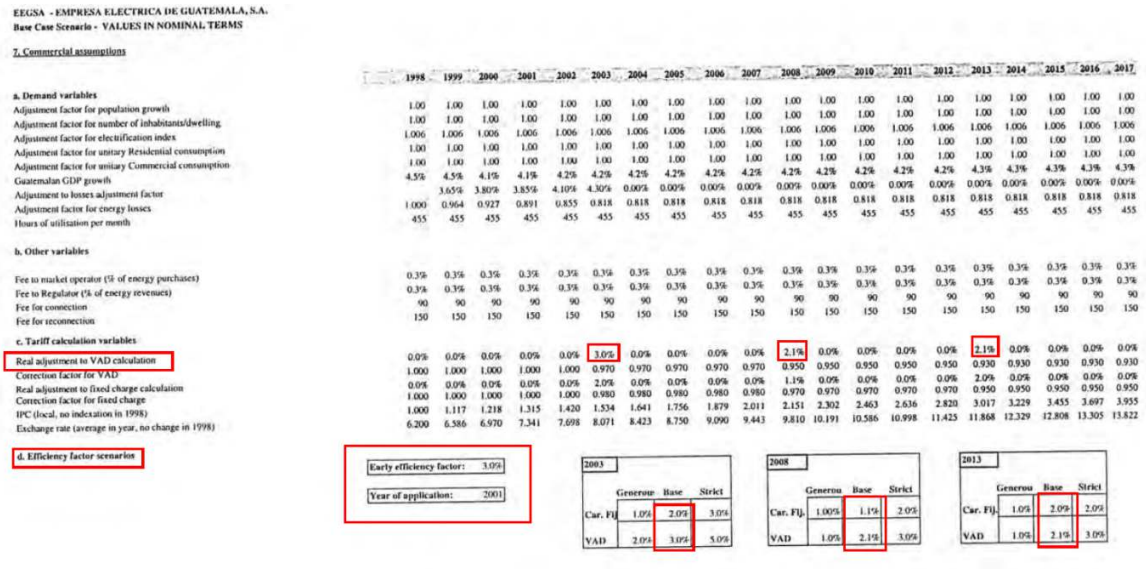
225. Moreover, the tariffs that EEGSA intended to use would also have been significantly higher than those of CAESS,[335] as shown in the figure below:

[335] Abdala and Schoeters, **Appendix RER-1**, Section IV.2.2.

Low Voltage (LV) VAD) - EEGSA vs. CAESS (El Salvador)[1033]



226. Even more importantly, the VAD evolution suggested by EEGSA greatly exceeded the values projected by Teco at the time of privatization. As shown below, at the time the investment was made, the consortium's consultant projected that <u>the VAD would go down in real terms</u> at each tariff review, once the efficiency factors were included in the calculation:[336]



EEGSA - EMPRESA ELECTRICA DE GUATEMALA, S.A.
Base Case Scenario - VALUES IN NOMINAL TERMS

7. Commercial assumptions

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
a. Demand variables																				
Adjustment factor for population growth	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Adjustment factor for number of inhabitants/dwelling	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Adjustment factor for electrification index	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006	1.006
Adjustment factor for unitary Residential consumption	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Adjustment factor for unitary Commercial consumption	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Guatemalan GDP growth	4.5%	4.5%	4.1%	4.1%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.3%	4.3%	4.3%	4.3%	4.3%
Adjustment to losses adjustment factor		3.65%	3.80%	3.85%	4.10%	4.30%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Adjustment factor for energy losses	1.000	0.964	0.927	0.891	0.855	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818	0.818
Hours of utilization per month	455	455	455	455	455	455	455	455	455	455	455	455	455	455	455	455	455	455	455	455
b. Other variables																				
Fee to market operator (% of energy purchases)	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Fee to Regulator (% of energy revenues)	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Fee for connection	90	90	90	90	90	90	90	90	90	90	90	90	90	90	90	90	90	90	90	90
Fee for reconnection	150	150	150	150	150	150	150	150	150	150	150	150	150	150	150	150	150	150	150	150
c. Tariff calculation variables																				
Real adjustment to VAD calculation	0.0%	0.0%	0.0%	0.0%	0.0%	3.0%	0.0%	0.0%	0.0%	0.0%	2.1%	0.0%	0.0%	0.0%	0.0%	2.1%	0.0%	0.0%	0.0%	0.0%
Correction factor for VAD	1.000	1.000	1.000	1.000	1.000	0.970	0.970	0.970	0.970	0.970	0.950	0.950	0.950	0.950	0.950	0.930	0.930	0.930	0.930	0.930
Real adjustment to fixed charge calculation	0.0%	0.0%	0.0%	0.0%	0.0%	2.0%	0.0%	0.0%	0.0%	0.0%	1.1%	0.0%	0.0%	0.0%	0.0%	2.0%	0.0%	0.0%	0.0%	0.0%
Correction factor for fixed charge	1.000	1.000	1.000	1.000	1.000	0.980	0.980	0.980	0.980	0.980	0.970	0.970	0.970	0.970	0.970	0.950	0.950	0.950	0.950	0.950
IPC (local, no indexation in 1998)	1.000	1.117	1.218	1.315	1.420	1.534	1.641	1.756	1.879	2.011	2.151	2.302	2.463	2.636	2.820	3.017	3.229	3.455	3.697	3.955
Exchange rate (average in year, no change in 1998)	6.200	6.586	6.970	7.341	7.698	8.071	8.423	8.750	9.090	9.443	9.810	10.191	10.586	10.998	11.425	11.868	12.329	12.808	13.305	13.822

d. Efficiency factor scenarios

Early efficiency factor:	3.0%
Year of application:	2001

2003	Generous	Base	Strict
Car. Fij.	1.0%	2.0%	3.0%
VAD	2.0%	3.0%	5.0%

2008	Generous	Base	Strict
Car. Fij.	1.00%	1.1%	2.0%
VAD	1.0%	2.1%	3.0%

2013	Generous	Base	Strict
Car. Fij.	1.0%	2.0%	2.0%
VAD	1.0%	2.1%	3.0%

336 Dresdner Kleinwort Benson Valuation Model, **Exhibit R-160**, page 43.

227. Lastly, for purposes of comparison, it is worth noting that in the 2013-2018 tariff review that is currently underway, the VAD increase requested by the investor in its first tariff study are around 15%. This value is in marked contrast to the 250% increase requested by Bates White based on its first study of 31 March 2008 and even to the 58% proposed by the last study of 28 July.[337]

3. The principal differences between the Sigla and Bates White VNRs and VADs lie in the design of the construction units

228. During the Hearing, the Tribunal demonstrated its interest in understanding the major differences between the VNRs and VADs submitted by Bates White on 28 July and those of Sigla.[338] As confirmed by Messrs. Damonte and Barrera during the Hearing, the principal difference between the values in both studies lies in the design of the construction units, i.e., in how the network of the model company is constructed. Mr. Barrera explained:

> So, I think that there are a number of reasons why the two VNRs are different, but mostly they have to do with the construction units.[339]

229. Mr. Damonte confirmed:

> So, the significant differences that you're going to see in calculation are going to be not in the prices, rather in the design of the construction units. So, you have the block, you have the house. You were told that the house had to be large enough for three people, but one has a house that is 500-meters and the other one is 100 meters. So, what is the good one? Well, you need to look at the Regulations.[340]

230. Therefore, the issues most disputed by TGH in this arbitration proceeding, for example, the FRC or the price of materials used by Sigla in its study, are only part of the disagreements between the parties and are not even the principal ones.

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[337] *See* paras. 355 et seq.

[338] Tr. (English), Day Two, 400:2-21, Mourre.

[339] Tr. (English), Day Six, 1466:4-7, Barrera.

[340] Tr. (English), Day Six, 1469:1-12, Damonte.

Question from the Tribunal: What significance does the price of materials have in the different VADs submitted by Sigla and Bates White?

231. That being said, the Tribunal specifically asked during the Hearing what portion of the difference in value between the Sigla and Bates White VADs can be attributed to depreciation as opposed to other factors, such as materials, i.e., the price of aluminum and copper.[341]

232. First of all, it is important to point out that depreciation only affects the VAD, not the VNR, and that the price of aluminum and copper mainly affects the VNR. We will now explain, first of all, the effect of prices on the VNR and then the effect of the FRC on the VAD.

233. As previously explained, the difference of US$ 542.8 million between the VNRs calculated by Sigla and Bates White[342] is mostly due to the difference in the design of the construction units, i.e., the price of each unit and the number of units necessary to meet the demand of EEGSA. The following is a description of the difference in the value of the most significant components of the model companies prepared by each consultant and the reasons for such differences:

- In its 28 July study, Bates White includes twice as many Transformer Substations (CT) as Sigla, which adds a cost of US$ 172.9 million to the final VNR.[343]
- The unit cost of the medium- and low-voltage Urban Lines is two to three times greater in the Bates White study than in the one by Sigla, which results in a difference of US$ 133.9 million in the VNRs.
- The unit cost of the medium-voltage Rural and Urban Distribution Lines in the Bates White study is double that in the one by Sigla, which leads to a difference of US$ 88.8 million.

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341 Tr. (English), Day Two, 400:2-21, Mourre.

342 SIGLA *(VNR $_{Base\ Year}$= US$ 468.5 million not including Working Capital and Contributions or VNR $_{Base\ Year}$= US$ 511.2 million including Working Capital and Contributions)* and the study calculated by Bates & White in its report of 28 July 2008 (*VNR $_{Base\ Year}$= US$ 1,011.3 million not including Working Capital and Contributions or VNR $_{Base\ Year}$= US$ 1,053.98 million including Working Capital and Contributions).*

343 The Bates & White study doubles the number of necessary Transformer Substations by refusing to locate them at corners (where there are outputs for four power lines) and instead places them in the middle of each street, where only two power lines can be extended. It should be pointed out that the Expert Commission's pronouncement was in favor of the CNEE on this point, and asked Bates White "to compare the alternative chosen in the study with another that places the transformer substation close to the intersection that divides the low-voltage network into four outputs—one per street. The Expert Commission also recognized that EEGSA's actual distribution system had an average of 4.04 feeders per Transformer Substation, (Report of the Expert Commission, 25 July 2008, **Exhibit R-87**).

- The unit cost of the low-voltage Distribution Lines and Meters is double that of the unit costs in the Sigla study, and Bates White has double the number of medium-voltage distribution lines and they are 40% more expensive, which leads to a difference of US$ 56 million.

- Bates White has six times more voltage regulators and they are 50% more expensive, and four times more equipment for Large Users and each one costs twice as much, which results in a difference of US$ 50.2 million.

- The unit cost of the medium-voltage lines in the Bates White study is double that in the Sigla study. Bates White also includes additional underground lines that are not contemplated in the Sigla study, which leads to a difference of US$ 40.9 million.

234. These differences are summarized in the following table:[344]

Item	BW-Sigla VNR Difference (2006 USD million)	% of Total	Reason
Total Urban Transformers	173	31.9%	BW has twice as many Transformer Substations
Total Urban Networks (LV and MV)	134	24.7%	The BW unit cost is between 2 and 3 times
Total LV Distribution Lines and Meters	52	9.5%	The unit cost of BW's LV distribution lines is double
Total MV Rural Feeders	49	9.1%	The unit cost of BW's trunk lines is more than double
Total MV Urban Feeders	47	8.7%	Same as above
Total Non-Urban Networks	41	7.5%	The unit cost of BW's rural MV networks is more than double and also has underground networks that Sigla does not have
Total MV Equipment	28	5.1%	BW has 6 times more voltage regulators and they are 50% more expensive
Total Additional Installations for Large Users	23	4.2%	BW has 4 times more Large Users and at double the price
Total MV Distribution Lines and Meters	4	0.8%	BW has double the number of distribution lines and they are 40% more expensive
Total Rural Transformers	(8)	-1.4%	BW has 10% fewer Transformer Substations and they are 10% less expensive
Total VNR	543	100.0%	

235. Another telling example of the inflation of the 28 July VNR is the significant discrepancy between its construction units and the real construction units. Recall that the TGH experts themselves acknowledge that the real company cannot greatly diverge from the model company.[345] Yet this rule was not adhered to in this case. By way of example, while the 28 July study included 463 voltage regulators in the model company, in reality, EEGSA only has 10

[344] *See* slide of Direct Examination of Mario Damonte, slide 20.

[345] Barrera, **Appendix CER-4**, paras. 23, 38, 41 and 61.

voltage regulators.[346] This element alone reflects an overstatement of the VNR in the amount of US$ 30.69 million.[347]

236. Contrary to TGH's assertions, the difference in the price of raw materials used by Bates White and Sigla –particularly aluminum– is not a decisive factor in the difference in the VNRs. As can be seen below, the prices of Bates White's aluminum cables are less than those of Sigla and similar to those of Deorsa and Deocsa:[348]

Price of AWG 1/0 urban triplex braided line (USD/m)	
BW	13.151
Deocsa Deorsa	13.483
Sigla	16.576

237. As already explained, what are relevant are not the unit prices of the materials but how those materials are used by the consultants in the respective construction units. As can be seen in the following graph, if Sigla's prices are applied to Bates White's construction units, the value of the construction unit is practically unchanged (see columns one and two), but when the same prices are used in Sigla's construction unit (column 3), the value of the construction unit decreases drastically:[349]

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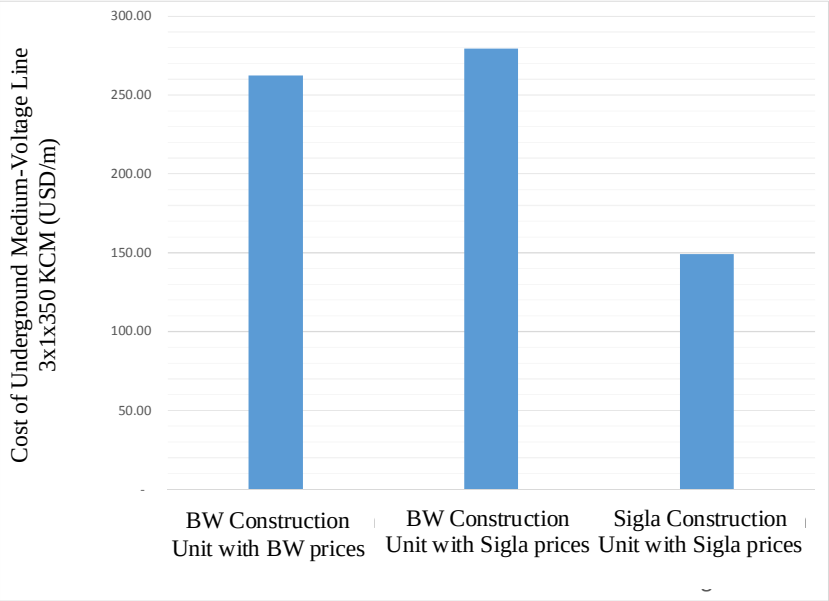
[346] Letter from EEGSA to Mr. Colom, 17 September 2007, **Exhibit R-235**.

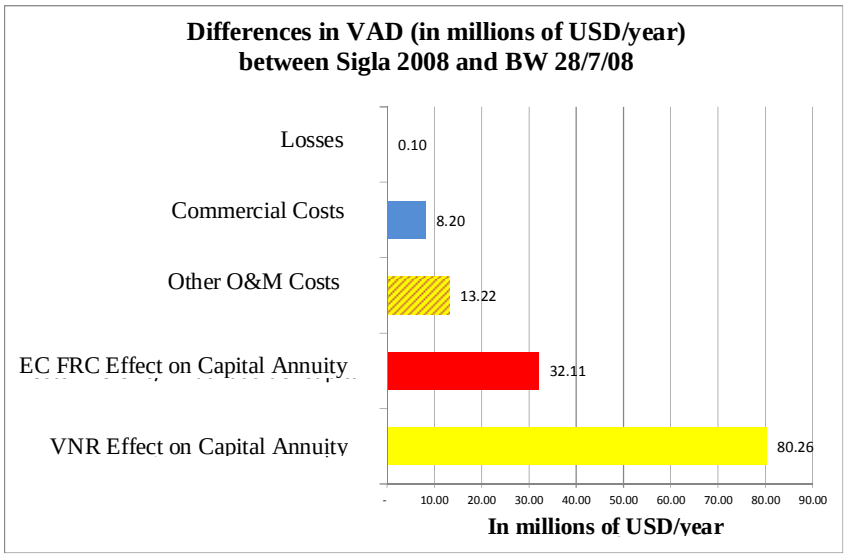
[347] Mario C. Damonte, "Analysis of Bates White 5-5-2008 and Recalculation of VNR and VAD based on the pronouncement of the Expert Commission," submitted in *Iberdrola Energía, S.A. v. Republic of Guatemala*, ICSID Case No. ARB/09/05, **Exhibit R-181**, para. 300.

[348] *See Ibid.*, slide 18. Tr. (English), Day Six, 1417:8-11, Damonte.

[349] *See* slide of Direct Examination of Mario Damonte, slide 19.



238. Having clarified the most significant differences in the VNRs, the following graph illustrates the principal differences between the Bates White 28 July VAD and the Sigla VAD:[350]



239. As can be observed in the graph, the major difference in VAD values is due to the VNR used to calculate the VAD. The higher the value of the VNR, the higher the resulting VAD will be. Meanwhile, the impact of purely applying one FRC over another is much lesser, as can be

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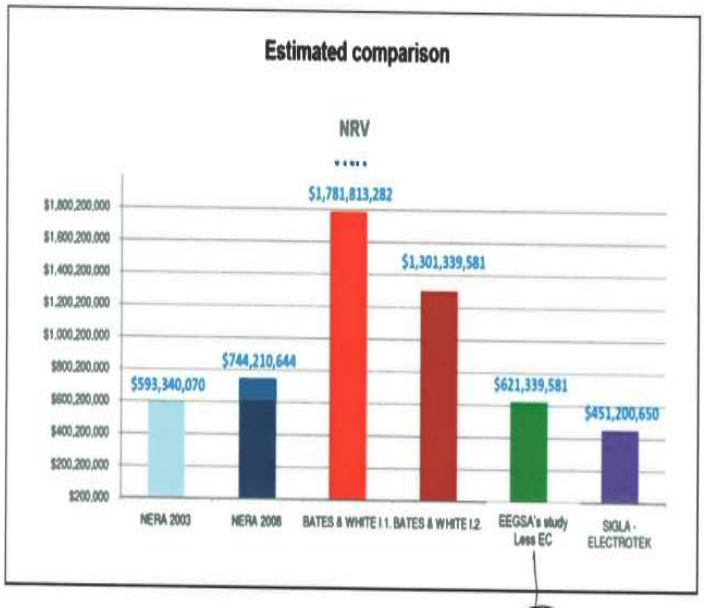
[350] *See also Ibid.*, slides 22 and 23. Tr. (English), Day Six, 1417:5-16, Damonte.

seen in the graph above. The remaining differences are the result of the costs and losses considered in each of the studies.

Question from the Tribunal: Why do the parties submit different figures for EEGSA's 2003 VNR?

240. Finally, in order to clarify for the Tribunal why the Claimant's VNR figures in slide 88 of its opening remarks differ somewhat from the figures submitted by the Respondent,[351] it should be noted that slide 88 of the Claimant's presentation contains figures for different dates and are therefore not directly comparable to each other.



241. With respect to the VNR figure of US$ 1,695 million submitted by the Respondent in its opening remarks,[352] this represents EEGSA's return VNR as of December 2006, as it appears in the Bates White study of 31 March 2008, expressed in US$ as of December 2006.[353] On the other hand, the US$ 1,781.8 million in Claimant's slide 88 represents the same VNR cited by Guatemala, but the investments made during 2007 have been added to it.[354] The figure of US$ 744 million in the Claimant's slide 88 likewise comes from the CNEE,[355] and

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351 Tr. (English), Day One, 214:8-22.

352 Tr. (English), Day One, 214:6-10, Respondent's Opening Statement.

353 Bates White, Value-Added for Distribution Study for EEGSA: Stage D Report: Annuity of the Investment, 31 March 2008, **Exhibit R-61**, p. 24.

354 *Ibid*., Chapter V, second paragraph, Results, p. 29.

355 Analysis of the Expert Commission Opinion, **Exhibit C-547**, p. 8.

represents (in US$ as of December 2006) the VNR that was calculated in the 2003 NERA study as being in the amount of US$ 584 million (expressed in US $ as of April 2002) and which was reflected in the NERA tariff study of July 2003.[356]

4. The direct impact on the consumer tariff is not as relevant as the impact on the return that EEGSA would have received if the 28 July study had been approved

Question from the Tribunal: What impact does the difference in the VAD have on the consumer?

242. During the Hearing, the Tribunal asked how the tariff paid by the consumer would change if, instead of applying the Sigla VAD (US$ 160 million per year), the CNEE had applied the Bates White VAD (US$ 252 million per year).[357]

243. As established by RLGE Article 83, the VAD is only one component of the final tariff that is charged to consumers. As an example, for low-voltage tariffs, while the VAD represents 14% of the total tariff billed to consumers, transportation represents 4%, losses 7% and generation costs 74%, so that an increase in the VAD does not directly generate a proportional increase in the tariff. However, on the basis of the Sigla VAD study, the tariffs charged to a typical user in the Low-Voltage Simple category (which represents the majority of EEGSA consumers) increased in 2008 by 2% over the tariffs in effect at the end of the prior tariff period. If the Bates White VAD from the 28 July VAD study had been adopted, the tariffs would have increased by 40% over the tariffs in effect at the end of the prior tariff period for the same users.[358] The comparison is shown in the following graph:[359]

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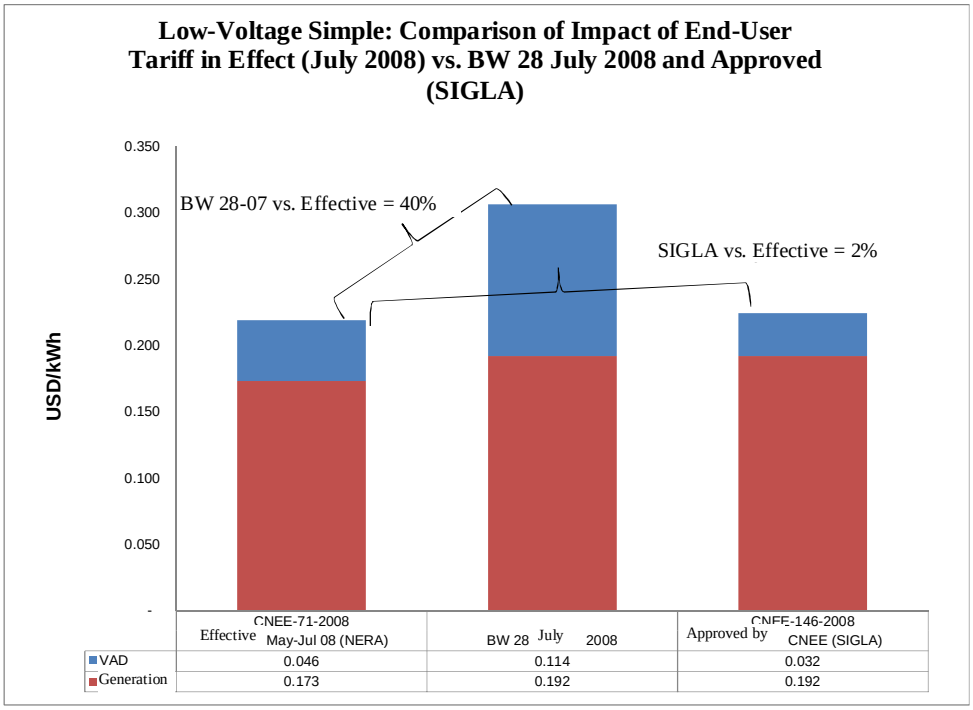
356 NERA, Stage C Report: Capital Component Calculation and Expansion Process, 30 July 2003, **Exhibit C-73**, pp. 1, 7, 10.

357 Tr. (English), Day One, 226:13-227:10 and Tr. (English), Day Two, 409:22-40:9, Mourre.

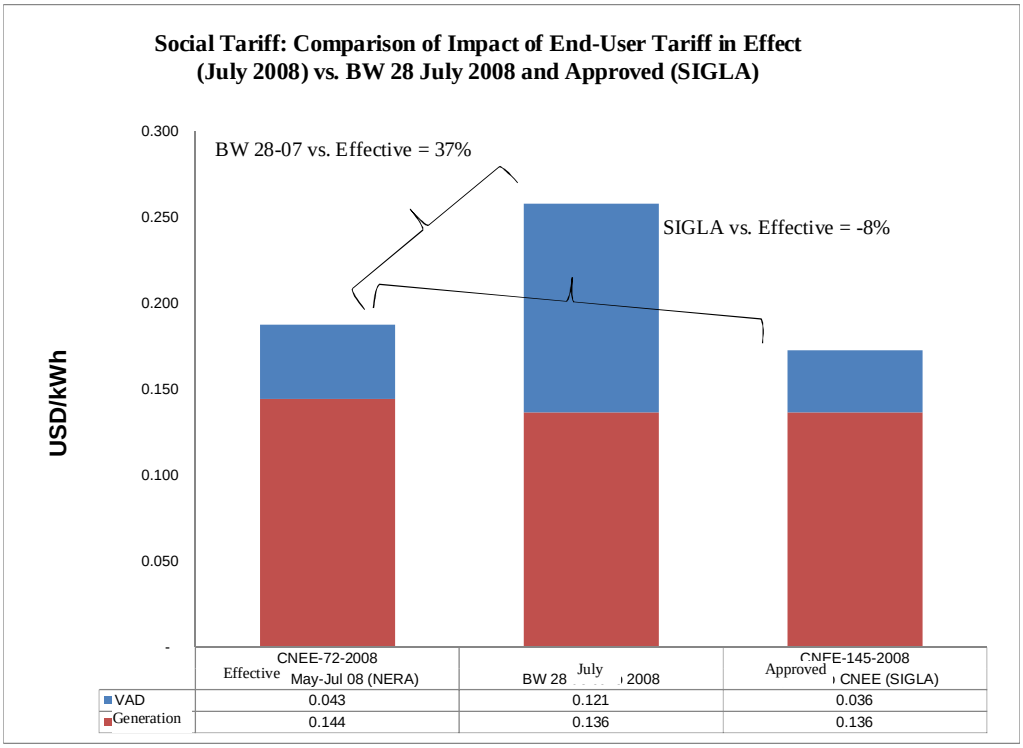
358 We include the graphs for the Low-Voltage Simple (BTS) and Low-Voltage Social Simple (BTSS) tariffs because they are the most representative. Together, these tariffs represent 98.9% of EEGSA users and 70.9% of the energy sold by EEGSA. Bates White, Value-Added for Distribution Tariff Study (Chart) of 28 July 2008, **Exhibit R-182**, Tables 4 and 5.

359 Calculated on the basis of average user monomial tariffs, based on data from the following resolutions or studies: Resolution No. CNEE-71-2008, 30 April 2008, **Exhibit R-240**, subsection I.III, p. 3 (converted into US$ at the exchange rate of Q 7.59615/US$ using the exchange rate of 30 June 2008); Bates White, Value-Added for Distribution Tariff Study: Stage I: Tariff Study, 28 July 2008, **Exhibit C-263**, pp. 93-94; Resolution No. CNEE-146-2008, 30 April 2008, **Exhibit C-274**.



244. The following graph shows the results for the Low-Tension Social Simple category:[360]

[360] Calculated on the basis of average user monomial tariffs, based on data from the following resolutions or studies: Resolution No. CNEE-71-2008, 30 April 2008, **Exhibit R-240**, subsection I.IV, p. 4 (converted into US$ at the exchange rate of Q 7.59615/US$ using the exchange rate of 30 June 2008); Bates White, Value-Added for Distribution Tariff Study: Stage I: Tariff Study, 28 July 2008, **Exhibit C-263**, pp. 93-94; Resolution No. CNEE-145-2008, **Exhibit C-274**.



5. The rate of return of other distributors has been more than satisfactory as a result of the tariffs approved in 2008 by the CNEE

Question from the Tribunal: How is it that Deorsa and Deocsa survived with apparently low tariffs?

245. During the Hearing, the Tribunal put this question to the parties: how were Deorsa and Deocsa able to survive with apparently low tariffs, without going into bankruptcy?[361] According to the public records pertaining to Deorsa and Deocsa, the internal rate of return of those companies between 2006 and 2010 was 10.4%. Between 2009 and 2010, the rate reached 13.2%.[362] The following graph shows the positive operating margin of these companies:

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361 Tr. (English), Day Two, 558:17-19, Mourre.

362 *See also* Deocsa 2006 and 2007 balance sheet audited by Deloitte, **Exhibit R-238**, pp. 3 and 4; Deocsa 2007 and 2008 balance sheet audited by Price Waterhouse, **Exhibit R-242**, p. 4; Deocsa 2008 and 2009 balance sheet audited by Price Waterhouse, **Exhibit R-245** pp. 3-5; Deocsa 2009 and 2010 balance sheet audited by Price Waterhouse, **Exhibit R-247**, pp. 3-5; Deorsa 2006 and 2007 balance sheet audited by Deloitte, **Exhibit R-239**, pp. 3-4; Deorsa 2007 and 2008 balance sheet audited by Price Waterhouse, **Exhibit R-243**, pp. 3-5; Deorsa 2008 and 2009 balance sheet audited by Price Waterhouse, **Exhibit R-246;** Deorsa 2009 and 2010 balance sheet audited by Price Waterhouse, **Exhibit R-248**, pp. 3-5.

	Ref.	2006	2007	2008	2009	2010
In thousands of US$						
DEORSA						
Operating Revenues	*a*	114.660	140.390	171.566	167.232	181.355
Operating Expenses	*b*	97.730	119.687	145.341	147.277	158.956
Operating Income (net profit)	*c = a + b*	16.930	20.704	26.225	19.955	22.399
Operating Margin	*c / a*	15%	15%	15%	12%	12%
Depreciations and amortisations	*d*	3.416	3.824	6.831	5.907	6.664
EBITDA	***c + d***	**20.346**	**24.528**	**33.056**	**25.862**	**29.062**
DEOCSA						
Operating Revenues	*a*	146.460	183.641	208.511	206.493	234.542
Operating Expenses	*b*	123.202	154.935	179.042	179.698	200.618
Operating Income (net profit)	*c = a + b*	23.258	28.706	29.469	26.795	33.923
Operating Margin	*c / a*	16%	16%	14%	13%	14%
Depreciations and amortisations	*d*	4.142	4.647	7.776	6.647	7.976
EBITDA	***c + d***	**27.399**	**33.353**	**37.245**	**33.442**	**41.899**

246. It is thus clear that the tariffs approved for those distributors, which were calculated following the same parameters and Terms of Reference applicable to EEGSA, were perfectly viable.

IV. GUATEMALA HAS NOT VIOLATED THE INTERNATIONAL MINIMUM STANDARD

A. THE TEST UNDER THE CAFTA IS DENIAL OF JUSTICE AND MANIFEST ARBITRARINESS

Tribunal's Question: What is the difference between the fair and equitable treatment standard and the international minimum standard? How do the claims and defenses of the parties interact with the wording of article 10.5, which provides for "customary international law," including fair and equitable treatment and full protection and security?[363]

247. At the Hearing, TGH insisted that there are no significant differences between what has been called the autonomous, purely treaty-based, fair and equitable treatment standard and the international minimum standard under customary international law.[364] Thus, TGH continues to cite precedent that does not interpret or apply the minimum standard, but rather

[363] Tr. (English), Day One, 386: 1-21, Park; Tr. (English), Day One, 387: 2-6, Mourre; Tr. (English), Day Two, 413:8-415-1; Letter from the Tribunal to the Claimant and the Respondent dated 11 March 2013, p. 2.

[364] Tr. (English), Day One, 113: 18-114:5, Claimant's Opening Statement.

the autonomous fair and equitable treatment standard.[365] This is a fundamental error, as it disregards the text of Article 10.5 of the Treaty. Not only Guatemala, but also the non-disputing parties (member States of the CAFTA-DR), have underscored the very limited nature of the obligation that they undertook, contrary to what TGH has argued.

1. The text of the Treaty limits protection to the international minimum standard

248. The starting point for any analysis of the applicable standard is the text of Article 10.5 of the Treaty. This Article only guarantees "the minimum standard of treatment of aliens in accordance with customary international law" and makes clear that "the concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights."

249. Annex 10-B adds that "'customary international law' […] results from a general and consistent practice of States that they follow from a sense of legal obligation."

250. Thus, the Treaty only guarantees the minimum standard of treatment under international law, not the autonomous standard of fair and equitable treatment. Moreover, the Treaty clearly indicates the source to which reference must be made to establish the content of the standard, namely, international custom, i.e. the general and consistent practice followed by States from a sense of legal obligation.

251. TGH, however, did not make any reference in it submissions and during the Hearing to the general practice of States, followed as a legal obligation, as the source of the protection standard.

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[365] Tr. (English) Day One 116: 6, Claimant's Opening Statement, referring to *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ICSID Case No. ARB/03/16) Award, 2 October 2006, **Exhibit CL-3** [*ADC*] and *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador* (ICSID Case No. ARB/04/19) Award, 18 August 2008, **Exhibit CL-20**; Tr. (English), Day One, 125: 1-5, Claimant's Opening Statement, again mentioning ADC; Tr. (English), Day One, 125: 6-9, Claimant's Opening Statement, referring to *ATA Construction, Industrial and Trading Company v. Kingdom of Jordan* (ICSID Case No. ARB/08/2) Award, 18 May 2010, **Exhibit CL-58**. *See also* Tr. (English), Day One, 124: 7-14, Claimant's Opening Statement, mentioning the cases against Argentina *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1) Decision on Liability, 3 October 2006, **Exhibit CL-27**; *Enron Corporation & Ponderosa Assets, L.P. v. Argentine Republic* (ICSID Case No. ARB/01/3) Award, 22 May 2007, **Exhibit CL-21**; *Sempra Energy International v. Argentine Republic* (ICSID Case No. ARB/02/16) Award, 28 September 2007, **Exhibit CL-43**; *BG Group Plc. v. Argentine Republic* (UNCITRAL Case) Award, 24 December 2007, **Exhibit CL-9;** and *National Grid P.L.C. v. Argentine Republic* (UNCITRAL Case) Award, 3 November 2008, **Exhibit CL-33**.

2. The CAFTA-DR member states, including the United States, have explained in this arbitration the meaning of the international minimum standard, which is different from the standard proposed by TGH

252. The participation of the CAFTA-DR member states as non-disputing parties makes this a very particular case.[366] This is so because the very states that negotiated the CAFTA-DR have provided the Tribunal with information regarding the meaning of the document which they negotiated and signed off to. The information provided was consistent among them. What should this Tribunal rely on – the interpretation of the parties to the treaty or the interpretation of a third party beneficiary of the treaty that did not participate in its negotiation? The interpretation of the non-disputing CAFTA-DR member states must prevail. What is that interpretation? It is worth reviewing the relevant part of the submissions of the non-disputing parties.[367]

253. The United States, for example, stated in its brief that the applicable standard is the international minimum standard and not the autonomous fair and equitable treatment standard. Therefore, case law regarding the latter (which is repeatedly cited by TGH) is not relevant:[368]

> 4. These provisions demonstrate the States Parties' intention that Article 10.5 articulate a standard found in customary international law – *i.e.*, the law that develops from State practice and *opinio juris* – rather than an autonomous, treaty-based standard. Although States may decide, expressly by treaty, to extend protections under the rubric of "fair and equitable treatment" and "full protection and security" beyond that required by customary international law, that practice is not relevant to ascertaining the content of the customary international law minimum standard of treatment.[2] Arbitral decisions interpreting "autonomous" fair and equitable treatment and full protection and security provisions in other treaties, outside the context of customary international law, do not constitute evidence of the content of the customary international law standard required by Article 10.5.

254. With respect to the content of the minimum standard and the burden of proof, which lies entirely with the claimant, the United States also explained:[369]

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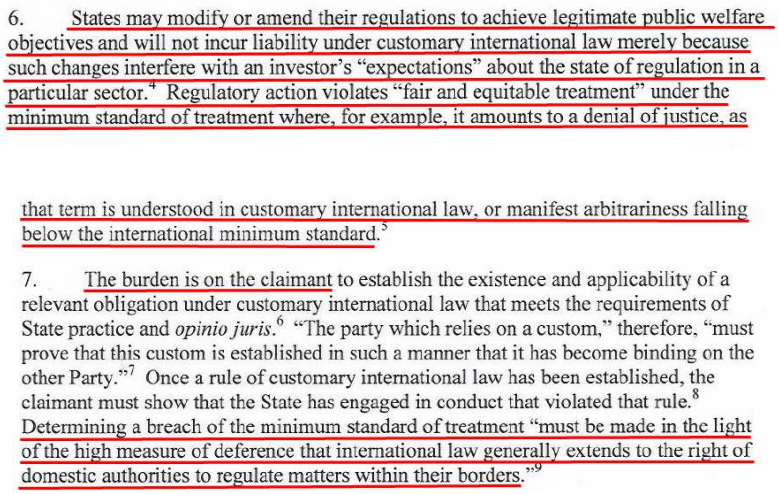
366 All except Costa Rica and Nicaragua, which, however, have not opposed the public presentations given by their partners.

367 Presentation by the United States of America, para. 4; Non-Disputing Party Submission of the Republic of El Salvador, para. 17; Non-Disputing Party Submission of the Republic of Honduras, paras. 6, 8; Non-Disputing Party Submission of the Republic of Honduras, paras. 9, 10 and Non-Disputing Party Submission of the Dominican Republic, paras. 3, 8 and 10.

368 Non-Disputing Party Submission of the United States of America, 23 November 2012, para. 4.

369 *Ibid.*, paras. 6, 7.



6. States may modify or amend their regulations to achieve legitimate public welfare objectives and will not incur liability under customary international law merely because such changes interfere with an investor's "expectations" about the state of regulation in a particular sector.[4] Regulatory action violates "fair and equitable treatment" under the minimum standard of treatment where, for example, it amounts to a denial of justice, as

that term is understood in customary international law, or manifest arbitrariness falling below the international minimum standard.[5]

7. The burden is on the claimant to establish the existence and applicability of a relevant obligation under customary international law that meets the requirements of State practice and *opinio juris*.[6] "The party which relies on a custom," therefore, "must prove that this custom is established in such a manner that it has become binding on the other Party."[7] Once a rule of customary international law has been established, the claimant must show that the State has engaged in conduct that violated that rule.[8] Determining a breach of the minimum standard of treatment "must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their borders."[9]

255. This demonstrates that the United States fully agrees that the standard only protects against denial of justice and manifest arbitrariness, providing a high measure of deference to the regulatory activity of domestic authorities. The claimant has the duty to establish the content of the standard, which requires proof of the relevant international custom. TGH disregards the position of its own Government, and ignores its obligations with respect to the burden of proof.

256. Other CAFTA-DR State parties also confirmed the limited scope of the protection granted by the international minimum standard. For example, El Salvador affirmed:[370]

> 17. As discussed in this submission, El Salvador believes that: 1) the concept of "fair and equitable treatment" in Article 10.5 of CAFTA-DR is used and must be understood strictly with reference to the Minimum Standard of Treatment in accordance with customary international law; 2) customary international law can only be established based on State practice followed out of a sense of legal obligation (*opinio juris*); 3) the burden of proof to establish the existence of a norm in customary international law falls on the Party that alleges its existence, and must be proven based on State practice and *opinio juris*, not based on decisions of arbitral tribunals; 4) the text of Article 10.5 only includes the applicability of the concept of "fair and equitable treatment" to the context of denial of justice, unless a party proves otherwise based on general and consistent State practice and *opinio juris*; 5) the concept of "fair and equitable treatment" included in the Minimum Standard of Treatment in Article 10.5 of the Treaty is very different from the autonomous concept by the same

[370] Non-Disputing Party Submission of the Republic of El Salvador, 5 October 2012, para. 17.

name; and 6) the concept of "fair and equitable treatment" in Article 10.5 of the Treaty does not include the protection of an investor's legitimate expectations and does not include protection against merely arbitrary measures.

257. For its part, Honduras described the standard as follows:[371]

> 6. Therefore, the terms of Article 10.5 of the Treaty clearly reflect the State Parties' intention to adopt the most limited concept possible of "fair and equitable treatment" as part of the minimum standard of treatment under customary international law.
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> […]
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> 8. In order to determine the current status of customary international law it is necessary to refer to State practice, not to decisions by arbitration tribunals that have not examined the minimum standard of treatment. From the time of the Permanent Court of Justice, it has been established that the party alleging the existence of a customary international law standard has the burden to prove the existence of general and consistent State practice followed from a sense of legal obligation that has given rise to the alleged standard.
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> 9. Due to the origin of the "Minimum Standard of Treatment" in customary international law, as an absolute "floor" to the obligation of States to provide to aliens at least the same standard of treatment that States afford to their own nationals, only State actions of an extreme, excessive or injurious nature can violate the minimum standard of treatment, including fair and equitable treatment as a concept included in the minimum standard of treatment.
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> 10. The Republic of Honduras views as valid the following specific examples of conduct that may be considered to be a violation of the minimum standard of treatment: a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination or a manifest failure to state reasons for a decision.[1] However, because the focus must be on the conduct of the State, the Republic of Honduras does not consider it valid or necessary to make reference to the expectations of investors for deciding whether the minimum standard of treatment has been violated.

258. Similarly, the Dominican Republic asserted the following:[372]

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[371] Non-Disputing Party Submission of the Republic of Honduras, undated, paras. 6, 8-10.

[372] Non-Disputing Party Submission of the Dominican Republic, 2 October 2012, paras. 3, 8, 10.

> From this it is derived that the "Fair and Equitable Treatment" established in the contract must be viewed as part of the "Minimum Standard of Treatment afforded to aliens according to Customary International Law," a concept that is very different from the standard of "Fair and Equitable Treatment" included in many investment protection treaties in an autonomous manner without reference to the Minimum Standard of Treatment under the Law
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> […]
>
> 8. Therefore, in the Dominican Republic's view, in order to violate the Minimum Standard of Treatment under Customary International Law included in Article 10.5 of the Treaty, a measure attributable to the State must be sufficiently egregious so as to fall below internationally accepted standards. Accordingly, only conduct which is manifestly arbitrary, blatantly condemnable and very serious conduct may be claimed under CAFTA-DR 10.5 and not a mere breach or mere arbitrariness.
>
> […]
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> 10. Because the focus must be on State practice and conduct, the Dominican Republic also notes that it is incorrect to make reference to the expectations of investors concerning the treatment they expect to receive based on what has been offered, to decide if the State has complied with the Minimum Standard of Treatment. State conduct is the only relevant factor for this purpose, because the Minimum Standard of Treatment must be an objective concept that evaluates the treatment that a State accords to an investor. It must be a […]

259. As El Salvador stated at the Hearing, the restrictive interpretation of the international minimum standard with respect to fair and equitable treatment is not excessively "*harsh or extreme*," given that "[a]*rticle 10.5 was always intended to offer a very limited protection—a floor, if you will—in the acceptable level of treatment to covered investments. This is why it is called 'Minimum Standard of Treatment*.'"[373] Such interpretation does not in any way mean that a foreign investor is left without protection. As El Salvador also stated, this standard is only one of the substantive protections of the Treaty:

> We should also keep in mind that Article 10.5 is not the only protection that CAFTA affords to covered investments. CAFTA includes protections related to national treatment, most favored nation treatment, and expropriation. CAFTA even allows an investor to bring claims to international arbitration for alleged

[373] Tr. (English), Day Five, 814:17-22, El Salvador.

> breaches of investment agreements, and investment authorizations; that is, for alleged breaches of contracts with the State. So, Article 10.5 is not the only protection available to a CAFTA investor. However, if an investor chooses to bring a claim for an alleged breach of Article 10.5 in areas other than denial of justice and Full Protection and Security, that Claimant has the burden to prove the existence of such obligation under customary international law in accordance with Annex 10-B[374].

260. The fact that the United States, El Salvador and the Dominican Republic have all decided to intervene at the Hearing to state their position[375] demonstrates the significance of the restrictive interpretation of the standard, and that the TGH's statements about the broadness of the standard are incompatible with the Treaty. Notably, the United States freely chose to intervene in this proceeding without being a party to the dispute.

261. As the United States explained at the Hearing:

> [T]he United States exercises its right as a non-disputing party to make submissions on questions of treaty interpretation, whether or not the investor is a United States investor. […][W]e exercised our right under the Treaty to draw the Tribunal's attention to the Treaty Parties' shared understanding that the customary international law Minimum Standard of Treatment in Article 10.5 results from a general and consistent practice of States that they follow from a sense of legal obligation. The burden, we noted, rests with the Claimant to establish the existence and applicability of a relevant obligation[376].

262. The CAFTA-DR member states have clarified for the Tribunal what their common intention and understanding was when they agreed to the international minimum standard. The common view of the States regarding the content of the obligations which they agreed to is binding on the parties to this proceeding and the Tribunal. This arbitration concerns the application of the Treaty, and the meaning of the Treaty must be that which the States that negotiated it intended it to be, and state it to be.

263. The States decided to intervene due to the extremely broad interpretation of the standard proposed by TGH. It is important to remember that the Treaty is not an old treaty, but was signed in 2004, when the debate concerning the content of the customary international law

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374 *Ibid*., 815:9- 816:2.

375 Tr. (English), Day Five, 822:2-824:7, United States; Tr. (English), Day Five, 808:18-816:14, El Salvador, and Tr. (English), Day Five, 817:2-821:20, Dominican Republic.

376 Tr. (English), Day Five, 822:12-16 and 822:21-823:7, United States (emphasis added).

minimum standard of treatment, its alleged evolution, and its relation to the fair and equitable treatment was fully fledged. The restrictive position adopted by the Treaty reflects the current trend, especially in this North and Central American region. It is worth recalling the NAFTA Free Trade Commission notes of interpretation of 2001,[377] the position of the United States in its most recent bilateral treaties, which is reflected in its 2004 model BIT,[378] as well as the current practices of Canada and Mexico.[379] Therefore, the selection of the minimum standard in the Treaty involved a conscious and deliberate decision by the states member to the Treaty, and such decision must be respected.

264. As the tribunal in *Glamis Gold* stated:

> The State Parties to the NAFTA can always choose to negotiate a higher standard against which their behavior will be judged. It is very clear, however, that they have not yet done so and therefore a breach of Article 1105 still requires acts that exhibit a high level of shock, arbitrariness, unfairness or discrimination.[380]

3. The minimum standard is different and less demanding on States than the autonomous standard of fair and equitable treatment; it only protects against denial of justice and manifest arbitrariness

265. At the Hearing, the three arbitrators asked about the difference between the fair and equitable treatment standard and the international minimum standard, and asked for an explanation of the content of the latter.[381] The President of the Tribunal also asked why the international minimum standard is lower than the fair and equitable treatment standard.[382]

266. First, it is important to note that, as discussed in the previous section, the burden of proof regarding the content of the standard falls on the claimant, i.e., TGH. Second, there is no

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377 NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (Washington D.C., 31 July 2001).

378 United States 2004 Model BIT, **Exhibit RL-19**, Art. 5.

379 Canada-Colombia Free Trade Agreement (signed 21 November 2008, in force 15 August 2011), Art. 805; Agreement between the United States of Mexico and the Republic of Panama for the Promotion and Reciprocal Protection of Investment (Mexico City, Federal District, signed 11 October 2005, in force 14 December 2006), Art. 6.

380 *Glamis Gold Ltd. v. United States of America* (UNCITRAL Case) Award, 8 June 2009, **Exhibit CL-23**, para. 829.

381 Tr. (English), Day One, 386: 1-21, Park; Tr. (English), Day One, 387: 2-6, Mourre; Tr. (English), Day Two, 413:8-415-1; Letter from the Tribunal to the Claimant and the Respondent dated 11 March 2013, p. 2.

382 Tr. (English), Day One, 387: 2-11, Mourre.

doubt that the international minimum standard imposes fewer restrictions on State conduct, and therefore provides a lower level of protection than the fair and equitable treatment standard. As UNCTAD explained in its recent study on this subject:

> A high threshold has been emphasized in the context of application of the minimum standard of treatment under customary international law. The classic early tests of the MST required a violation to be "egregious" or "shocking" from the international perspective. Even though the world has moved on, and the understanding of what can be considered egregious or shocking has changed, these terms still convey a message that only very serious instances of unfair conduct can be held in breach of the MST.
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> […]
>
> A second approach, using a somewhat lower threshold, has been taken by tribunals applying an unqualified FET standard (the one not linked to the customary law MST). These tribunals have—albeit to a lesser extent—also tended to express a significant degree of deference for the conduct of sovereign States.[383]

267. Furthermore, in its recommendations to States on how to draft a fair and equitable treatment clause, UNCTAD explains:

> A reference to the MST [minimum standard of treatment] assumes that tribunals examining FET claims will hold the claimant to this demanding standard. […] [T]he main feature of this approach remains a high liability threshold that outlaws only the very serious breaches[384].

268. Thus, the international minimum standard is less demanding on States than the fair and equitable treatment standard, and is violated only when there is particularly egregious and serious conduct.[385]

269. This position has been reaffirmed in the jurisprudence.[386] For example, in *Thunderbird v. México*, the Tribunal affirmed:

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[383] United Nations Conference on Trade and Development, *Fair and Equitable Treatment*, UNCTAD/DIAE/IA/2011/5, 2012, **Exhibit RL-26,** pp. 86-87 (emphasis added).

[384] *Ibid.*, p. 105-106 (emphasis added).

[385] Counter-Memorial, paras. 464-467.

[386] *See*, for example, *Cargill, Incorporated v. United Mexican States* (ICSID Case No. ARB[AF]/05/2) Award, 18 September 2009, **Exhibit CL-12**, para. 296; *Glamis Gold Ltd. v. United States of America* (UNCITRAL Case) Award, 8 June 2009, **Exhibit CL-23**, paras. 616-617.

> Notwithstanding the evolution of customary law since decisions such as *Neer* Claim in 1926, the threshold for finding a violation of the minimum standard of treatment still remains high, as illustrated by recent international jurisprudence. For the purposes of the present case, the Tribunal views acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards.[387]

270. The requirement of egregious conduct has been applied even more recently by other tribunals such as *Glamis Gold v. United States*:

> [T]o violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105(1).[388]

271. In short, the minimum standard is more deferential towards states and only condemns particularly egregious and serious conduct.

272. By contrast, the principle of fair and equitable treatment has been interpreted in a broader manner. This is probably because the principle of fair and equitable treatment in many BITs is not connected to international custom. Therefore, arbitral tribunals have not been duty-bound to examine the content of general international law regarding the treatment of aliens. Instead, tribunals have been free to incorporate what they believe to be inherent to the concepts of "*fairness*" and "*equity*," such as, for instance, legitimate expectations,[389] which is a domestic law doctrine, which, however, has limited application even in that context.

273. In any event, these broad interpretations cannot be applied here. The CAFTA-DR member states have bound themselves only to the minimum standard of customary international law. Moreover, the states have expressly defined the content of the standard,

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[387] *International Thunderbird Gaming Corporation v. The United Mexican States* (UNCITRAL Case) Award, 26 January 2006, **Exhibit CL-25**, para. 194 (emphasis added, footnotes omitted).

[388] *Glamis Gold Ltd. v. United States of America* (UNCITRAL Case) Award, 8 June 2009, **Exhibit CL-23**, para. 616.

[389] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB (AF)/00/2) Award, 29 May 2003, para. 154.

agreeing to limit it to denial of justice and, at most, manifest arbitrariness. As will be seen below, manifest arbitrariness requires an element of volition in the arbitrary conduct.

4. The concept of manifest arbitrariness

274. Arbitrariness was defined by the International Court of Justice (***ICJ***) in the *ELSI* case. The ICJ's definition of arbitrariness is commonly accepted in the contemporaneous jurisprudence; it states as follows:

> Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the *Asylum* case, when it spoke of "arbitrary action" being "substituted for the rule of law" *(Asylum, Judgment, I.C.J. Reports 1950,* p. 284). It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.[390]

275. TGH refers to this decision but does not analyze it in any detail. There are several considerations to point out. First, arbitrariness does not relate to a mere violation of a legal rule, but rather to conduct that defies the idea of law. Arbitrariness is the disregard of the principles of the rule of law, that is, the principle of submission by all public authorities to the rule of law. A mere illegality (which in any case does not even exist here) does not amount to arbitrariness:

> Yet it must be borne in mind that the fact that an act of a public authority may have been unlawful in municipal law does not necessarily mean that that act was unlawful in international law, as a breach of treaty or otherwise. A finding of the local courts that an act was unlawful may well be relevant to an argument that it was also arbitrary; but by itself, and without more, unlawfulness cannot be said to amount to arbitrariness […].[391]

276. The violation must be deliberate, intentional and conscious, which is precisely what is encapsulated in the concept of "*willful disregard*" alluded to by the ICJ in the above-cited decision. In his question to the parties regarding the content of the international minimum standard, arbitrator Park referred to intentionality as an element that could potentially help to distinguish between a violation of such standard and unfair and inequitable treatment.[392] In

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[390] *Elettronica Sicula S.p.A. (ELSI) (USA v. Italy)* [1989] ICJ Rep 15, 20 July 1989, **Exhibit RL-1**, para. 128.

[391] *Ibid.*, para. 124.

[392] Tr. (English) Day One 386:1-22, Park.

fact, arbitrariness *requires* an element of intentionality, which is different from mere negligence. Such intentionality is what makes it possible to characterize a mere illegality as a violation of the basic concept of law and submit public authorities to the rule of law.

277. Second, it is necessary to examine which matters the ICJ considered to be relevant in *ELSI* in determining the existence of arbitrariness. The ICJ examined whether a decision by the mayor of Palermo (Italy) to intervene in a U.S.-held company that was experiencing serious financial difficulties comported with Italy's obligations under the Treaty of Friendship and Cooperation between the United States and Italy. The ICJ considered the following points in determining that the intervention was not arbitrary:

> [I]t was nonetheless within the competence of the Mayor of Palermo, according to the very provisions of the law cited in it; one finds the Court of Appeal of Palermo, which did not differ from the conclusion that the requisition was *intra vires***,** ruling that it was unlawful as falling into the recognized category of administrative law of acts of "*eccesso di potere.*" Furthermore, here was an act belonging to a category of public acts from which appeal on juridical grounds was provided in law (and indeed in the event used, not without success). Thus, the Mayor's order was consciously made in the context of an operating system of law and of appropriate remedies of appeal, and treated as such by the superior administrative authority and the local courts. These are not at al1 the marks of an "arbitrary" act.[393]

278. In other words, a measure is not arbitrary when, although it is reprehensible or even clearly illegal, it has been adopted in the exercise of the functions of the accused authority, and "*in the context of an operating system of law and of appropriate remedies of appeal.*"[394] That is why, as the United States asserted in its non-disputing party submission:

> ARBITRATOR PARK: I would just pose one question to both sides, and I think we're going to have a chance for questions on Friday also. So if you want to wait until Friday to answer it, that's fine. And it has to do with the methodology that the Tribunal ought to use in approaching customary international law in this context. If I'm correct, and I might not be, both sides seem to say that the fact that a regulator makes a mistake is not enough to create liability. On the other hand, both sides seem to accept that if the mistake is big enough, egregious enough, atrocious enough, then at some point the magnitude of that mistake does potentially create liability. And my question would be whether or not, in trying to distinguish between the mistakes that can create liability and the mistakes that cannot, there must be an element of intentionality, that the regulator intended to do something wrong; or is it enough that there be simple negligence in the regulatory act? Is that question clear to both sides?

[393] *Elettronica Sicula S.p.A. (ELSI) (USA v. Italy)* [1989] ICJ Rep 15, 20 July 1989, **Exhibit RL-1**, para. 129.

[394] *Ibid.*

> Determining a breach of the minimum standard of treatment "must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their borders."[395]

279. These are the same concepts that Guatemala has referred to throughout this arbitration, citing extensive jurisprudence demonstrating that customary international law (and even fair and equitable treatment) is not violated by mere regulatory measures that have already been subject to the scrutiny of domestic courts, as is the case here.

280. The arbitrariness must be manifest. This point is not open to dispute. The concept of "manifest" is commonly interpreted and applied in international law: in the case of the ICSID annulment committees, the question is whether [the Tribunal] has "manifestly exceeded its powers."[396] In the case of disqualification of arbitrators in the ICSID framework, the question is whether there is manifest lack of independence and impartiality.[397]

281. As the arbitrators stated in *Suez et al. v. Argentina* with respect to the disqualification of arbitrator Kaufmann-Kohler:

> At the outset, it must be recalled that Article 57 of the ICSID Convention requires a "manifest lack of the qualities required" of an arbitrator. The term "manifest" means "obvious" or "evident." Christoph Schreuer, in his *Commentary*, observes that the wording *manifest* imposes a "relatively heavy burden of proof on the party making the proposal [...]" to disqualify an arbitrator.[398]

282. In short, the arbitrariness must be apparent, evident and not merely possible or even probable. Manifestly arbitrary measures are those that have obviously, apparently or deliberately been taken with no legal basis or following any legal process whatsoever.

283. A mere appearance of arbitrariness (which also does not exist in this case) is not sufficient, as the tribunal understood in *Glamis Gold*:

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395 Non-Disputing Party Submission of the United States of America, 23 November 2012, para. 7.

396 Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (open for signing on 18 March 1965, in force on 14 October 1966), Art. 52(1)(b).

397 *Ibid.*, art. 57.

398 *Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. Argentine Republic* (ICSID Case No. ARB/03/17) Decision on the Proposal for the Disqualification of a Member of the Arbitral Tribunal, 22 October 2007, **Exhibit RL-33**, para. 34.

> [T]he Tribunal notes the standard articulated above as to when an act is so manifestly arbitrary as to breach a State's obligations under Article 1105: this is not a mere appearance of arbitrariness—a tribunal's determination that an agency acted in way with which the tribunal disagrees or a State passed legislation that the tribunal does not find curative of all the ills presented; rather, this is a level of arbitrariness that, as *International Thunderbird* put it, amounts to a "gross denial of justice or manifest arbitrariness falling below acceptable international standards." The act must, in other words, "exhibit a manifest lack of reasons." [399]

5. The doctrine of legitimate expectations is not applicable in the context of the international minimum standard

284. Guatemala and the non-disputing parties have made clear in their submissions that the doctrine of legitimate expectations is not applicable in the context of the international minimum standard. As the United States affirmed in its brief: "*States may modify or amend their regulations to achieve legitimate public welfare objectives and will not incur liability under customary international law merely because such changes interfere with an investor's 'expectations' about the state of regulation in a particular sector.*"[400]

285. Although some tribunals have used the language of legitimate expectations in the context of the minimum standard, the test applied for determining a violation is not different from that applied to determine manifest arbitrariness. In *Glamis Gold*, for example, even after having examined the investor's legitimate expectations, the tribunal ruled as follows:

> [T]he Tribunal first notes that it is not for an international tribunal to delve into the details of and justifications for domestic law. If Claimant, or any other party, believed that Solicitor Leshy's interpretation of the undue impairment standard was indeed incorrect, the proper venue for its challenge was domestic court. In the context of this claim, this Tribunal may consider only whether the [conduct] occasioned "a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons."[401]

286. In other words, expectations of the correct interpretation of a regulatory framework are not sufficient in any case. Such matters are for domestic courts. In the context of an

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399 *Glamis Gold Ltd. v. United States of America* (UNCITRAL Case) Award, 8 June 2009, **Exhibit CL-23**, para. 803.

400 Non-Disputing Party Submission of the United States of America, 23 November 2012, para. 6.

401 *Glamis Gold Ltd. v. United States of America* (UNCITRAL Case) Award, 8 June 2009, **Exhibit CL-23**, para. 762.

international claim, the claimant must prove that the state's conduct was manifestly arbitrary. As the United States explained: "*Regulatory action violates* […] *the minimum standard of treatment where, for example, it amounts to* […] *manifest arbitrariness.*"[402]

287. Thus, it is not surprising that TGH has not provided a single example of a case involving the international minimum standard in which such standard was violated due to a violation of legitimate expectations. Even when the concept of legitimate expectations applies, only specific and unambiguous commitments (such as a legal stability clause) give rise to such expectations. The concept does not protect against any regulatory change, but rather only against fundamental changes to essential aspects of the regulation. This has already been explained in previous pleadings and will be discussed briefly below.

288. As the tribunal stated in *Mobil v. Canada*:

> This applicable standard does not require a State to maintain a stable legal and business environment for investments, if this is intended to suggest that the rules governing an investment are not permitted to change, whether to a significant or modest extent. Article 1105 may protect an investor from changes that give rise to an unstable legal and business environment, but only if those changes may be characterized as arbitrary or grossly unfair or discriminatory, or otherwise inconsistent with the customary international law standard. In a complex international and domestic environment, there is nothing in Article 1105 to prevent a public authority from changing the regulatory environment to take account of new policies and needs, even if some of those changes may have far-reaching consequences and effects, and even if they impose significant additional burdens on an investor. Article 1105 is not, and was never intended to amount to, a guarantee against regulatory change, or to reflect a requirement that an investor is entitled to expect no material changes to the regulatory framework within which an investment is made. Governments change, policies changes and rules change. These are facts of life with which investors and all legal and natural persons have to live with. What the foreign investor is entitled to under Article 1105 is that any changes are consistent with the requirements of customary international law on fair and equitable treatment. Those standards are set, as we have noted above, at a level which protects against egregious behavior. It is not the function of an arbitral tribunal established under NAFTA to legislate a new standard which is not reflected in the existing rules of customary international law. The Tribunal has not been provided with any

[402] Non-Disputing Party Submission of the United States of America, 23 November 2012, para. 6.

> material to support the conclusion that the rules of customary international law require a legal and business environment to be maintained or set in concrete.[403]

289. In summary, legitimate expectations are not the appropriate instrument for determining whether a State's conduct falls within the limits of the international minimum standard. The concept of legitimate expectations does not replace a determination that the state's conduct is grave enough to constitute a violation of international law. The changes to the regulatory framework that are condemnable are those that give rise to manifest arbitrariness, that are implemented through government or legislative instruments, and result in a deliberate disregard for the commitments clearly undertaken with the investor.

290. In fact, the doctrine of legitimate expectations has been the subject of general criticism for erroneously focusing on the protected investment or investor, and not on the State conduct that would constitute a violation of such expectations, and thus of international law. As arbitrator Pedro Nikken stated in his separate opinion in *Suez et al. v. Argentina*:

> "Fair and equitable treatment" is primarily a "treatment," that is, a behavior, a conduct of each State Party when in the position of recipient of investment. That conduct must be "fair and equitable." *In essence* fair and equitable treatment is a standard of *conduct* or *behavior* of the State *vis à vis* foreign investment. […] it could never lose its essence as ***a standard of conduct or conduct of the State with respect to foreign investments***, which should not automatically translate into a source of subjective rights for investors. The BITs contain a list of the States' obligations regarding their respective investments, not a declaration of rights for investors. […] Nothing in the text of the BITs, nor in their context, object and purpose to indicate that the State Parties were extending the obligation to accord fair and equitable treatment to protected investments beyond their own conduct, such as the so-called "legitimate expectations" of investors.[404]

291. In other words, TGH's concept of legitimate expectations is erroneous, as it does not focus on the limits of prohibited behavior, but rather on the subjective position of the investor. The concept does not specify which state conduct constitutes a violation of international law. This must be determined by an arbitral tribunal. The focus on legitimate expectations does not allow for a proper assessment of the limits, for example, of intentionality, abuse of power or

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[403] *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada* (ICSID Case No. ARB (AF)/07/4) Decision on Liability and Quantum (public version), 22 May 2012, **Exhibit RL-37**, para. 153.

[404] Separate Opinion of Arbitrator Pedro Nikken in *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v. Argentine Republic* (ICSID Case No. ARB/03/19) and *AWG Group v. Argentine Republic* (UNCITRAL Case) Decision on Liability (translation from Spanish version), 30 July 2010, **Exhibit RL-35**, paras. 4, 19-20 (emphasis in original).

manifest lack of legal basis that must be found in the state conduct in order for a violation of the international minimum standard to take place. The concept may in certain cases lead to objective liability, that is, to an excessive affirmation of the duty to guarantee regulatory stability, which is not imposed by any principle of international law.

B. GUATEMALA HAS NOT COMMITTED ANY MANIFEST ARBITRARINESS

292. This case involves a regulator, the CNEE, which in the exercise of its functions understood that once the opinion of the Expert Commission had been issued, it alone was responsible for determining whether the distributor's tariff study could be used to set the tariffs, or if the tariffs should be set based on an independent tariff study. It is notable that, as explained above, there is nothing in the LGE and RLGE requiring that a new tariff study be conducted by the distributor following the pronouncement of the Expert Commission, and much less that that study be approved by the Expert Commission. There is also no provision requiring that the tariffs be determined on the basis of such tariff study. In fact, a provision to such effect was contained in the draft LGE, but it was eliminated from the draft.

293. On the contrary, the LGE and the RLGE make it perfectly clear that the CNEE approves the methodology of the tariff review, the tariff studies, the VAD that complies with the law and, ultimately, the tariffs. They also provide that the CNEE may commission its own tariff studies from independent consultants, which was advised by the father of the LGE, Mr. Bernstein. The CNEE frequently approves tariffs on the basis of VAD studies carried out by its own consultants.[405] Therefore, it is not surprising that the CNEE interpreted its role to include the power to decide the conclusions to be drawn from the Expert Commission's pronouncement. This view was supported by the Constitutional Court in its decisions relating

[405] CNEE Resolution 184-2008 of 25 September 2008, approving the Tariff Study prepared by the Association of companies comprised of Mercados Energéticos Consultores, Sociedad Anónima and Geotecnología, Construcción y Servicios, Sociedad Anónima (GEOCONSA), corresponding to the Empresa Eléctrica Municipal Zacapa, **Exhibit R-241**; CNEE Resolution 16-2009 of 28 January 2009, approving the Tariff Study prepared by the Association of companies comprised of Mercados Energéticos Consultores, Sociedad Anónima and Geotecnología, Construcción y Servicios, Sociedad Anónima (GEOCONSA), corresponding to the Empresa Hidroeléctrica Municipal de Retalhuleu **Exhibit R-244**.

to this case, and TGH has not accused the Court of manifest arbitrariness (which would amount to a denial of justice).[406]

294. We should not lose sight of the numerous irregularities in the conduct of EEGSA and its consultant firm Bates White during the tariff review process, including Bates White's invocation of its alleged right to deviate from the Terms of Reference on 423 occasions, a VAD that was three times higher than that of the previous tariff review, Mr. Pérez's offer "outside the study" to increase the VAD by only 10%, insistence on using underground power lines when the LGE excludes them, the refusal by Bates White to link the study worksheets and make them traceable and auditable, its consistent refusal to submit the price database used in its study, the contract between Bates White and EEGSA which obliged Bates White to follow EEGSA's instructions with respect to the preparation and results of the VAD study, and the fact that EEGSA and Bates White foresaw in the contract the constitution of an Expert Commission during this tariff review, when such commission had never been established before in Guatemala. These elements, together with the problems pointed out by the Expert Commission, clearly show the lack of objectivity and reliability of the EEGSA study.

295. Therefore, the CNEE not only had the power but also the obligation to decide whether the Bates White study complied with the regulatory framework. No other body could assume such function.

296. The CNEE's conduct therefore conformed to the law. Even if it hadn't, the CNEE could in no way be described as *arbitrary*, much less *manifestly arbitrary*. The CNEE at all times acted in accordance with its interpretation of the LGE and RLGE that is plausible at very least (and in fact is correct). Moreover, the CNEE relied on external consultants throughout the entire tariff review process, especially with respect to complex technical matters such as the FRC. This reduces even further any potential margin for arbitrariness. It is possible that EEGSA and TGH suffered a "disappointment" (to quote the *Azinian* award). However, international law offers no protection against mere disappointments, only against manifest arbitrariness. The latter is not present in this case.

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[406] Decision of the Constitutional Court (Consolidated Case Files 1836-1846-2006) Appeal of Amparo Decision, 18 November 2009, **Exhibit R-105**, Sections I and II; and Decision of the Constitutional Court (Case File 3831-2009) Amparo Appeal, 24 February 2010, **Exhibit R-110**, Sections I and II.

C. GUATEMALA HAS NOT VIOLATED ANY LEGITIMATE EXPECTATION OF TGH

1. Legitimate expectations require specific, unambiguous, and repeated commitments expressly directed at the investor

Tribunal's Question: What type of "representations", that is, promises or guarantees, may give rise to legitimate expectations?

297. At the Hearing, the Tribunal asked what type of "*representations*," that is, what promises or guarantees, may give rise to legitimate expectations.[407] Without prejudice to Guatemala's position that the doctrine of legitimate expectations does not apply in the context of the minimum standard of treatment, if that standard were to apply, the representations would have to be specific and directed at the investor in question.

298. Guatemala has provided extensive case law demonstrating that the promises or commitments made by the state to the investor must be specific. One example is the *Glamis Gold* award, in which the tribunal stated that the promises must be specific and made with the objective of attracting the specific investment of the claimant, and resulting in a quasi contractual relationship:

> [A]s the Tribunal has explained in its discussion of the 1105 legal standard, a violation of Article 1105 based on the unsettling of reasonable, investment-backed expectation requires, as a threshold circumstance, at least a quasi-contractual relationship between the State and the investor, whereby the State has purposely and specifically induced the investment.[408]

299. Guatemala has also cited case law that relates to situations of regulatory change, which is what TGH (erroneously) argues in this case. As the tribunal stated in *EDF v. Romania*, applying the broader fair and equitable treatment standard:

> The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation. The FET might then mean the virtual freezing of the legal regulation of economic activities, in contrast with the State's normal regulatory power and the evolutionary character of economic life. Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of

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[407] Letter from the Tribunal to the Claimant and the Respondent dated 11 March 2013, p. 2.

[408] *Glamis Gold, Ltd. v. United States of America, NAFTA Chapter Eleven, UNCITRAL*, Award, 8 June 2009, **Exhibit CL-23**, para. 766.

> insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable.
>
> Further, in the Tribunal's view, the FET obligation cannot serve the same purpose as stabilization clauses specifically granted to foreign investors.[409]

300. A similar conclusion was reached by the tribunal in *AES v. Hungary*, also in relation to the more protective standard of fair and equitable treatment:

> A legal framework is by definition subject to change as it adapts to new circumstances day by day and a state has the sovereign right to exercise its powers which include legislative acts.
>
> [...]
>
> In this case, however, the Tribunal observes that no specific commitments were made by Hungary that could limit its sovereign right to change its law (such as a stability clause) or that could legitimately have made the investor believe that no change in the law would occur.
>
> [...]
>
> In these circumstances, absent a specific commitment from Hungary that it would not reintroduce administrative pricing during the term of the 2001 PPA, Claimants cannot properly rely on an alleged breach of Hungary's Treaty obligation to provide a stable legal environment based on the passage of Act XXXV and the Price Decrees. This is because any reasonably informed business person or investor knows that laws can evolve in accordance with the perceived political or policy dictates of the times.[410]

301. TGH cites the award in *Total v. Argentina*, which also concerns the fair and equitable treatment rather than the international minimum standard, but which, as is the case with the awards cited above, also requires a specific commitment:

> [S]ignatories of BITs do not thereby relinquish their regulatory powers nor limit their prerogative to amend legislation in order to adapt it […] [T]the legal regime in force in the host country at the time of making the investment is not per se covered by a "guarantee" of stability due to the mere fact that the host country entered into a BIT with the country of the foreign investor. A specific provision in the BIT itself or some "promise" of the host State, are required to

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[409] *EDF Services (limited) v. Romania* (ICSID Case No. ARB/05/13) Award, 8 October 2009, **Exhibit RL-13**, paras. 217-218.

[410] *AES Summit Generation Limited and AES-TISZA EROMU KFT v. Republic of Hungary* (ICSID Case No. ARB/07/22) Award, 23 September 2010, **Exhibit RL-24**, paras. 9.3.29, 9.3.31, 9.3.34.

> this effect so rendering such an expectation legitimate […]Representations made by the host State are enforceable and justify the investor's reliance only when they are made specifically to the particular investor […] [L]egislative provisions, regulations of a unilateral normative or administrative nature, not so specifically addressed, cannot be construed as specific commitments that would be shielded from subsequent changes to the applicable law. [...]
>
> In light of the above principles, the Tribunal does not agree with Total's argument that the legal regime (the pricing rules) that Argentina changed was the object of a "promise" by Argentina that was binding on Argentina, and on which Total was entitled to rely ("legitimate expectations") as a matter of international law. It is immaterial in this respect whether or not the "radical" changes in the Electricity Law regime that Total complains of are also in breach of Argentina's law and/or represent a use by SoE of its power in disregard of the Electricity Law. [...][411]

302. Aside from being specific, the promises or commitments must be unequivocal and repeated. As the tribunal explained in *Duke v. Peru* "*for the conduct or representation of a State entity to be invoked as grounds for estoppel, it must be* unequivocal,"[412] In the words of the tribunal in *Unglaube v. Costa Rica*:

> [T]he unilateral expectations of a party, even if reasonable in the circumstances, do not in and of themselves satisfy the requirements of international investment law. To satisfy such requirements Claimants must demonstrate reliance on specific and unambiguous State conduct, through definitive, unambiguous and repeated assurances, and targeted at a specific person or identifiable group.[413]

303. Another example is *Feldman v. Mexico*, in which the tribunal rejected the possibility of legitimate expectations because "the assurances allegedly relied on by the Claimant (which assurances are disputed by Mexico) were at best ambiguous,"[414] unlike those in the *Metalclad* case in which "the assurances received by the investor from the Mexican government […], were definitive, unambiguous and repeated."[415]

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411 *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability, 27 December 2010, **Exhibit CL-70**, paras. 309, 310. *See also* paras. 117, 119, 120 with respect to measures relating to the gas sector.

412 *Duke Energy Int'l Peru Investments No. 1, Ltd. v. Peru*, ICSID Case No. ARB/03/28, Award, 18 August 2008, **Exhibit CL-20**, para. 249.

413 *Marion Unglaube v. Republic of Costa Rica* (ICSID Case No. ARB/08/1) Award, 16 May 2012, **Exhibit RL-36**, para. 270.

414 *Marvin Feldman v. United Mexican States* (ICSID Case No. ARB(AF)/99/1) Final Award, 16 December 2002, **Exhibit RL-5**, para. 149.

415 *Ibid.*, para. 148.

304. Therefore, the passages from *EDF* and *AES* quoted above demonstrate that the basis for legitimate expectations regarding the absence of modifications to a regulatory framework – which, again, is erroneously claimed by TGH here– are legal stability clauses. In the words of the tribunal in *Parkerings*:

> It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a *stabilization* clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. […]
>
> […] [A]n investor must anticipate will and that the circumstances could change, and thus structure its investment in order to adapt it to the potential changes of legal environment.[416]

305. As it will be demonstrated below, TGH comes far from demonstrating an expectation based on promises and commitments made by Guatemala that meets any of these requirements.

Tribunal's Question: Can a sales memorandum contain a promise that gives rise to a legitimate expectation?

306. The Tribunal also asked whether a sales memorandum, such as that prepared during the privatization of EEGSA, could contain a guarantee of this type.[417] The answer is no. An isolated statement in a sales memorandum not supported or confirmed by the regulatory and contractual framework is not specific, unambiguous, repeated and definitive so as to give rise to legitimate expectations.

307. TGH refers to the Argentine emergency cases in which some sales memoranda were considered to be relevant in establishing the existence of promises or guarantees by the State. However, in those cases the memoranda confirmed in a clear and unambiguous way what was already plainly stated in the regulations, in the bidding rules and in the concession contracts themselves. For example, in *Enron v. Argentina* the tribunal cited the sales memorandum only as a supporting element:

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[416] *Parkerings-Compagniet AS v. Republic of Lithuania* (ICSID Case No. ARB/05/8) Award, 11 September 2007, **Exhibit RL-10**, paras. 332-333 (emphasis in original).

[417] See para. 297 above. Letter from the Tribunal to the Claimant and the Respondent dated 11 March 2013, p. 2.

> This conclusion is based first on the examination of the legal and regulatory framework. If the Gas Decree and the Basic Rules of the License unequivocally refer to the calculation of tariffs in US dollars, and such feature was also explained in the same terms by the Information Memorandum, there cannot be any doubt about the fact that this is the central feature governing the tariff regime.[418]

308. The Argentine emergency cases focus on other aspects of the regulatory and contractual framework. For example, TGH cites one paragraph in the *Suez et al. v. Argentina* case, but taken as a whole that paragraph supports Guatemala's contention that a mere sales memorandum cannot generate expectations that are protected under a BIT. Such expectations require commitments that are much more specific, clear and repeated:

> The Concession Contract and the legal framework of the Concession described above clearly meet the conditions proposed in the cases just referred to. They set down the conditions offered by the Province at the time that Claimants made their investment; they were not established unilaterally but by the agreement between the Provincial authorities and the Claimants; and they existed and were enforceable by law. Like any rational investor, the Claimants attached great importance to the tariff regime stipulated in the Concession Contract and the regulatory framework. Indeed, their ability to make a profit was crucially dependent on it. The importance of the tariff regime was underscored even before the bidding took place, as shown inter alia by the "clarifying circulars (circulares aclaratorias) issued by the Province in response to questions raised by bidders concerning the terms of the Article 11.4.4.2 of the Model Contract concerning tariff revisions, particularly with respect to changes in exchange rates and financial costs. These expectations of the Claimants were later included in the Concession Contract, a document which certainly reflects in detail the Claimants' legitimate expectations, as well as those of the Province. In view of the central role that the Concession Contract and legal framework placed in establishing the Concession and the care and attention that the Province devoted to the creation of that framework, the Claimants' expectations that the Province would respect the Concession Contract throughout the thirty-year life of the Concession was legitimate, reasonable, and justified. It was in reliance on that legal framework that the Claimants invested substantial funds in the Province of Santa Fe. And the Province certainly recognized at the time it granted the Concession to the Claimants that without such belief in the reliability and stability of the legal framework the Claimants – indeed no investor - would ever have agreed to invest in the water and sewage system of Santa Fe.[419]

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[418] *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award of 22 May 2007, **Exhibit CL-21**, para. 128.

[419] *Suez, Sociedad General de Aguas de Barcelona S.A. and InterAgua Servicios Integrales del Agua S.A. v. Argentine Republic* (ICSID Case No. ARB/03/17) Decision on Liability, 30 July 2010, **Exhibit RL-17**, para. 212 (emphasis added).

2. TGH has not demonstrated any legitimate expectation that Guatemala could have violated

309. TGH cannot demonstrate any alleged legitimate expectation that it could have acquired at the time of the privatization of EEGSA, when TGH did not even exist. This point has been explained on earlier occasions and will not be repeated here.[420]

310. In any case, it is worth asking what legitimate expectations TGH claims to have are, and from which specific, unambiguous, and repeated commitments made by Guatemala those would have derived. It is notable that TGH did not provide, either in its written submissions or at the Hearing, a description or list of those expectations.

311. It must be noted that, as regards TGH's claim of regulatory changes, there is not a single guarantee of legal stability that TGH could invoke. Quite the contrary, Guatemala clearly informed EEGSA and its shareholders of the possibility of amendments to the regulatory framework. The contracts which govern EEGSA's operation, and thus TGH, explicitly accept that regulatory and legislative changes may take place:

> [It] agrees to comply with all the provisions of the [LGE] and [the RLGE] and amendments to them and other regulations and provisions of general application […].[421]

312. Throughout this arbitration, TGH has repeatedly relied on one single basis for its alleged expectations at the time of EEGSA's privatization. Its basis is a single word in the Sales Memorandum prepared by Salomon Smith Barney, which says "VADs must be calculated by distributors by means of a study commissioned [by] an engineering firm," and that the CNEE "will review those studies and may make observations, but in the event of discrepancy, a Commission of three experts will be convened to resolve the differences."[422] The word that would have given rise to its legitimate expectations in this case is "resolve" ["*resolver*"], which, according to TGH, indicates that the Expert Commission had the last word

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[420] See for example Rejoinder, paras. 173-181.

[421] Authorization Contract Between the Ministry of Energy and Mines and Empresa Eléctrica de Guatemala S.A., 15 May 1998, **Exhibit C-31**, Clause 20; Final Electricity Authorization Agreement for the Departments of Chimaltenango, Santa Rosa and Jalapa, 2 February 1999, **Exhibit R-20**, Clause 20 (emphasis added).

[422] Salomon Smith Barney, "EEGSA: Sales Memorandum," May 1998, **Exhibit R-16**, p. 63. Reply, para. 264. Tr. (English) Day Five 1172:19-1173:19, Alegría.

on the approval of the Bates White study and the VAD applicable to EEGSA in the 2008 tariff review.

313. With all due respect, this is absurd. Neither the word "resolve," nor the phrase in which it is contained, say anything about the powers of the CNEE regarding tariff matters being limited, or about the Expert Commission having binding decision-making powers, or that it is the Expert Commission that approves the tariff studies. On the contrary, the Memorandum is clear in that the CNEE has the power to approve the VAD studies and set tariffs.[423] The verb "to resolve" does not in and of itself mean binding; it must be interpreted in a manner compatible with the verb *pronunciarse* ("pronounce itself") and the term "expert," which are used in the Law itself. There is no document in the file evidencing the interpretation that TGH (or rather the Teco group) seeks to apply now. The only motivation for the investment voiced by the Teco group at the time was the vertical integration of its electricity generation business.[424]

314. Guatemala cannot be held responsible for TGH's inaccurate interpretation of the regulatory framework. Not a single organ in Guatemala provided a specific commitment that the Guatemalan legal framework would be interpreted as TGH does in this arbitration. In fact, one would have hoped that the Teco group would have sought legal advice from local lawyers on the applicable regulatory framework. In spite of multiple document requests concerning the alleged "due diligence" carried out by the Teco group, TGH was unable to submit a single document showing that it sought or received any advice concerning the domestic regulatory framework at the time of the investment.[425] The reality is that TGH made up the supposed expectation of the Teco group with this arbitration, as will be seen below.

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[423] Salomon Smith Barney, "EEGSA: Sales Memorandum," May 1998, **Exhibit R-16**, pp. 54-55, where it states:

> The basic functions of the [CNEE] are, among others […] set the tariffs required by law […] The Commission, formally a technical boy of the MEM with budgetary and functional independence, is the regulatory and supervisory body of the electricity sector. The basic functions of the Commission are: (1) enforce the Law […], (4) regulate the transmission and distribution tariffs […].

[424] "TECO Energy, Inc., Action Regarding the Privatization o fan Electric Utility in Guatemala", Board Book Write-up, July 1998, **Exhibit C-32**, p. 2.

[425] Despite Guatemala's request for documentation of any *due diligence* in its request for documents (**Exhibit R-142**, Documentation A.2), TGH did not present even a single document, neither related to the supposed *due diligence* supposedly conducted when it invested in 2005, nor in 1998 when the other companies in the consortium invested in EEGSA.

315. It is notable that TGH's theory regarding legitimate expectations does not find support on the facts; this was admitted by TGH's own witnesses at the Hearing. For example, Mr. Gillette, the Teco employee in charge of following the privatization of EEGSA, stated as follows:

(a) He never participated in any of the roadshows.[426]

(b) He is does not know if and which members of his team participated in the roadshows.[427]

(c) He did not recall having seen a *due diligence* report on the regulatory framework.[428]

(d) He did not review any promotional materials regarding the bidding process.[429]

(e) He could not show any *briefing* from his team that was involved in the bidding process.[430]

(f) He stated that information was obtained through "*casual inputs in random ways*."[431]

(g) He could not recall having had any discussions with the legal team.[432]

(h) He admitted that he did not receive any advice from Guatemalan lawyers,[433] including regarding key questions.[434]

(i) He never read the Concession Contract.[435]

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426 Tr. (English), Day Two, 443:5-444:11.

427 *Ibid*., 445:2-10.

428 *Ibid*., 460:19-462:5.

429 *Ibid*., 449:7-11 y*Ibid*., 454:4-9.

430 *Ibid*., 451:11-22y *Ibid*., 452:17-22.

431 *Ibid*., 457:17-458:12y*Ibid*., 466:10-467:1.

432 *Ibid*., 459:12-460:10.

433 *Ibid*., 460:19-461:2.

434 *Ibid*., 469:1-471:4 y *Ibid*., 473:16-474:2.

435 Tr. (English), Day Two, 464:22-465:2.

(j) He stated that his knowledge of the regulatory framework was based on his experience with the regulatory framework in the United States.[436]

316. Ms. Callahan also admitted to knowing nothing about tariff reviews, and to having never seen anything on the subject at the time the investment was made.[437]

317. TGH has not presented a single document or any information relating to the due diligence supposedly carried out at the time of the investment in 2005, or anything from 1998 when other companies of the Teco group acquired their participation in EEGSA.[438] It is unusual that a sophisticated U.S. company such as Teco did not seek legal advice in making an investment of this magnitude. This is even more surprising when one considers TGH's statements to the effect that the investment in Guatemala was made based on the understanding that, in the event of disagreement between EEGSA and the regulator, the Expert Commission would have the power to issue a binding decision on the VAD; all this notwithstanding the fact that the LGE is silent on this question, but is clear to the effect that the CNEE has the power to approve the VAD and the tariffs. TGH should have by some means sought advice on this matter. Rather, the minutes of the board of directors of Teco (not TGH) in 1998 show that the regulatory framework was discussed fleetingly and that the main motivation for making the investment was the integration of EEGSA's distribution business with Teco's power generation business.[439]

318. In short, TGH's theory of legitimate expectations is only of academic interest, since TGH cannot prove that it had any such expectation, much less one based on specific, unequivocal and repeated promises or guarantees given by Guatemala.

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[436] Tr. (English), Day Two, 460:4-18.

[437] Tr. (English), Day Two, 580:11-19.

[438] It should be noted that in accordance with the public bidding procedure for EEGSA's shares, the interested companies could make inquiries or request clarifications with respect to the regulatory framework. Teco did not submit any inquiries or comments whatsoever with respect to the role of the regulator and/or its powers and attributions. Nor did it submit any questions with respect to the role of the Expert Commission, the nature of its pronouncement or the procedure to be followed after such pronouncement was issued (see Counter-Memorial, para. 228).

[439] TECO Energy, Inc. Action Regarding the Privatization of an Electric Utility in Guatemala, Board Book Write-up, July 1998, **Exhibit C-32**.

319. Regarding any expectation that the Consortium that acquired EEGSA in 1998 (of which Teco, not TGH, was part) may have had as to the prospective evolution of the VAD, it must be noted that the valuation made by Dresdner Kleinwort Benson (the ***DKB Valuation***) —prepared by financial entities for the purpose of obtaining the financing of 60% of the purchase price offered— projected EEGSA's revenue on the basis of the VAD of 1998, i.e., a VAD established on the basis of a comparable company in El Salvador, CAESS. As can be seen in the DKB Valuation, it was also anticipated that with each tariff review the VAD would be reduced in real terms due to the expectation that efficiencies would result in tariff reductions.[440]

Tribunal's Question: How was the purchase price of EEGSA calculated?

320. At the Hearing, the Tribunal asked how the Consortium calculated the purchase price of EEGSA.[441] The value of the company was calculated on the basis of anticipated cash flow,[442] and not on the value of physical assets. The DKB Valuation shows that the "valuation methodology used" was the discounted cash flow method.[443] The VAD reductions at each tariff review were taken into account in this assessment.

321. The EEGSA Privatization Management Presentation (the ***Management Presentation***) demonstrates that the valuation was based upon anticipated cash flow, in full awareness of the tariffs already in place in 1998. The financial evaluation of the base case only evaluated "annual operating profits," the "annual net income" and the "dividend payout," each of which includes anticipated cash flow for EEGSA:[444]

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[440] Dresdner Kleinwort Benson Valuation Model, 10 August 1998, **Exhibit R-160**, p. 43.

[441] Tr. (English), Day Two, 402:11-403:20, Mourre.

[442] Dresdner Kleinwort Benson Valuation Model, **Exhibit R-160**, p. 8.

[443] *Ibid*., p. 4.

[444] EEGSA "EEGSA Privatization, Management Presentation," 9 July 1998, **Exhibit R-161**, p. 8.

BUSINESS MODEL

Base Case Economics	EEGSA	
	1998	1999
•Annual Operating Profits	$47M	$47M
•Annual Net Income	$32M	$36M
•Dividend Payout (1)	$21M	$20.5M(2)

(1)Based on 100% distribution of the lesser of available cash or net income
(2)Assumes debt repayments by EEGSA in 1999 are refinanced

•Target IRR Discussion

322. The Management Presentation therefore established that the business model was based on "***project cash flows and earnings***" and "provides ***the purchase price based upon the targeted IRR***":[445]

Business Model

•20 Year Model of Annual Expenses and Revenues developed by Dresdner with input from experts in each functional business area

•Provides projection of project cash flows and earnings

• Provides Purchase Price based upon Targeted IRR

6

323. Both parties agree that the Consortium hoped to obtain cash flows from the tariffs, and that the 1998 tariffs were already in effect when the Consortium submitted its offer. Such tariffs were therefore a determining factor in the calculation of the purchase price. The high purchase price offered by the Consortium indicates that other factors, such as synergies, had an impact on the valuation of the company.[446]

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445 EEGSA "EEGSA Privatization, Management Presentation," 9 July 1998, **Exhibit R-161**, p. 6.

446 See para. 6 of this document and "TECO Energy, Inc., Action Regarding the Privatization o fan Electric Utility in Guatemala", Board Book Write-up, July 1998, **Exhibit C-32**, p. 2.

Tribunal's Question: What is the difference between the Price Waterhouse valuation of 1991 and the price paid in 1998 for EEGSA?

324. Another question from the Tribunal related to the above concerns the difference between the Price Waterhouse valuation of 1991 and the price actually paid in 1998.[447] The 1991 Price Waterhouse report contained two valuations:

- Valuation of the assets or "book value" (USD 59.6 M); and
- Valuation of the anticipated value of cash flows using the discounted cash flow methodology, which produced the following results:[448]
    - Case I: USD 13.9 MM (without taking future tariff increases into account; this value represented only 23% of the book value).
    - Case II: USD 57 MM.
    - Case III: USD 57 MM.

325. First, the 1991 *book value* cannot be compared with the privatization price since the book value was not taken into account in calculating the purchase price, as noted above.[449]

326. Second, the valuation of the 1991 *cash flows* cannot be compared with the 1998 privatization price because these valuations are based on:

- ***Different regulatory frameworks*.** The regulatory framework in 1991 was completely different from that in effect in 1998. The LGE and the RLGE had not yet been adopted. The Price Waterhouse report expressly recognizes this in the following proviso: "[a]lthough this type of regulation / method of establishing prices may not be used if EEGSA is privatized."
- ***Different market conditions.*** Price Waterhouse utilized an equity cost (own capital) of 25%,[450] but it noted that an investor could have an even greater discount rate.[451]

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[447] Tr. (English), Day Two, 402:4-403:20, Mourre.

[448] Price Waterhouse, *Estudio de la Empresa Eléctrica de Guatemala*, 11 January 1991, **Exhibit C-7**, pp. 24-25. In Case I, it is assumed that the tariffs will remain at the levels projected by EEGSA. In Case II, it is assumed that the tariffs may be raised to a level that would allow the investors to recover the book value of the property. In Case III, it is assumed that the government will provide debt financing for part of the company at a subsidized cost in order to keep tariffs low.

[449] *Ibid.*, p. 19. As noted above, the value of the assets is not relevant to determining the offer price, which is calculated exclusively on the basis of cash flows. However, it is no possible to determine whether this value reflects the real value of the infrastructure at that time. Indeed, it is possible that the accounting practices of a state-owned company in Guatemala in 1991 did not follow standard accounting practices.

[450] *Ibid.*, p. 23.

[451] *Ibid.*, p. 26.

At the time of the privatization, the Consortium considered an equity cost of 15.1%[452] (and a CPPC of 12.3%). The difference in the discount rate has a significant impact on company value. This is mainly due to the fact that the general economic conditions in Guatemala were much worse in 1991 than they were in 1998. For example, inflation rates stood at 70% in 1991[453] against 7% in 1997.[454]

- ***Company operations.*** Price Waterhouse projected a significantly smaller company. For example, Price Waterhouse projected revenues of GTQ 860 billion for 1998,[455] while before privatization the DBK Valuation projected revenues of GTQ 1.628 trillion for that same year.[456] Even PWC's most optimistic hypothesis estimated revenue at GTQ 940-960 billion for 1998.[457] Moreover, PWC's valuation was based on only ten years of cash flow, while the offer was based on perpetual flows, which results in a higher value. The DBK Valuation shows the importance of perpetual cash flows.[458]

- ***Higher tariffs.*** The tariffs in effect in 1991, which were used by Price Waterhouse to project future cash flows, were significantly lower than the 1998 tariffs. Indeed, there were several tariff increases between 1991 and 1998, as described in a U.S. Congressional report on Latin America. As described in that report, tariffs increased almost 160% between 1991 and 1993 alone, and increased again in 1998 at the time of the first tariff review, when tariffs were fixed to be similar to El Salvador.

D. LEGITIMATE EXPECTATIONS ARE ONLY VIOLATED BY FUNDAMENTAL CHANGES TO THE REGULATORY FRAMEWORK AGAINST SPECIFIC COMMITMENTS

Tribunal's Question: What type of change in the legal framework may be considered a breach of the investor's legitimate expectations?

327. The Tribunal also asked at the Hearing what sort of change to the legal framework could result in a violation of the legitimate expectations of the investor.[459] It is worth repeating that the doctrine of legitimate expectations does not apply in this case, given that the applicable standard is the international minimum standard, and because there has been no specific

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452 Dresdner Kleinwort EEGSA Base Case Scenario, 1998, **Exhibit C-418**, p. 1.

453 Price Waterhouse, *Estudio de la Empresa Eléctrica de Guatemala*, 11 January 1991, **Exhibit C-7**, p. 18.

454 Empresa Eléctrica de Guatemala, S.A., Preliminary Information Memorandum prepared by Salomon Smith Barney, April 1998, **Exhibit C-27**, p. 70.

455 Price Waterhouse, *Estudio de la Empresa Eléctrica de Guatemala*, 11 January 1991, **Exhibit C-7**, p. 24, exhibit 4.

456 Dresdner Kleinwort Benson Valuation Model, **Exhibit R-160**, p. 28.

457 Price Waterhouse, *Estudio de la Empresa Eléctrica de Guatemala*, 11 January 1991, **Exhibit C-7**, p. 24, exhibits 5 and 6.

458 *See* Letter from Britt Doughtie to Néstor Martínez of 22 June 1998, **Exhibit R-234**, para. 2.

459 Tr. (English), Day Two, 413:10-16, von Wobeser.

commitment, promise, or guarantee of legal or other type of stability. In any event, as Guatemala explained in previous submissions, a fundamental change to the legal framework is required for expectations to be frustrated; this has not happened in this case. TGH does not address this question.

328. The cases related to the 2002 Argentine emergency legislation are clear examples of this. In those cases, Argentina had legislatively abolished the provisions to calculate public services tariffs; this has not occurred here. In *CMS,* for example, the tribunal stated:

> The measures that are complained of did in fact entirely transform and altered the legal and business environment under which the investment was decided and made. The discussion above, about the tariff regime and its relationship with a dollar standard and adjustment mechanisms unequivocally shows that these elements are no longer present in the regime governing the business operations of the Claimant.
>
> […]
>
> It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects. [460]

329. Along the same lines, in *LG&E v. Argentina* the tribunal stated as follows:

> Specifically, it was unfair and inequitable to pass a law discarding the guarantee […] that the tariffs would be calculated in U.S. dollars and then converted into pesos. […]
>
> Argentina acted unfairly and inequitably when it prematurely abandoned the PPI tariff adjustments and essentially froze tariffs […] and when it refused to resume adjustments, […] History has shown that the PPI adjustments that initially were supposed to be postponed have been abandoned completely and are now being "negotiated" away.
>
> […]

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[460] *CMS Gas Transmission Company v. Republic of Argentina* (ICSID Case No. ARB/01/8) Award, 12 May 2005. **Exhibit CL-17,** para. 275, 277 (emphasis added).

> Likewise, the Government's Resolution No. 38/02 issued on 9 March 2002, which ordered ENARGAS to discontinue all tariff reviews and to refrain from adjusting tariffs or prices in any way, also breaches the fair and equitable treatment standard.
>
> […] But here, the tribunal is of the opinion that Argentina went too far by completely dismantling the very legal framework constructed to attract investors.[461]

330. In the same vein, the award in *BG Group v. Argentina* stated:

> Argentina […] entirely altered the legal and business environment by taking a series of radical measures, starting in 1999 […] Argentina's derogation from the tariff regime, dollar standard and adjustment mechanism was and is in contradiction with the established Regulatory Framework as well as the specific commitments represented by Argentina, on which BG relied when it decided to make the investment. In so doing, Argentina violated the principles of stability and predictability inherent to the standard of fair and equitable treatment.
>
> […]
>
> […] the Emergency Law and subsequent legislation were enacted to promote a new deal with the licensees, impeding the application and execution of the original Regulatory Framework. […]
>
> In summary, […] Argentina fundamentally modified the investment Regulatory Framework […]. [462]

331. Some of the earlier quoted awards are also relevant in that they conclude that "*any reasonably informed business person or investor knows that laws can evolve in accordance with the perceived political or policy dictates of the times*,"[463] and that an investor "*may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any*

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[461] *LG&E Energy Corp., LG&E Capital Corp. & LG&E International Inc. v. Republic of Argentina* (ICSID Case No. ARB/02/1) Decision on Liability, 3 October 2006, **Exhibit CL-27**, paras. 134, 136, 138-139 (emphasis added).

[462] *BG Group Plc. v. Republic of Argentina* (UNCITRAL Case) Final Award, 24 December 2007. **Exhibit CL-9**, paras. 307, 309-310 (emphasis added).

[463] *AES Summit Generation Limited and AES-TISZA ERÖMÜ KFT v. Hungary* (ICSID Case No. ARB/07/22) Award, 23 September 2010, **Exhibit RL-24**, para. 9.3.34.

changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable."[464]

332. Therefore, it is clear that only fundamental alterations of the legal framework can violate legitimate expectations. There is no violation of such expectations in cases involving public authorities' non-compliance with the regulation, as TGH alleges. There would also be no violation in cases involving limited reforms to the regulatory framework that did not revoke or abolish the basic premises of the regulation, as was the case with the reforms to RLGE Article 98.

V. THE HEARING DEMONSTRATED THAT TGH'S CLAIM FOR DAMAGES IS NOT CREDIBLE

A. THE BUT FOR SCENARIO PRESENTED BY EXPERT MR. KACZMAREK LACKS ALL FOUNDATION

333. As was clarified during the Hearing, this Tribunal should only consider the positions of the parties with respect to damages if, after having analyzed the arguments put forward by Guatemala to date, it still considers that it has jurisdiction to decide the regulatory questions discussed during this arbitration proceeding, and likewise decides that the CNEE failed to act in accordance with the law when it set tariffs on the basis of the Sigla study.[465] Even if this were the case, the lack of credibility of TGH's damages claim was apparent at the Hearing, as described below.

334. As explained during the Hearing, given that the parties are essentially in agreement regarding EEGSA's value in the actual scenario, the principal focus of their disagreement is the but for scenario.[466] While expert Mr. Kaczmarek calculates a but for value for EEGSA of US$1.479 billion, the experts Dr. Abdala and Mr. Schoeters estimate said value to be US$562.4 million.[467]

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[464] *EDF Services Ltd v. Romania* (ICSID Case No. ARB/05/13) Award, 8 October 2009, **Exhibit RL-13**, para. 217.

[465] Tr. (English), Day Six, 1527:22-1528:7, Abdala.

[466] *Ibid*., 1528:22-1529:3.

[467] *Ibid*., 1529:3-7. M Abdala and M Schoeters, **Exhibit RER-4**, para. 32; Kaczmarek, **Exhibit CER-5**, para. 140 and Table 13.

335. To calculate the value of EEGSA in the but for scenario, Mr. Kaczmarek relies upon the 28 July Bates White study. As already explained, Mr. Kaczmarek adopted this value because he believed that the 28 July study contained all of the Expert Commission's pronouncements, such that the CNEE should have used that study to establish the 2008-2013 tariffs.[468] As Mr. Kaczmarek himself admitted in the Hearing, however, he never verified whether the pronouncements were incorporated, let alone the general validity of the 28 July study:

> I've not offered any opinion because I haven't done any work to check whether or not all of the Expert Commission's findings were incorporated.[469]

336. Mr. Kaczmarek simply accepted as valid the statements of the author of the study, Mr. Giacchino.[470] This circumstance alone serves to dismiss the entirety of Mr. Kaczmarek's analysis in his but for scenario. In any event, as already explained in Section III.E above, the reality is that the 28 July study did not contain all the pronouncements of the Expert Commission and therefore could never have been used as a basis for establishing the tariffs. Furthermore, the 28 July study incorporated the Expert Commission's FRC which, as already explained, contained serious technical errors and was not contemplated by the regulation.

337. Moreover, as Dr. Abdala explained in the Hearing, Mr. Kaczmarek's model projects investments far below the needs of the company (US$46.2 million per year). More importantly still, the projections are lower than those included in the Bates White model (US$76.5 million per year).[471] This element was neither coincidental nor innocent. The immediate effect of including lower maintenance and expansion costs, while maintaining the tariffs requested in the Bates White study, is to generate an increase in the funds available to the company, and thereby increase the value of the damages claimed by TGH.[472] As explained by Dr. Abdala in the Hearing, this point alone represents more than US$ 400million of EEGSA's value calculated by Mr. Kaczmarek in the but for scenario.[473]

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468 Tr. (English), Day Six, 1520:22-1521:8, Kaczmarek.

469 *Ibid*., 1521:5-8.

470 *Ibid*., 1520:22-1521:2-4.

471 Tr. (English), Day Six, 1529:10-1530-8, Abdala.

472 *Ibid*., 1531:17-20.

473 *Ibid*., 1531:4-22.

338. In contrast to Mr. Kaczmarek's approach, experts Dr. Abdala and Mr. Schoeters calculated EEGSA's value in the but for scenario on the basis of the independent exercise carried out by Mr. Damonte. Mr. Damonte incorporated the pronouncements of the Expert Commission into the Bates White 5 May study, with the exception of the FRC, which he replaced with a technically correct formula. The implicit depreciation level in Mr. Damonte's formula for the calculation of the return is 29.6%.[474] It should be noted that this value is conservative given that it is (i) very close to that applied in 2003 (30%); (ii) less than the actual EEGSA accounting depreciation of 43.5%, and (iii) lower than the 42.2% applied to Deorsa and Deocsa.[475]

339. As explained by Dr. Abdala in the Hearing,[476] it is important to compare the asset base with an accounting tariff base in order to evaluate the reasonableness of the divergent but-for scenarios presented by the parties' experts. The asset base is the undepreciated portion of the VNR, which as is shown in the following graph, amounts to US$1.031 billion in Mr. Kaczmarek's view (calculated on the basis of a VNR of US$1.102 billion of Bates White on 28 July 2008) and US$491.9 million according to Abdala and Schoeters (calculated on a VNR of US$661.1 million in accordance with the study of Mr. Damonte). When this is compared with EEGSA's accounting tariff base of US$448.9 million, it is evident that while the asset base used to calculate EEGSA's return according to Mr. Damonte's study is consistent with the EEGSA's actual asset base, that of Mr. Kaczmarek is much higher:[477]

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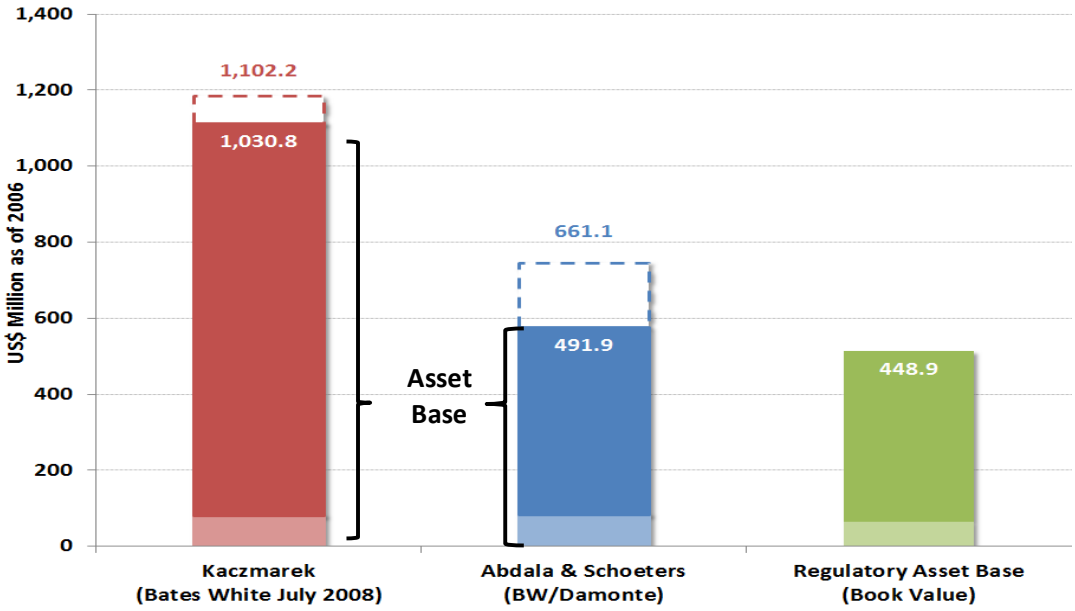
474 Tr. (English), Day Six, 1418:18-20, Damonte; Direct Examination of Mario Damonte, slide 17.

475 Tr. (English), Day Six, 1418:8-11, Damonte; Direct Examination of Mario Damonte, slide 17.

476 Tr. (English), Day Six, 1536:21-1537:6, Abdala; Direct Examination of Manuel Abdala, slide 6.

477 Direct Examination of Manuel Abdala, slide 7.



340. While the Guatemalan regulatory system is not based on the accounting tariff base, the reality is that no regulator would remunerate the investor for a regulatory base which substantially deviates from the amounts actually invested.

B. KACZMAREK'S REASONABLENESS TEST CONTAINS IRREPARABLE ERRORS

341. In an attempt to demonstrate the reasonableness of his calculation of the corporate value, Mr. Kaczmarek presented to the Tribunal a reasonableness test based on the IRR for TGH since the beginning of its investment.[478] However, as indicated during the Hearing, this test contains irreparable errors.

Question from the Tribunal: Are the parties in disagreement with respect to the IRR?

342. First, to clarify the Tribunal's question as to whether the parties disagree about whether an IRR was guaranteed to EEGSA or TGH,[479] it is important to emphasize that the Guatemalan regulation does not guarantee a return but rather the opportunity to obtain a regulated return. Furthermore, the guaranteed "opportunity" to obtain a return corresponds to the distributor (EEGSA) and not its shareholder (TGH).[480] As the Guatemalan experts explain in their report,

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478 Tr. (English), Day Six, 1521:9-17, Kaczmarek.

479 Tr. (English), Day Two, 404:5–408:4.

480 M Abdala and M Schoeters, **Exhibit RER-4**, paras. 59-64. The parties also disagree with respect to the prospective nature of the IRR calculation. While Kaczmarek calculates a historic IRR for Teco, Dr. Abdala and Mr. Shoeters calculate a prospective IRR for EEGSA, as of August 2008 and thereafter. The approach of

the shareholder's return may be affected by dividend distribution policies, financing and other corporate decisions, and therefore cannot serve to measure the return in this case.[481]

343. Secondly, as Mr. Kaczmarek admitted during the Hearing, despite the fact that there is no provision within the regulatory framework to ensure a return on the initial value paid in the privatization, the reasonableness test submitted by Mr. Kaczmarek includes those values. As explained by the expert Mr. Kaczmarek during the Hearing:

> Q. And to do that [IRR] analysis, basically, you take as an initial point the price offered by TECO in the privatization; is that correct?
>
> Kaczmarek: That's correct, with one adjustment, yes.
>
> Q. Could you point to me anywhere in the law where it says that the initial price after privatization was going to be guaranteed--as the basis of the guaranteed return?
>
> Kaczmarek: I don't argue, and I agree with Compass Lexicon's statement that there's no guarantee of return. But if you operate efficiently, then, of course, since there is no competition, the prices are fixed; you should be able to earn your return.[482]

344. As already explained, the LGE only guarantees a return of between 7 and 10% on the value of the asset base of the model company, not on the amounts invested by the distributor, much less on the amount offered in the privatization. The amount offered by Teco in the privatization, as demonstrated in this proceeding, was strongly influenced by the potential to integrate Teco's business in Guatemala and improve group positioning in the region.[483] In fact, it should be noted that the amount paid by Teco exceeded that recommended by its own financial advisors by almost US$100 million.[484] It is clear that Guatemalan consumers are not

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Dr. Abdala and Mr. Schoeters is consistent with what a regulator should do at the time of the tariff review, that is, seek an objective future rate of return for EEGSA, and not retroactively for the shareholder.

481 M Abdala and M Schoeters, **Exhibit RER-4**, para. 60.

482 Tr. (English), Day Six, 1521:14-1522:4, Kaczmarek.

483 Rejoinder, paras. 267-271.

484 *Compare* Dresdner Kleinwort Benson Valuation Model, **Exhibit R-160**, p. 26 (EEGSA valuation of US$ 420 million) *with* Notarized Act of Notary Laura Vargas Florido, 14 April 2000, **Exhibit 14 to RER-5** (Teco offered US$ 520 million).

involved in these corporate decisions and the tariff cannot, therefore, guarantee a return on these amounts.

345. Furthermore, not only does Mr. Kaczmarek's logic contradict the regulatory framework, but it also does not withstand scrutiny. As the expert recognized during the Hearing, such logic makes the investor's return directly dependent on the bid amount.[485] Had Teco offered more money for EEGSA, its IRR would be lower; had it offered less, its IRR would be higher, completely independent of any actions by the regulator or its operating performance. It is clear that the Guatemalan regulatory system does not function in this manner. Additionally, the logic applied by Mr. Kaczmarek results in perverse incentives for the bidders, who would offer high values for the sole purpose of receiving a return on these amounts. Certainly, this is not what was foreseen by legislators in the Guatemalan regulatory system.

346. In addition to this conceptual error in the IRR test, it was demonstrated in the Hearing that Mr. Kaczmarek had even included an initial Teco investment amount that was higher than that set forth in the company's financial statements. Mr. Kaczmarek admitted at the Hearing that he had not reviewed the financial statements:

> Q. Did you see this document [Teco's financial statements] when you incorporated the initial price in your calculation?
>
> Kaczmarek: I don't recall seeing it.[486]

347. This error, in addition to leading to an erroneous IRR calculation for TGH by Mr. Kaczmarek, essentially demonstrates the expert's lack of precision. It is inconceivable that an expert can render an opinion such as that offered by Mr. Kaczmarek without having at the very least verified the company's financial statements and the figures included in his report.

348. Notwithstanding the foregoing and despite the fact that the LGE does not ensure a profit on actual amounts invested, but rather on the optimum asset base of the model company, Guatemala's experts produced a reasonableness test of EEGSA's return during its operation,

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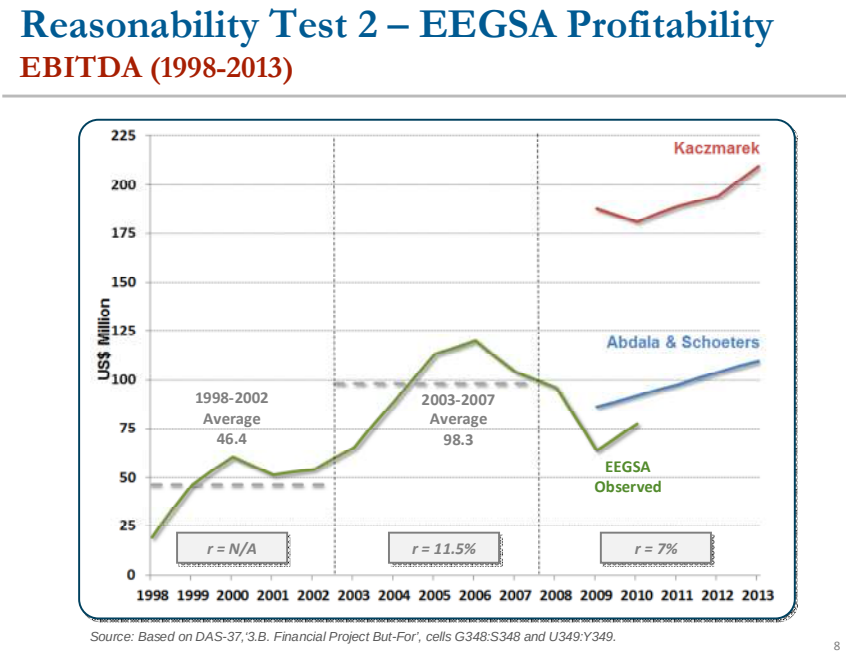
485 Tr. (English), Day Six, 1521:14-17, Kaczmarek.

486 *Ibid*., 1523:12-14.

based on the EBITDAs contained in EEGSA's financial statements from 1998 through 2010. The results can be seen in the graph below:[487]



349. As explained by Dr. Abdala in the Hearing, during the first tariff period there was no rate of return expressly established for the purposes of review. Nevertheless, as previously explained, the projections of Teco's consultant firm Dresdner confirm that, at the time of investment, Teco expected a VAD reduction of between 2 and 3% in real terms during the first five-year period and also during subsequent five-year periods. Despite this, EEGSA's return actually increased during the first five-year period, reaching an annual average of US$46.4 million. In 2003, the legal rate of return was established by the CNEE at 11.5% and EEGSA experienced an increase, achieving an annual average return of US$98.3 million. Finally, in 2008, the CNEE fixed the rate of return at 7%, which implied a 4.5% reduction of the rate applied in 2003 and, consequently, EEGSA's return. Nevertheless, it should be explained that this reduction was within the CNEE's margin of discretion as permitted by the LGE. It should be recalled that the CNEE can establish the rate of return between 7 and 13%.[488] EEGSA's

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487 Tr. (English), Day Six, 1541:4-12, Abdala; Direct Examination of Manuel Abdala, slide 8.

488 LGE, **Exhibit R-8**, Article 79.

return in these circumstances was, in any event, close to US$75 million, which was even higher than the average levels of US$46.4 million of the first tariff period.[489]

350. As is clear from the graph presented, the profitability levels that EEGSA would have achieved had the 28 July tariff study been applied (as proposed by Mr. Kaczmarek) would raise the profitability of the company to exorbitant levels. The annual average return of US$98 million for the prior five-year period would increase to almost double, reaching an annual average of between US$180 and 200 million.[490] It is clear that Mr. Kaczmarek's proposal is neither reasonable nor correct. For comparative purposes, the maximum proposed by Guatemala's experts, in the event the Tribunal considers that the Sigla study should not have been used to establish the rates,[491] would make the EEGSA profitability during the five-year period amount to an annual average of between US$85 and $120 million. This is in line with the profitability for the immediately preceding tariff period, even when the legal profitability rate is lower in the tariff period under analysis.[492]

351. Finally, the reasonableness of Dr. Abdala's proposal and the unreasonableness of Mr. Kaczmarek's proposal is also demonstrated by comparing the evolution of EEGSA's tariffs in each scenario with those of CAESS, the company used as a benchmark for setting tariffs at the time that Teco made its projections:[493]

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489 Tr. (English), Day Six, 1539:17:1541:3, Abdala.

490 *Ibid*., 1540:7-1941:3; Direct Examination of Manuel Abdala, slide 8.

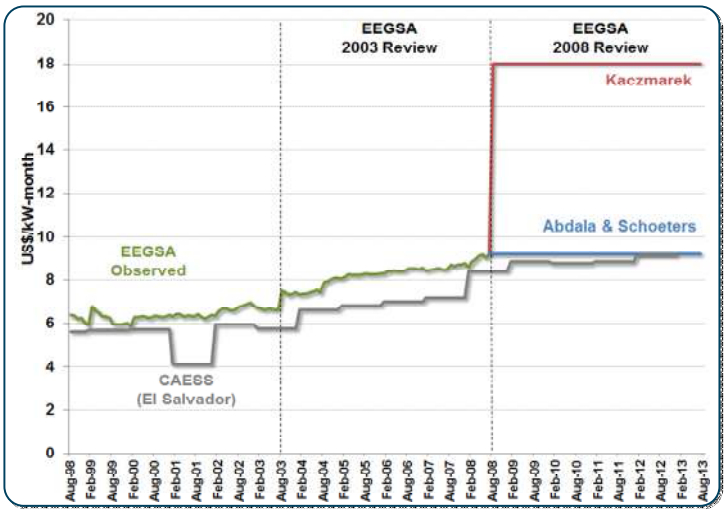
491 As explained by Dr. Abdala during the Hearing, his recommendation for damages in the event the Tribunal considers that the Sigla study was not appropriate for the establishment of tariffs is between zero and US$ 8 million in damages. Tr. (English), Day Six, 1541:20-1542:4, Abdala.

492 Tr. (English), Day Six, 1541:9-1542:14, Abdala.

493 Direct Examination of Manuel Abdala, slide 9.

Reasonability Test 3 – VAD Benchmark

Benchmark with CAESS (El Salvador) – Low Voltage



Source: Based on Abdala & Schoeters Second Report, Graph I.

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352. As shown in the graph above, while Mr. Kaczmarek's proposal is not in line with prior tariffs, the proposals of the Guatemalan experts do conform to them.

353. Finally, as explained above, the Guatemalan regulation only guarantees the opportunity to obtain a regulatory return on the asset base for the five-year period under analysis, but does not contemplate retroactive adjustments to previous returns. The IRR test presented by Mr. Kaczmarek, however, incorrectly assumes that the Guatemalan regulation guarantees a return on the initial value paid on privatization, over the 1998-2010 period. Thus, experts Dr. Abdala and Mr. Schoeters correct this assumption in their IRR test, that is, by calculating the prospective IRR for the five-year period under analysis (2008-2013). Experts Dr. Abdala and Mr. Schoeters obtain an IRR of 7.3%, which is higher than the regulatory rate of return of 7%.[494] This demonstrates that the exercise undertaken by experts Dr. Abdala and Mr. Schoeters is consistent with the Guatemalan regulation on the point, that is, that the level of regulatory return of 7% can only be considered to guarantee the "opportunity" to obtain a regulatory return.

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[494] Direct Examination of Manuel Abdala, slides 12 and 17.

C. THE POSSIBLE VAD INCREASE IN THE 2013-2018 TARIFF REVIEW SHOWS THAT THE EXPERT MR. KACZMAREK'S PROJECTIONS REGARDING PERPETUITY ARE INCORRECT

354. As was established at the Hearing, Mr. Kaczmarek's model not only contains projections for the 50 years of the contract, it also assumes that there will be automatic renewals of this contract in perpetuity.[495] The main problem with this approach is that it is actually impossible to know what will happen with the tariffs in the future. The fact that a possible rate increase of 15% is being discussed in the 2013-2018 tariff review shows that the "measures" really cannot be considered beyond the five-year period.

Question from the Tribunal: Can it be assumed that the tariffs set in the 2008-2013 period will apply forever?

355. This directly addresses the concerns expressed by the Tribunal as to whether it is correct to assume for the purposes of calculation of damages that the tariffs set in the 2008-2013 period will remain fixed forever.[496] Clearly this is not correct given that there is potential for increases over this five-year period[497] and in subsequent five-year periods. Given that the measures TGH complains of were implemented only during the 2008-2013 five-year period, TGH's damages, if any, should be limited only to that five-year period.

356. If Mr. Kaczmarek's DCF model is limited only to the 2008-2013 period, both in the actual scenario and in the but for scenario, the damages alleged by TGH (calculated as the difference between the net present value of the free cash flows under each scenario) will decrease from US$226.6 million to US$ 47.9million, that is, a decrease of approximately 78%. As explained by Dr. Abdala during the Hearing:[498]

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[495] Tr. (English), Day Six, 1530:16-20, Abdala. Tr. (English), Day Six, 1602:11-1604:1, Kaczmarek. Mr. Kaczmarek also utilizes the relative strategy in the real scenario for 2009 profits related to Sigla, and therefore implicitly perpetuates the tariff gap between the Bates White July 2008 study and the Sigla study in this methodology.

[496] Tr. (English), Day Six, 1602:21-1603:9, Mourre; Letter dated 11 March 2013 from the Tribunal to the parties, page 2.

[497] "EEGSA propone alza de 15 por ciento al VAD", El Periódico, 13 May 2013, **Exhibit R-249.**

[498] Tr. (English), Day Six, 1604:21-1605:7, Abdala. In the calculation of the alleged damages by experts Dr. Abdala and Mr. Schoeters, in contrast, it is impossible to limit the analysis period given that such experts have not modeled the real scenario. In the calculation of damages performed by experts Dr. Abdala and Mr. Schoeters, on the other hand, the analysis period cannot be restricted to the 2008-2003 five-year period because the DCF model of the real scenario does not go beyond TGH's divestiture. Specifically, the real scenario proposed by Guatemala's experts is based on the real cash flow generated by EEGSA between 1

> Like any damages eventually if you were to do a DCF versus DCF, DCF but-for and DCF actual, then you have to control for the fact that we don't know the outcome in 2013, and thus there is no reason to assume that the gap between tariffs that we are modeling for the 2008-2013 period should be prolonged over perpetuity, and that's one of the issues as well in the Sr. Kaczmarek model because, I mean, he has just confirmed as this cap forever.

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D. THE SALE OF TGH TO EPM

357. The fact that TGH did not try to sell its ownership stake for more than two years after the measures, and proceeded to sell only at the suggestion of its partner Iberdrola, is sufficient to prove that the catastrophic effect of the measures alleged by TGH is a fallacy.[499] This was confirmed at the Hearing by Ms. Callahan, who not only admitted that she never made any attempt to mitigate the alleged effect of the measures, but also recognized that EEGSA continued to have positive results after 2008.[500]

Question from the Tribunal: Is there evidence of the value assigned to EEGSA in the sale to EPM?

358. The Tribunal asked during the Hearing whether there was evidence of the value assigned to EEGSA in the sale to EPM.[501] The capital share of DECA II, the company holding 80.88% of the capital in EEGSA, was sold to EPM for US$605 million. Considering the net

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August 2008 (the date of the tariff review) and October 2010 (date that TGH relinquished its stake in EEGSA), plus the sale price that TECO received for their shareholdings in EEGSA, M Abdala y M Schoeters, **Appendix RER-1**, Section III.2.4.b. The sale price includes the anticipated evolution of the tariffs. Consequently, the use of this value avoids the necessity of making assumption on any future evolution of the tariffs in the real scenario.

499 Tr. (English), Day One, 187:15-189:13, Respondent's Opening Statement

500 Tr. (English), Day Two, 580:20-584:18, Callahan, and specifically 584:12-18:.

> Q: […] Why is that? TECO Energy is a sophisticated energy company. Why wouldn't it be in a position to identify potential buyers of an asset such as this?
>
> A. Not necessarily.
>
> Q. But it didn't even try, did it?
>
> A. No, we did not put -- we did not put our piece up to be marketed.

Tr. (English), Day Two, 577:22-578:4 Callahan:

> Q. […] You spend some time in your Statement explaining the negative effect of those tariffs on EEGSA's income. But is it right that, notwithstanding the reduced VAD, EEGSA did remain in positive income after you did that analysis?
>
> A. They did, yes.

Tr. (English), Day Two, 577:21-578:5, Callahan.

501 Letter from the Tribunal to the parties dated 11 March 2013, page 2.

debt of DECA II, this price implies a DECA II company value of US$647.9 million.[502] The offer, however, did not include an express indication of the value assigned to EEGSA. Thus, the Respondent does not have in its possession any direct evidence of the value assigned to EEGSA in the purchase price.

359. That said, the Claimant's consultant in the sale to EPM, Citigroup, carried out a valuation exercise based on the DCF method and valuation by multiples, assigning individual values to each of the companies comprising DECA II (including EEGSA).[503] Of the various methods of valuation used by Citigroup to value DECA II, the value obtained with the DCF method is the closest to the actual value of the transaction.[504] Using Citigroup's DCF valuation, the company value corresponding to EEGSA subtracted from the purchase price is approximately US$582 million.[505]

360. Apart from the contemporaneous evidence presented by the Citigroup analysis, both experts have valued EEGSA based on the transaction price, using EEGSA's share in the EBITDA of DECA II to estimate EEGSA's contribution to the total value of the transaction. While both experts agree on the methodology, there is a slight difference in the time period used for the underlying data in calculating the EBITDA ratios.[506] While Mr. Kaczmarek uses information on the EBITDA for the 12 calendar months of 2009, Dr. Abdala and Mr. Schoeters use the most recent data available at the time of the sale to EPM (i.e., information on the last 12 months prior to the sale of DECA II, from October 2009 to September 2010). EEGSA's

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502 *See* Kaczmarek, **Appendix CER 2**, Table 24, and Letter from EPM to Iberdrola, TPS, and EDP, dated 6 October 2010, p. 11 **Exhibit C-352**, p. 11 (Annex 2).

503 *See* Citigroup Fairness Opinion, 14 October 2010, **Exhibit C-531**.

504 Citigroup valued the DECA II capital at US$572-670 million with the DCF method, US$541-626 million with the comparable transactions method, and US$465-560 million with the "selected companies" method. The sale price of US$605 million is closer to the midpoint of the valuation range determined by the DCF method. *See* Citigroup Fairness Opinion, with respect to the law of 14 October 2010, **Exhibit C-531**, p. 6.

505 Citigroup valued the DECA II share of EEGSA's equity at a minimum and maximum value of US$373.3 million and US$448.2 million respectively, and valued the total capital of DECA II at a minimum and maximum value of US$572.1 million and US$669.6 million respectively. This means that Citigroup considered that EEGSA represented 65.3% as a minimum and 66.9% as the maximum of the total capital of DECA II, and in that range the midpoint would be 66.1%. Using this 66.1%, we can estimate that US$399.9 million of the sale price of US$605 million related to EEGSA (US$605 million x 66.1%). As DECA II owned 80.88% of EEGSA's capital, the implied value of 100% stake in EEGSA is US$494.4 million (US$399.9 million / 80.88%). Finally, if we add EEGSA's net debt of US$87.6 million, we get a company value of US$582 million for EEGSA. *See* M Abdala & M Schoeters, **Appendix RER-1,** para. 82; Citigroup Fairness Opinion, 14 October 2010, **Exhibit C-531**, pp. 6-7 and Corrected NCI Model, Sheet "EPM Price," cells J80:87, **Exhibit DAS-27**.

506 *See* M Abdala & M Schoeters, **Appendix RER-1**, para. 81.

value when this methodology is used is US$498 million according to Mr. Kaczmarek's calculation and US$518.2 million according to that of Dr. Abdala and Mr. Schoeters.[507]

Question from the Tribunal: How was the 2008 tariff taken into account in establishing the sale price of EPM?

361. That said, regarding the arbitral Tribunal's question on how the 2008 tariff was taken into account in establishing the sale price of EPM,[508] the reality is that only the buyers and sellers, and not Guatemala, know that for certain.

362. Nevertheless, it is reasonable to assume that EPM's purchase price reflects the actual tariff level of the 2008 VAD (adjusted for inflation), at least up to 2013. EPM's press release, presented at the Hearing by Guatemala,[509] suggests that EPM expected a minimal change in the level of VAD in the future. This in turn suggests that, contrary to TGH's allegation, the 2008 tariffs were sufficient for EEGSA to sustain profitable operations. This is also supported by the US$620 million price paid for the assets of DECA II, of which EEGSA is the main asset, and by the slight tariff increase requested by EEGSA in the 2013 review.

* * *

363. In accordance with the above, even if this Tribunal considers that Guatemala is internationally responsible for its conduct during the 2008-2013 tariff revision, it cannot condemn Guatemala to pay the damages as calculated by Mr. Kaczmarek. In such a case, this Tribunal must use as a basis the valuations made by the experts for Guatemala. These experts calculated that, had the CNEE been required to approve the tariffs based on the tariff study of 5

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[507] *See* Kaczmarek, **Appendix CER-2**, Tables 23 and 24, and Abdala & Schoeters, **Appendix RER-1**, para. 81.

[508] Tr. (English), Day Two, 402:20-403:20, Mourre:

> PRESIDENT MOURRE: Another question is -- it regards the sale to TCM to Energía de Medellin in 2010. There is an exhibit which has been discussed yesterday, which is R-133, which is the interview of the CEO, I believe, of Energía De Medellin; and there is a question there which says: "The shareholders argued that there would be low revenue and profitability due to the VAD. Despite this issue, you decided to buy." And the answer is: "This is reflected in the value of the transaction. We bought on the basis that the current tariff model and layout is the one that exists. So there is an assumption that the tariff, as established in 2008, would remain the same for future tariff periods." And my question is: Why was there such an assumption, given that the tariff is reviewed every five years? How was the 2008 tariff, which is in this interview referred to as being low, how was that taken into account in the sale -- in fixing the sale -- the sale price to Energía de Medellin?

[509] Respondent's Opening Statement, slide 30, "We won't wave a flag. We respect people's roots," *Prensa Libre*, 23 October 2010, **Exhibit R-133**.

May 2008 (as amended according to the pronouncements of the Expert Commission) instead of the tariffs based on the Sigla study, TGH's alleged damages would be roughly between zero and US$ 8.1 million (in US$ as at October 2010).[510]

VI. REQUEST FOR RELIEF

The Republic of Guatemala respectfully requests that this Tribunal:

(a) DECLARE that it does not have jurisdiction over this dispute as presented by TGH;

(b) Alternatively and as a substitute to request (a) above, fundamentally REJECT all and each of the claims advanced by TGH; and in either case, additionally:

(c) AWARD any other compensation to Guatemala that the Tribunal considers appropriate and convenient;

(d) ORDER that TGH pay all of the costs of this arbitral proceeding, including the fees and expenses of the Tribunal and ICSID, as well as all fees and expenses incurred by Guatemala in connection with its legal representation in this arbitration, with interest before and after the publication of the Award and until payment has been satisfied. The foregoing is in conformity with the written claim for costs which Guatemala will present in due course.

Respectfully presented by the Republic of Guatemala on 10 June 2013.

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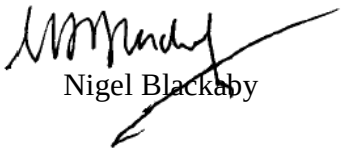
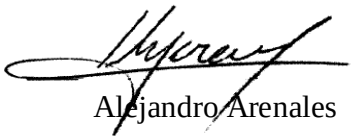
[510] M Abdala and M Schoeters Rejoinder, **Exhibit RER-4**, para. 78, Table VI.

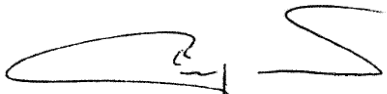


Nigel Blackaby



Alejandro Arenales

Alfredo Skinner Klée



Rodolfo Salazar