

**INTERNATIONAL CENTRE FOR  
SETTLEMENT OF INVESTMENT DISPUTES  
ADDITIONAL FACILITY**

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**WASTE MANAGEMENT, INC.**

**Claimant**

**v.**

**THE GOVERNMENT OF THE UNITED MEXICAN STATES**

**Respondent**

**ICSID Case # ARB (AF)/00/3**

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**REPLY**

**SUBMITTED BY**

**WASTE MANAGEMENT, INC.**

**Claimant**

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## CHAPTER ONE

### INTRODUCTION

1.1 In its Counter-Memorial, Respondent builds a house of cards more notable for its omissions than its content. Respondent's construction is founded on three principal arguments: (1) the Concession is a mere contract; (2) Claimant alleges simple breach of contract claims; and (3) the proper forum in which to resolve the claims is a domestic arbitration in Mexico. With this foundation in place, Respondent concludes that Claimant has no viable claim under NAFTA Articles 1110 and 1105. But each component of Respondent's foundation is factually and/or legally deficient. Once these deficiencies are exposed, Respondent's entire defense collapses and it becomes clear that Claimant has been subjected to precisely the sort of expropriation and unfair treatment that Chapter 11 of NAFTA was intended to remedy.

1.2 First, as Respondent itself has always maintained prior to filing its Counter-Memorial in this case, the Concession at issue in this arbitration was far more than a simple contract for goods or services. Indeed, Claimant invested in a public Concession predicated on the City of Acapulco and State of Guerrero (both backed by the Federal Government of Mexico) taking specified sovereign acts in exchange for the long-term development of Acapulco's waste management infrastructure. Such concessions have consistently been afforded special treatment under international law. Indeed, although not mentioned by Respondent in the Counter-Memorial, the City of Acapulco itself had consistently maintained that the Concession was a public contract:

It is indisputable that the provision in question is one of public law, given that the matter at hand involves the concession of a public service granted by the City Council of the Municipality of Acapulco to a company. This possibility cannot even be conceived of as a mixed act, as we insist that this is a concession of a public service, whose nature is administrative.<sup>1</sup>

Concessions for public service, like the one at issue in this arbitration, are simply not ordinary contracts.

1.3 Second, Claimant does not allege simple breach of contract, but a series of arbitrary and expropriatory acts by all levels of Mexican government calculated to frustrate Acaverde's operations and ultimately destroy Claimant's investment. Such action and inaction included failures to exercise sovereign powers (*i.e.*, enforce laws), abuses of sovereign power (*i.e.*, active violations of the law), arbitrary and tortious conduct (*i.e.*, conspiracy to violate Claimant's rights), and a denial of justice (*i.e.*, concerted action to deny Claimant's legal rights). In its totality, this pattern of willful misconduct (i) effected an expropriation of Claimant's investment in violation of Article 1110, and (ii) unacceptably subjected Claimant's investment to unjust and arbitrary treatment in violation of established international norms, resulting in a complete denial of justice, and violations of Article 1105.

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<sup>1</sup> Brief filed by the City of Acapulco before the Guerrero State Court (Exhibit G-40) (courtesy translation), p. 10 (emphasis added).

1.4 Third, this Tribunal, duly convened in accordance with Chapter 11 of NAFTA, is the appropriate place to consider Respondent's violations of Chapter 11 and international law. Respondent is not able to point to any precedent or authority that would divest this panel of jurisdiction over what is plainly an international dispute. Moreover, Respondent's suggestion that this dispute should be resolved in Mexican domestic arbitration is disingenuous. Respondent fails to inform the Tribunal that in the domestic proceedings, the City objected to the arbitration and filed a lawsuit seeking damages against Acaverde and a declaration that the arbitration clause in the Concession was null and void.<sup>2</sup> The Mexican government has never been willing to allow the merits of this dispute to be presented to an objective body in Mexico, or elsewhere.

1.5 This Reply is organized in six chapters. Chapter Two addresses Claimant's status as an investor and demonstrates that Mexico is fully responsible under NAFTA for the conduct of the City of Acapulco, the State of Guerrero and Banobras – a proposition that Mexico remarkably disputes in the Counter-Memorial despite earlier statements to the contrary.

1.6 In Chapter Three, Claimant provides a comprehensive analysis of the facts giving rise to Respondent's violations of Article 1110 and 1105. Such a detailed analysis was necessary to (i) rebut Respondent's improper characterization of the dispute as one for breach of contract, (ii) correct the numerous factual misstatements in the Counter-Memorial, and (iii) demonstrate that none of the "excuses" tossed out by Respondent justifies its expropriatory conduct.

1.7 In Chapter Four, Claimant sets out additional legal analysis of its Articles 1110 and 1105 claims, including a discussion of NAFTA arbitral decisions rendered after Claimant's Memorial was submitted in September 1999. Claimant also provides the Tribunal with information concerning the inconsistent positions taken by the City, State and Federal Governments in the domestic Mexican legal proceedings.

1.8 In Chapter Five, Claimant updates its compensation analysis and demonstrates that Respondent's damage proposal, if accepted, would create a perverse incentive for governments to engage in "creeping expropriations." In Chapter Six, Claimant presents its submissions and requests that the Tribunal award Claimant its damages and costs resulting from Respondent's arbitrary and expropriatory conduct.

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<sup>2</sup> See, *infra*, ¶ 4.18-4.22.

## CHAPTER TWO

### STATUS OF THE PARTIES UNDER NAFTA

2.1 At the outset, Claimant wishes to address the status under NAFTA of both Waste Management and the Federal Government of Mexico. Waste Management must demonstrate that it qualifies as "an investor" in order to assert a claim under Chapter Eleven, and this demonstration is set forth below in Subchapter A.

2.2 It is also important to clarify that the Federal Government of Mexico is fully responsible under NAFTA for the conduct of both the State of Guerrero and the City of Acapulco, and its own conduct carried out through Banobras. This issue is critical to address as a threshold matter because Respondent repeatedly suggests in its Counter-Memorial that, somehow, it is not responsible under NAFTA for the actions of its political subdivisions.<sup>3</sup> As demonstrated in Subchapter B, this position has no merit.

#### A. Waste Management Qualifies As An "Investor of a Party, On Behalf of An Enterprise."

2.3 Respondent spends 15 pages of its Counter-Memorial discussing how Waste Management acquired Acaverde,<sup>4</sup> describing the legal implications of that acquisition,<sup>5</sup> and requesting the Tribunal to draw a series of negative inferences regarding the acquisition.<sup>6</sup> However, Respondent never once explains how this discussion of Acaverde's acquisition is relevant to Waste Management's status as an investor.

2.4 Instead, Respondent claims that its discussion of the acquisition "relates to the credibility of the claims being made, to damages, and [will] aid in explaining Sanifill's conduct."<sup>7</sup> Respondent also states that its discussion is "potentially pertinent to questions of international public policy," although no explanation (or identification) of those public policy questions is provided. However, Respondent never once in its Counter-Memorial actually challenges Waste Management's status as an investor. And for good reason: there is no challenge to be made.

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<sup>3</sup> See, e.g., Counter-Memorial, ¶ 290.

<sup>4</sup> *Id.*, ¶¶ 41-50.

<sup>5</sup> *Id.*, ¶¶ 280-289.

<sup>6</sup> *Id.*, ¶¶ 290-315. Respondent's motives are apparent; it is trying to distract the Tribunal from considering the relevant facts. See discussion, *infra*, ¶ 4.3, fn. 153.

<sup>7</sup> Counter-Memorial, ¶ 280.

2.5 Waste Management's status as an investor was determined by the Tribunal in the first Waste Management proceeding in the following language:

Specifically, NAFTA Article 1117, paragraph 1, allows for submission of a claim to arbitration on behalf of an enterprise coming within the jurisdiction of the other Party, in cases where the investor controls said enterprise directly or indirectly. For such purposes, WASTE MANAGEMENT has, in the exhibits filed along with its Memorial of Claim, provided evidence of its status as "investor of a Party, on behalf of an enterprise," ACAVERDE S.A.<sup>8</sup>

2.6 The legal effect of that language in this proceeding was addressed by the Tribunal in Procedural Order No. 1. Respondent argued that it had reserved the right to challenge Claimant's status as an investor in its Counter-Memorial on the merits.<sup>9</sup> The Tribunal decided that Respondent was not precluded by the quoted language from challenging, in a non-preliminary way, Claimant's standing under NAFTA in this proceeding.<sup>10</sup>

2.7 Although Respondent was thus expressly authorized to file a direct challenge to Claimant's status as an investor, Respondent failed to do so. Respondent never argues or even suggests in its Counter-Memorial that Waste Management does not currently own or control Acaverde, that Waste Management did not own or control Acaverde at the time that this arbitration proceeding was instituted in September 2000, or that Waste Management did not own or control Acaverde during the entire time period that Acaverde was implementing the Concession, which was between August 1995 and November 1997.<sup>11</sup>

2.8 Although Respondent has not challenged Claimant's status as an investor, Claimant is fully aware of this Tribunal's directive that Claimant carries the burden of demonstrating that it owned or controlled Acaverde at the "relevant times."<sup>12</sup> Claimant submits that the "relevant times" are those periods set forth in the preceding paragraph. Claimant further submits that the documentation set forth in Exhibit E to its Memorial demonstrates Claimant's ownership or control as of the date the Memorial was filed, which was September 1999. In response to the Tribunal's directive in Procedural Order No. 2, Claimant has attached an updated certificate demonstrating its ownership of Acaverde as of January 2003.<sup>13</sup>

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<sup>8</sup> June 2, 2000 Arbitral Award in *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/98/2, ¶ 11.

<sup>9</sup> Letter from Respondent to Tribunal dated September 23, 2002, attached as Exhibit G-1.

<sup>10</sup> Procedural Order No. 1, October 1, 2002, ¶ 7.

<sup>11</sup> Indeed, Respondent's own factual discussion at ¶¶ 47 and 48 of its Counter-Memorial confirms that Acaverde was owned by Waste Management (through Sanifill) between August 1995 and November 1997.

<sup>12</sup> Procedural Order No. 2, November 27, 2002, ¶ 15.

<sup>13</sup> Attached as Exhibit G-2.



2.9 In summary, Claimant attached documentation to its Memorial demonstrating its ownership or control of Acaverde at all times relevant to its claim. Claimant has updated that documentation in this Reply. Although Respondent attempts to raise questions about the transactions through which Waste Management acquired Acaverde, its Counter-Memorial never directly challenges Claimant's status as an "investor of a Party, on behalf of an enterprise." Nor does Respondent explain how the alleged acquisition issues raised in its brief have any bearing on Claimant's status as an investor. Therefore, Claimant respectfully submits that no further issue exists regarding its status as an "investor of a Party, on behalf of an enterprise."

**B. Mexico Is Fully Responsible For The Conduct Of The City Of Acapulco, The State Of Guerrero, And Banobras.**

2.10 Respondent attempts at several points in its Counter-Memorial to cast itself as an innocent bystander, suggesting that it is not responsible for the conduct of the City of Acapulco, the State of Guerrero or even Banobras.<sup>14</sup> This notion is both factually inaccurate and inconsistent with fundamental NAFTA principles as expressed in the language of the agreement itself and the decisions of previous NAFTA tribunals.

2.11 With respect to the City and the State, Article 105 of NAFTA directs the Parties to ensure that the provisions of NAFTA are observed by the Parties' state and provincial governments, which (under the language of Article 201(2)) include local governments of a state or province. Although Article 1108(1) provides a limited exemption from this directive for claims under Articles 1110 and 1105, that exemption does not apply to state or local governments. As a consequence, Respondent is fully responsible under NAFTA for the acts (and failures to act) of both the State of Guerrero and the City of Acapulco.

2.12 This conclusion is consistent with Respondent's own prior admissions, as demonstrated by the following language from the decision of the Tribunal in *Metalclad*:

A threshold question is whether Mexico is internationally responsible for the acts of SLP [the State] and Guadalcázar [the City]. The issue was largely disposed of by Mexico in paragraph 233 of its post-hearing submission, which stated that "[Mexico] did not plead that the acts of the Municipality were not covered by NAFTA. [Mexico] was, and remains, prepared to proceed on the assumption that the normal rule of state responsibility applies; that is, that the Respondent can be internationally responsible for the acts of state organs at all three levels of government."<sup>15</sup>

2.13 Respondent is also fully responsible for the conduct of Banobras. In a filing submitted in the first Waste Management proceeding, Mexico stated that it "has never disputed

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<sup>14</sup> See, e.g., Counter-Memorial, ¶¶ 212, 214 and 260.

<sup>15</sup> *Metalclad Corporation v. United Mexican States*, ICSID No. ARB(AF)/97/1, Final Award, September 2, 2000, ¶ 73 (brackets in original).

that Banobras is a federal government entity. The law is clear on this point.”<sup>16</sup> Further, the Tribunal in the first proceeding characterized Mexico’s submission as describing “state-run organizations and political subdivisions for whose actions the Government was liable.”<sup>17</sup>

2.14 In summary, the conduct of the City of Acapulco, the State of Guerrero and Banobras is fully attributable to and the responsibility of the Federal Government of Mexico.

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<sup>16</sup> Respondent’s Rejoinder Regarding the Competence of the Tribunal, dated November 16, 1999, fn. 3.

<sup>17</sup> June 2, 2000 Award, ¶ 6. This includes responsibility for the administrative, executive and legislative acts of the Federal, State and Local Governments, as well as the actions (or failures to act) taken by the courts operating in these different governments. *See Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Final Award, October 11, 2002, in which the United States Federal Government could have been held responsible for the acts of one of its state courts, if that court’s decision had been determined (which it was not) to have violated Article 1105 of NAFTA.

## CHAPTER THREE

### FACTUAL OVERVIEW

#### A. Prior to the Concession, Waste Collection In Acapulco Was Inadequate and Unsanitary.

3.1 Although Respondent admits that, prior to 1995, waste collection and disposal services were deficient in Acapulco,<sup>18</sup> it is important for the Tribunal to understand how dire the situation was. A summary of Acapulco's status prior to the Concession highlights both the "urgent need" to change the then-existing system and the City, State and Federal Governments' apparent commitment (to be arbitrarily abandoned later) to effectuate such change.<sup>19</sup>

3.2 Before 1995, waste management services in Acapulco were environmentally unsound and threatened the very livelihood of the City. Acapulco did not have a environmentally-sound landfill, and the continuous burning of waste in open-air dumps resulted in a smog and foul odor that permeated the City. According to the official decree of the State of Guerrero, which authorized the City to grant the Concession to Acaverde:

The dumps that are currently used are "Carabali" and "Paso Texca" in the open with no technique, which makes them totally obsolete and out of control. The dumps are approximately 22 years old, holding to date two million tons of organic and inorganic waste which generates high and severe levels of contamination produced by smoke, gases and lixiviate seepage, indiscriminately damaging human settlements around them and the population at large in the Port of Acapulco.

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Taking into account the high risks of infection and contamination generated by the current garbage dumps, it is of utmost importance to build new garbage dumps, with true solid waste - processing techniques, complying with all preventative health and ecological provisions and, in general, with environmental and health protection for the inhabitants of the Port of Acapulco in general.<sup>20</sup>

3.3 In addition to the problems with the open-air dumps, the City Sanitation Department could not adequately pick up trash or keep streets clean. The City lacked sufficient and adequate vehicles, repair facilities and personnel. Additionally, the City Sanitation

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<sup>18</sup> Counter-Memorial, ¶ 65 ("It is admitted that the municipality's waste disposal methods, particularly its landfilling practices, needed improvement.").

<sup>19</sup> As demonstrated later, an analysis of Acapulco's waste collection services before 1995 also highlights the substantial improvements made by Acaverde during its two years of operation, despite the City, State and Federal Governments' best efforts to ensure Acaverde's failure.

<sup>20</sup> January 3, 1995 State of Guerrero Decree (Exhibit D-5) at 6.

Department had no fixed collection schedule, and random dumping of solid waste occurred throughout Acapulco.<sup>21</sup>

3.4 Respondent's current contention that, prior to the Concession, the City kept the tourist zones clean is contrary to the conclusion reached by the State Government before authorizing the Concession:

The severe waste problem currently suffered by Acapulco is accentuated mainly in the following tourist zones: Acapulco tradicional, Dorado and Diamante; in these areas, due to the importance of tourist services, priority treatment must be given, taking into account the impression and image their appearance causes for national and international tourism.<sup>22</sup>

The Mayor of Acapulco even admitted in October 1994 that it was extremely difficult for the City to render effective sanitation service in the areas near Avenida Costera Miguel Alemán, the main avenue through the tourist zone of Acapulco.<sup>23</sup>

3.5 After reviewing the situation, the State of Guerrero concluded that "the current system of waste collection and deposit (dumps) in Acapulco is totally obsolete and outdated." Accordingly, the State recognized that due to the City's inability to provide waste management services, there existed an "urgent need" to grant a concession.<sup>24</sup>

**B. Respondent Induced Claimant To Make A Substantial Investment With Assurances That The City Would Enact And Enforce Exclusivity Ordinances.**

3.6 The details of the negotiations leading up to the Concession are set forth in paragraphs 3.3 through 3.12 of Claimant's Memorial and are generally undisputed.<sup>25</sup> Although Claimant will not repeat those details here, it is important to correct a fundamental misstatement contained in Respondent's Counter-Memorial concerning the parties' negotiation of, and expectations for, the Concession.

3.7 In the Counter-Memorial, Respondent argues that the Concession was premised upon several assumptions that affected its economic viability. Specifically, Respondent argues

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<sup>21</sup> January 3, 1995 State of Guerrero Decree (Exhibit D-5) at 5 ("The extensive demographic growth has led to a worsening of various social and economic problems, including health, ecology (flora and fauna), lack of employment, social security, irregular human settlements and environmental contamination due mainly to inefficient waste collection . . ."); James Herak Statement (Exhibit A-4), ¶ 3.

<sup>22</sup> January 3, 1995 State of Guerrero Decree (Exhibit D-5) at 5.

<sup>23</sup> Minutes of Municipal Council Meeting (Exhibit D-4), p. 1.

<sup>24</sup> January 3, 1995 State of Guerrero Decree (Exhibit D-5) at 6.

<sup>25</sup> Counter-Memorial, Annex A (admitting the substance of paragraphs 3.3 through 3.12).

that although Claimant may have formed an expectation that all potential customers within the Concession area would pay the published rates for its services, ultimate success under the Concession was in reality subject to market forces (*i.e.*, the economy) and customer demand (*i.e.*, the public's willingness to contract). This is simply not true.

3.8 The success of the Concession, and thus the viability of Claimant's investment, was almost entirely dependent upon the establishment and enforcement of exclusivity ordinances. Without exclusivity, Acaverde could not receive the benefits granted under the Concession. Without exclusivity, Acaverde would never have agreed to serve as the concessionaire. The City Government knew this and, during negotiations, assured Claimant that Acaverde's right to exclusivity within the Concession area would be protected.<sup>26</sup>

3.9 The City also assured Claimant that the customers within the Concession area would be required to pay published rates for Acaverde's services. The City also promised that customers within the Concession area would be prohibited from littering – a practice that, if tolerated, would have allowed customers to avoid using Acaverde's services. The City not only told Claimant that these assurances would be codified into municipal law, the City assured Claimant that such laws would be enforced. Based on the City's assurances, which were made to induce Claimant's investment, Claimant invested substantial sums in initiating and conducting operations.

#### **C. Respondent Repeated Its Assurances In The Concession And Municipal Ordinances.**

3.10 The assurances concerning exclusivity that induced Claimant's investment were reinforced and repeated in the Concession and Municipal Ordinances.

##### **1. The Concession.**

3.11 On February 9, 1995, the City and Banobras signed the fifteen-year concession authorizing Acaverde to provide waste collection, street sweeping and landfill services. On May 12, 1995, after Banobras insisted on a number of changes to the original Concession, a modified Concession was signed by the City, Banobras and Acaverde.<sup>27</sup>

3.12 The Concession resulted from the collective efforts of all three levels of Mexico's government: Local, State and Federal. The Local Government, the City of Acapulco, obviously played a major role by proposing the Concession. The State Government authorized the Concession – a requirement under the Mexican Constitution – by official decree. The Federal Government, through Banobras, was actively involved in negotiations for the Concession and revised the Concession after it was initially granted.<sup>28</sup>

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<sup>26</sup> Rod Proto Statement (Exhibit A-3), ¶ 12.

<sup>27</sup> Memorial, ¶¶ 3.7-3.12; Concession Title dated February 9, 1995 (Exhibit D-6); Concession Title dated May 12, 1995 (Exhibit B-1).

3.13 The purpose of the Concession was to address Acapulco's "urgent need" to improve "obsolete and outdated" practices by encouraging a long-term investment by a foreign investor with substantial experience in waste collection and landfill operations. This encouragement came from assurances that the foreign investor: (a) would be the exclusive provider of services within the Concession area; (b) could charge and collect a published rate for its services; and (c) would be supported by the Local Government, which would enact and enforce laws designed to protect the investment.

3.14 The terms of the Concession are consistent with this purpose. Regarding exclusivity, the Concession makes clear that Acaverde was to be the exclusive provider of services within the Concession area for the duration of the Concession:

The Concessionaire will have the exclusive responsibility and right to perform residential waste collection services in the Concession Area. [Exhibit B-1, Annex A, Article 2.1(a)]

The Concessionaire will have the exclusive right and responsibility to provide waste collection services to all businesses located in the Concession Area. [Exhibit B-1, Annex A, Article 2.2(a)]

The City shall not grant a similar concession to another company or person to collect, transport, use, recycle or dispose of any waste generated anywhere in the Concession Area, during the term of this Concession Agreement or its extensions, nor shall the City grant to any person or entity any right or concession inconsistent with the rights of the Concessionaire under this Concession Agreement. [Exhibit B-1, Condition Fifteenth]

3.15 The protections favoring Acaverde in the Concession were not just limited to exclusivity. The Concession was also designed to ensure that the City did not take action to interfere with Acaverde's economic rights under the Concession:

[S]hould the City at any time . . . take any action or series of actions directly imputable to the City that prevent or hinder the Concessionaire from receiving all or any material portion of its benefits or rights under this Concession Agreement, then the Concessionaire shall be entitled to the immediate payment of a penalty equivalent to [a liquidated damage formula set forth in the Tenth Article of the Concession] [Exhibit B-1, Condition Tenth]

3.16 In the Concession, the City said it would enact municipal laws, with sufficient penalties for violations, to guarantee Acaverde's right to exclusivity. More importantly, the City Government gave assurances that it would actively enforce such laws:

The City shall . . . establish such ordinances and local statutes as may be necessary to forbid manual street sweeping, the collection, transportation, use, recycling or disposal by any person or entity other than the Concessionaire of any Waste generated within the Concession Area. Such ordinances and statutes shall carry fines and other penalties reasonably calculated to eliminate the collection, transportation, use or disposal of Waste generated in the Concession Area by any

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<sup>28</sup> Memorial, ¶¶ 3.6-3.12.

person or entity other than the Concessionaire, and the City shall fully and promptly enforce such ordinances and statutes. [Exhibit B-1, Annex A, Article 2.1(d)]

## **2. The July 1995 Ordinances.**

3.17 The municipal laws described in the Concession were enacted on July 18, 1995 (the "July 1995 Ordinances"). Like the Concession, the July 1995 Ordinances repeated the assurances of the City, State and Federal Governments during negotiations. The July 1995 Ordinances were designed to ensure that Acaverde could carry out its activities under the Concession and Claimant would receive the benefits of its long-term investment. Indeed, the express purpose of the July 1995 Ordinances was to "guarantee[] the best manner in which the service is to be rendered by the concessionaire and, at the same time, ensure[] environmental and ecological improvements, as demanded by the residents of [the] Municipality."

3.18 The July 1995 Ordinances provided that, within the Concession area: (a) Acaverde was the exclusive provider of waste collection services; (b) all residents and businesses had to use Acaverde; and (c) all residents and businesses had to pay the published rates for Acaverde's services.

3.19 Regarding exclusivity, Article 16(1) of the July 1995 Ordinances prohibited "any individual or company other than the concessionaire [from] collect[ing] any class or type of solid waste within the awarded area."<sup>29</sup> The ordinances also mandated that in the event any person violated Acaverde's right to exclusivity, a substantial fine (set at a minimum of 80 times the daily minimum wage) would be imposed.<sup>30</sup> Furthermore, any repeat violation of the exclusivity law would result in double the fine, and subsequent offenses would be punished by doubling the previous sanction.<sup>31</sup> Obviously, such hefty fines were designed to protect Acaverde's valuable right to exclusivity under the Concession. Respondent does not dispute that the July 1995 Ordinances (on their face) provided such protection.

3.20 Respondent does dispute Claimant's contentions regarding the obligation of residents and businesses within the Concession area to use Acaverde's services and pay Acaverde the published rates. Respondent also argues that the City had no obligation to ensure that residents and businesses used and paid for Acaverde's services.<sup>32</sup> Respondent takes this

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<sup>29</sup> July 1995 Ordinances (Exhibit B-3), Article 16(1).

<sup>30</sup> July 1995 Ordinances (Exhibit B-3), Article 24.

<sup>31</sup> July 1995 Ordinances (Exhibit B-3), Article 25-b.

<sup>32</sup> Counter-Memorial, ¶ 104 ("It bears first examining whether Acapulco actually had an obligation under the Title of Concession to compel residents and businesses to enter into waste collection contracts with Acaverde. The Concession did not include such a clause") (emphasis added). Here, Respondent is very careful with its words because the obligation to ensure that customers use and pay for Acaverde's services is expressed in the July 1995 Ordinances.

position because it has to – the City Government did nothing during the entirety of Acaverde's operations to compel residents and businesses to use and pay for Acaverde's services. Unfortunately for Respondent, the July 1995 Ordinances expressly set forth these obligations.

3.21 The Tribunal need only read Articles 8 and 9 of the July 1995 Ordinances to conclude that residents and businesses were obligated to use and pay for Acaverde's services:

**Article 8.-** All individuals and companies that own or hold, regardless of the title, a property designated as a residential home or business in general, located in the awarded zone, must request the concessionaire for the public cleaning service in the 90 (ninety) days following the start of its operations.

**Article 9.-** Property owners or holders that request the concessionaire for the public cleaning service are under the obligation of paying it the fees established in the corresponding price list.<sup>33</sup>

If all persons in the Concession area were obligated to "request the concessionaire," and if all persons who "request the concessionaire" were obligated to pay Acaverde the published rates, only one conclusion can be reached: all residents and businesses in the Concession area were required to use Acaverde's services and pay Acaverde the published rates.

3.22 In its Counter-Memorial (¶ 111), Respondent states that Article 8 of the July 1995 Ordinances establishes that persons within the Concession area "should request" (*deberían solicitar*) the services from the concessionaire. This is incorrect. Article 8 states that persons within the Concession area "must request" (*deberán solicitar*) Acaverde's services.<sup>34</sup>

3.23 Respondent also argues that Article 9 of the July 1995 Ordinances establishes "the payment obligation only for those who had effectively contracted for the service."<sup>35</sup> This is wrong too. Articles 8 and 9 are unambiguous: all residents and businesses must request Acaverde's services, and all who request Acaverde's services (*i.e.*, everyone) must pay the published rates. Article 9 says nothing about payment obligations only for those who "effectively contracted" for the service. Respondent has simply mischaracterized Articles 8 and 9.

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<sup>33</sup> July 1995 Ordinances (Exhibit B-3), Articles 8, 9. The published rates are set forth at the end of July 1995 Ordinances. These rates were also listed in the Concession and were thus approved by the City and Banobras. Concession (Exhibit B-1), Annex B; MX 00036; letter dated May 15, 1995 from Armando de Anda to Acaverde (Exhibit G-3) (approving rates).

<sup>34</sup> Other evidence demonstrates that the July 1995 Ordinances compelled residents to use and pay for Acaverde's services. Counter-Memorial, ¶ 113(a) (president of the local bar association believed that the July 1995 Ordinances compelled residents to contract with Acaverde); newspaper article dated October 13, 1995 (Exhibit D-24) (Mayor of Acapulco describes the mandatory character of contracting with Acaverde).

<sup>35</sup> Counter-Memorial, ¶ 111.



3.24 Respondent is again incorrect when it asserts that the City had no obligation to compel residents and businesses to use and pay for Acaverde's services. The express language of the July 1995 Ordinances requires the City Government to enforce any and all violations of the July 1995 Ordinances:

Article 4. For purposes of the preceding article, the Department of Municipal Public Service shall designate three supervisors whose powers shall include, *inter alia*:

1. To enforce the municipal regulations, ordinances and policies concerning licensed public sanitation services;

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3. To impose financial sanctions and even bodily punishment on persons or corporate entities which, through their actions or omissions, violate the provisions of this regulation, environmental laws, or the provisions set out in the Policy and Good Government Order (*Bando de Policía y Buen Gobierno*)

Article 21. The Municipal President, the Director of Municipal Public Services, Inspectors *from* this Body and Judges assigned cases involving the violators are responsible for applying corresponding sanctions referred to in this regulation.

Article 22. Violations of the rules found in this Regulation will be sanctioned with fines, community service and/or administrative arrest, depending on the case. [July 1995 Ordinances (Exhibit B-3) (emphasis added)]

3.25 Any person who did not use Acaverde and pay the published rates violated Articles 8 and 9 of the July 1995 Ordinances. It was then up to the City Government, consistent with its sovereign powers and Articles 4, 21 and 22, to impose fines or other sanctions to ensure that the municipal laws were upheld. It is disingenuous for Respondent to argue that it was under no obligation to compel residents and businesses to use and pay for Acaverde's services.

3.26 Even without Articles 8 and 9, however, residents and businesses would still have been obligated to use and pay for Acaverde's services. The July 1995 Ordinances strictly prohibited any other individuals or companies from collecting waste within the Concession area.<sup>36</sup> The ordinances also strictly prohibited an individual or company from littering or otherwise discarding its waste in public areas and set forth a minimum fine of 50 times the daily minimum wage for any violation.<sup>37</sup> The combination of these two prohibitions - as long as they were enforced - would ensure that all customers would use Acaverde (and pay published rates).<sup>38</sup>

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<sup>36</sup> July 1995 Ordinances (Exhibit B-3), Article 16(1).

<sup>37</sup> July 1995 Ordinances (Exhibit B-3), Article 16(4).

3.27 The municipal laws concerning exclusivity, the requirement to use and pay for Acaverde's services, and prohibitions against littering were enacted to ensure that Acaverde achieved 100% market penetration and received 100% of the published rates for servicing that market.<sup>39</sup> Claimant expected just that, and its expectation was consistent with the Concession, the July 1995 Ordinances and the City, State and Federal Governments' assurances.

3.28 In its Counter-Memorial, Respondent argues that "there was no doubt that the parties' expectation that the combined effect of the granting of the exclusive concession and the ordinances would induce businesses and residents located in the zone to contract with Acaverde."<sup>40</sup> Claimant's expectation was not that the July 1995 Ordinances "would induce" customers to contract. Claimant's expectation was that the City Government would enforce its own laws and that all customers would use and pay for Acaverde's services.

3.29 Realization of Claimant's economic rights under the Concession depended on one variable that was completely beyond Claimant's control: whether the City Government would enforce its own laws. Unfortunately for Claimant, the City did not enforce its laws (and instead actively violated its own laws), and Claimant's expectations were never realized.

#### **D. The Public Reacted Unfavorably To The New Municipal Laws.**

3.30 Prior to the enactment of the July 1995 Ordinances, the Concession received widespread support. Private business interests expressed their approval regarding the City's decision to allow Acaverde to provide waste management services within the Concession area.<sup>41</sup> When Acaverde began operations in August 1995, however, the public reaction to the July 1995 Ordinances was less than favorable.

3.31 The obligation to use and pay for Acaverde's services met with resistance by some residents and businesses. As Respondent notes, there were several demonstrations and complaints by citizens protesting the July 1995 Ordinances.<sup>42</sup> Citizens were not used to paying such rates for waste collection, and were not pleased with the City Government for enacting laws requiring citizens to use and pay for Acaverde's services.

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<sup>38</sup> If a resident cannot use another waste collector and cannot litter, that resident has only two choices: (1) use Acaverde (and pay the published rates) or (2) allow trash to pile up inside his house until the Concession expires in 15 years.

<sup>39</sup> As Professor Slottje notes, it is more realistic to assume that Acaverde would only have achieved 95% market penetration. Supplemental Expert Witness Report of Daniel J. Slottje ("Supplemental Slottje Report") (Exhibit H-1), ¶ 62.

<sup>40</sup> Counter-Memorial, ¶ 10 (emphasis added).

<sup>41</sup> Public Notices of Support for Acaverde dated October 3, 1994 (Exhibit D-7).

<sup>42</sup> Counter-Memorial, ¶113(b).

3.32 Furthermore, the opposition political party (the National Action Party or "PAN") seized on the new municipal laws as an opportunity to advance its agenda and put political pressure on the City administration. With elections set for the following year, PAN called for civil disobedience and suggested that citizens protest the City administration by dumping garbage outside municipal offices.<sup>43</sup> The political pressure placed on the City Government cannot be overstated.

3.33 Thus, shortly after Acaverde began operations under the Concession, the City found itself facing public and political pressure regarding the July 1995 Ordinances. At that point, the City had two options: (1) to enforce its laws, ensure Acaverde's right to exclusivity, and stick with its long-term commitment to improve waste collection in Acapulco; or (2) succumb to public and political pressure, ignore its laws and disavow the assurances given to induce the foreign investment.

3.34 The City chose the latter. Indeed, shortly after Acaverde began operations, the City (often in concert with the State and Federal Governments) undertook a series of actions calculated to reduce the value of Claimant's investment and, ultimately, to remove Acaverde altogether.

#### **E. The City Failed To Enforce Its Own Laws.**

3.35 From the beginning of the Concession, the City ignored the July 1995 Ordinances. Not surprisingly, the City's failure to enforce its own laws significantly impaired Acaverde's ability to carry out its operations and Claimant's ability to realize the benefits of its investment.

##### **1. Contracts with residents and businesses.**

3.36 As mentioned, Articles 8 and 9 of the July 1995 Ordinances obligated residents and businesses to use Acaverde and pay the published rates. The City was required to enforce these obligations and fine those who did not comply.

3.37 Due to a lack of support by the City, Acaverde encountered tremendous difficulty soliciting customers within the Concession area. By mid-October 1995 (two months after starting operations), Acaverde had only been able to contract with approximately 12% of its potential customers. Acaverde complained numerous times and asked the City Government to enforce its laws. The City did not take any action to alleviate the problem, and no individuals or businesses were fined or otherwise sanctioned for not using and paying for Acaverde's services.<sup>44</sup>

3.38 Respondent does not claim that the City fined or sanctioned residents or individuals for violating Articles 8 and 9. Instead, Respondent argues that the City was

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<sup>43</sup> The call for civil disobedience by the PAN was clearly a protest against the City and State Governments. In the article cited by Respondent, PAN asked "What is wrong with the Government of Guerrero?" and asserted that the Concession granted to Acaverde was another in a series of mistakes by the State Government. MX 2307 (Exhibit G-4).

<sup>44</sup> Joseph Coradetti Statement (Exhibit A-6), ¶ 8.

powerless to do anything about the situation. Indeed, Respondent argues that Acaverde's inability to contract with residents and businesses was caused, not by the City's failure to enforce Articles 8 and 9 of the July 1995 Ordinances, but by two other factors: (1) the economic crisis and (2) the habits and culture of the public. This argument has no merit.

3.39 By Respondent's own admission, the financial crisis began in December 1994.<sup>45</sup> That means that the City, State and Federal Governments undertook the following administrative and legislative acts with full knowledge that Mexico was in the midst of a financial crisis:

- On January 3, 1995, the State of Guerrero issued an official decree authorizing the Concession;
- On February 9, 1995, the City and Banobras signed the original Concession;
- On May 12, 1995, the City and Banobras signed the Modified Concession after Banobras insisted on certain modifications to the Concession;
- On May 15, 1995, the City informed Acaverde that it had approved the customer rates proposed by Acaverde for services;
- On June 9, 1995, the City, State and Federal Governments signed the Line of Credit Agreement, in which Banobras obligated itself to pay Acaverde's invoices if the City did not pay; and
- On July 18, 1995, the City enacted the July 1995 Ordinances establishing the obligation to use, and pay the published rates for, Acaverde's services.

Thus, the Mexican Governments knew that Mexico was facing an economic crisis when they granted the Concession and enacted the July 1995 Ordinances.<sup>46</sup>

3.40 Rather than accept responsibility for its administrative and legislative acts, Respondent attempts to blame Claimant for not anticipating the impact of the economic crises.<sup>47</sup> Presumably, Banobras (a Mexican national development bank) and the State and City Governments were better able than Acaverde to assess the potential impact of the financial crisis on the ability of its citizens to pay the published rates. With full knowledge of the economic crises, the City and State Governments granted the Concession and enacted the July 1995 Ordinances. Thus, the Tribunal should summarily reject Respondent's attempt to use the economic crisis as justification for its expropriatory conduct.

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<sup>45</sup> Counter-Memorial, ¶ 139.

<sup>46</sup> Respondent's witness, Armando de Anda, acknowledged that by March 1995, the amount of federal funds received by the municipality had been reduced by 40%. MX 2361.

<sup>47</sup> Counter-Memorial, ¶ 139 ("Sanifill knew - or should have known - of the potential impact of the crisis on the concession.").

3.41 Respondent's next argument is that the inability to contract with customers was caused by Acaverde's failure to appreciate the culture and habits of local residents.<sup>48</sup> This is another example of Respondent refusing to accept responsibility for its actions. Presumably, the City and State Governments had knowledge of its citizens' habits and culture when, through administrative acts, they granted the Concession and enacted the July 1995 Ordinances. Any blame for failing to take into account the culture of Acapulco's citizens falls squarely on Respondent's shoulders.

3.42 The City assured Acaverde during negotiations that it would provide assistance in educating the public concerning the requirement to use Acaverde's services.<sup>49</sup> Despite repeated requests from Acaverde, the City never provided that assistance. Acaverde was left completely on its own and even had to spend its own money to distribute the July 1995 Ordinances to residents after the City claimed it lacked the money to print the ordinances.<sup>50</sup>

3.43 Throughout its 27 months of operations, Acaverde pleaded with the City to enforce Articles 8 and 9 and require customers to use and pay for Acaverde's services. In its Memorial, Claimant submitted a number of letters written to the City between September 1995 and May 1997 identifying residents and business who refused to contract and asking the City to enforce its own laws by assessing fines or other sanctions.<sup>51</sup> Respondent has not submitted any evidence that the City ever assessed any fine or sanction against anyone for refusing to use or pay for Acaverde's services.

## **2. Acapulco's Mayor Revoked Acaverde's Rights.**

3.44 It was bad enough that the City Government refused to enforce its laws requiring Acaverde's service. But the City took it one step farther. On October 13, 1995, the Mayor of Acapulco made a shocking announcement. In a newspaper article entitled "*No es obligatorio Acaverde*" (Acaverde is Not Obligatory), the Mayor told Acapulco's citizens that the laws requiring them to use and pay for Acaverde's services would be eliminated:

Mayor Rogelio de la O Almazán reported that the mandatory nature of the contract for the service of Acaverde will be eliminated, in order to put an end to what was interpreted as an imposition.

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<sup>48</sup> Counter-Memorial, ¶ 68 ("Acaverde insisted on changing the practices and culture of the local residents, rather than adjusting its own to local conditions."), ¶74 (p. 23).

<sup>49</sup> Rod Proto Statement (Exhibit A-3), ¶ 16.

<sup>50</sup> Joseph Coradetti Statement (Exhibit A-6), ¶¶ 5-8 (discussing Acaverde's efforts to educate the public and the complete lack of cooperation from the City).

<sup>51</sup> See Letters to City Regarding Resistance to Contracting (Exhibit D-25). From the beginning, Acaverde pleaded with the City Government to provide stronger support regarding the obligatory nature of Acaverde's services. See Letter dated December 18, 1995 from Francisco Larequi to Mayor of Acapulco (Exhibit G-5), p. 3.

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De la O Almazán commented that, concerning the concessionaire for cleaning services in the tourist strip of the Port, Acaverde, right now, an analysis is being done of the juridic form in which the concession contract should be changed; the word "will have to" (*deberá*) will be changed to "may" (*podrá*) in order to eliminate the mandatory character of the contracting of the service of said company, since this is a circumstance that affects negatively the state of spirit of the supposed captive clients of Acaverde.<sup>52</sup>

Instead of enforcing its laws and fulfilling its commitments to the foreign investor, the City chose instead to appease local residents and avoid further political criticism.

3.45 In doing so, the City Government further alienated Acaverde from its potential customers. Rather than accept responsibility for its own administrative and legislative acts, the City blamed Acaverde – and its status as a foreign company – for the public's negative reaction:

"We asked Acaverde to understand that, even though they are an American company, they operate in Mexico, and they must adjust to Mexican ideas and way of being; to adjust their rates also to the economic circumstances of Acapulco and, above all, to have more sensitivity in their marketing means to avoid making people to feel forced, but to seek ways of agreeing and compromising."<sup>53</sup>

In addition to driving a wedge between Acaverde and its potential customers, the Mayor's statements rendered meaningless the mandatory requirement to use and pay for Acaverde's services. It goes without saying that residents and businesses did not feel compelled to use Acaverde (and pay published rates) after the Mayor promised that those requirements would be eliminated. The Mayor's statement was effectively a revocation of Articles 8 and 9 of the July 1995 Ordinances – laws enacted to protect Claimant's investment.<sup>54</sup>

### 3. Exclusivity Laws.

3.46 The July 1995 Ordinances codified the City Government's earlier promises that Acaverde would have – and the City would enforce – the exclusive right to collect waste within the Concession area.<sup>55</sup> Article 16(1) of the July 1995 Ordinances made it illegal for any other

<sup>52</sup> Article published in the *Sol de Acapulco* October 13, 1995 (Exhibit D-24) (emphasis added).

<sup>53</sup> Exhibit D-24.

<sup>54</sup> The Mayor's statements also served as a signal that Acaverde's right to exclusivity would not be protected. After all, if citizens were not required to use Acaverde (as the Mayor stated), then obviously alternative means of waste collection must have been available within the Concession area.

<sup>55</sup> Rod Proto Statement (Exhibit A-3), ¶ 12 ("[C]ity officials assured me and other Acaverde employees that Acaverde's exclusive right would be protected").

person or entity to collect waste within Acaverde's exclusive territory. Any and every violation of this law was supposed to result in a severe fine.<sup>56</sup> In theory, the July 1995 Ordinances should have ensured exclusivity within the Concession area. Unfortunately, the City Government did not enforce this law either.

3.47 The City's obligation to enforce the exclusivity law was never met, and the problem of unauthorized waste collectors began when Acaverde started operations and grew worse over time.<sup>57</sup> Acaverde complained many times in writing and during meetings about the City's failure to enforce its laws and sanction unauthorized waste collectors. But Acaverde's complaints fell on deaf ears, and the City never did anything meaningful to enforce Acaverde's exclusivity.<sup>58</sup>

3.48 The presence of unauthorized waste collectors had a devastating effect on Acaverde's operations. After all, even though it was supposed to, by law, be the exclusive provider of waste collection services and receive the published rates, Acaverde was only able to contract with approximately 50% of potential customers, and charge less than 50% of the published rate, by the time it suspended operations in November 1997.<sup>59</sup> Thus, the City Government's failure to enforce the exclusivity law effectively reduced the scope of the Concession by 75% and negated the possibility of any meaningful return on Claimant's investment.

3.49 Respondent's position on exclusivity is inconsistent and contradicted by the documentary evidence. Initially, Respondent argues that there "were only a small number of

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<sup>56</sup> July 1995 Ordinances (Exhibit B-3), Articles 16(1), 24 and 25(b).

<sup>57</sup> Rod Proto Statement (Exhibit A-3), ¶13-14 ("The exclusivity problem continued until Acaverde ceased operations in November 1997 and actually grew worse over time."); James Herak Statement (Exhibit A-4), ¶ 8 ("Beginning in August 1995, I also saw numerous unauthorized private waste collectors operating within the Concession area. Indeed, these pirates were even telling Acapulco's citizens and businesses that they were not required to sign up with Acaverde."); Francisco Larequi Statement (Exhibit A-5), ¶ 8 ("The presence of garbage collectors who did this work illegally at low cost prevented Acaverde from contracting clients in the concession area."); Joseph Coradetti Statement (Exhibit A-6), ¶ 9 ("[F]rom the beginning of Acaverde's operations in August 1995, unauthorized waste collectors operated in the Concession area, and Acaverde never had an exclusive concession. There were a dozen or more private haulers who would contract with small businesses and restaurants within the Concession area and undercut Acaverde's rates; I witnessed unauthorized vehicles collecting wastes within the Concession area on numerous occasions.").

<sup>58</sup> Letters from Acaverde to City complaining of unauthorized waste collectors (Exhibit D-21); Coradetti Statement (Exhibit A-6), ¶ 9 ("Despite our repeated and constant protests, to my knowledge, the City never made any significant effort to enforce Acaverde's right to exclusivity.").

<sup>59</sup> Memorial, ¶ 3.60.

unauthorized collectors" and while they "may have taken away some of Acaverde's business, [] they were never a threat to the viability of the concession."<sup>60</sup> Not surprisingly, Respondent fails to cite any evidence to support its statement that unauthorized waste collectors had no material impact on Acaverde. Such a statement is directly at odds with Acaverde's witness statements and the undeniable fact that Acaverde was only able to penetrate 50% of the potential market.<sup>61</sup>

3.50 Next, Respondent argues that the City issued numerous citations for exclusivity violations during Acaverde's first few months of operations – a tacit admission that the unauthorized waste collector problem was significant.<sup>62</sup> But a careful examine of MX 1780-1785 (a list of all citations issued for violations of the July 1995 Ordinances) reveals that only one citation was issued for unauthorized waste collection from December 1995 through August 1996.<sup>63</sup> Furthermore, there is absolutely no evidence that any individuals or businesses were ever fined for unauthorized waste collection, much less fined the minimum 80 times the daily minimum wage called for in the July 1995 Ordinances.

3.51 To explain this, Respondent argues that the complete absence of citations for exclusivity violations shows that the *pirata* problem "waned after early 1996."<sup>64</sup> A better explanation is that the City Government just stopped issuing citations to unauthorized waste collectors in 1996. The *pirata* problem certainly did not diminish. Acaverde wrote more than a dozen letters to the City in 1996 complaining about the activities of unauthorized waste collectors, who became "more and more active" in the latter part of 1996 and 1997.<sup>65</sup> Respondent's argument that the *pirata* problem "waned" after early 1996 is revisionist history.

3.52 To assess Respondent's claim that it dealt effectively with the unauthorized waste collector problem, the Tribunal should compare Exhibit G-6 (an inspection report from

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<sup>60</sup> Counter-Memorial, ¶¶ 125, 127. Respondent's argument that there were only five or six unauthorized waste collectors operating in the Concession area is demonstrably false. The letters submitted by Acaverde to the City show that the number of *piratas* was significant. Letter dated November 13, 1995 (Exhibit G-6) (attaching inspection report listing ten different unauthorized waste collectors in a single day); Letter dated December 13, 1996 (Exhibit G-7) (attaching inspection report listing 12 different unauthorized waste collectors).

<sup>61</sup> Obviously, other waste collectors were servicing some of the approximately 5,000 customers who did not contract with Acaverde.

<sup>62</sup> Counter-Memorial, ¶ 126.

<sup>63</sup> MX 1780-1785 (showing after November 1995 only one citation [on January 20, 1996] for violation of Article 16(1) – the exclusivity prohibition). The remaining citations listed are for violations of Article 16(4) – littering – or other ordinances altogether.

<sup>64</sup> Counter-Memorial, ¶ 126.

<sup>65</sup> Letters from Acaverde to City (Exhibit D-25); Joseph Coradetti Statement (Exhibit A-6), ¶ 9; Rod Proto Statement (Exhibit A-3), ¶14.



November 1995) with Exhibit G-7 (an inspection report from December 1996). That comparison shows that after Acaverde identified specific unauthorized vehicles to the City, those same vehicles continued to collect waste from the same customers 13 months later.<sup>66</sup>

3.53 As a private company, even one with a Concession, Acaverde had no legal authority to enforce the municipal laws; only the City Government could do so. The City's affirmative direction to the public to ignore Acaverde's right to exclusivity, and the City's failure to enforce its own laws, stripped Acaverde of its economic rights under the Concession and severely damaged Claimant's investment.<sup>67</sup>

#### **F. The City Government Actively Violated Its Own Laws.**

3.54 In addition to ignoring and refusing to enforce the July 1995 Ordinances, the City actively violated its own laws. Specifically, the City engaged in the following illegal acts: (a) City sanitation trucks collected waste in the Concession area in violation of Article 16(1); and (b) in violation of Articles 8 and 9, governmental offices within the Concession area refused to use Acaverde's services. In addition, the City granted permits to unauthorized waste collectors in violation of Article 15 of the Concession.

##### **1. City Sanitation Trucks.**

3.55 During the 27 months of Acaverde's operations, City sanitation trucks collected waste in the Concession area on a "regular basis" in violation of Article 16(1) of the July 1995 Ordinances.<sup>68</sup> By flagrantly violating its own laws, the City Government sent a clear signal that (a) residents were not required to use and pay for Acaverde's services and (b) other waste collectors could operate within the Concession area. In fact, City sanitation drivers affirmatively told residents and businesses in Acapulco that the City was permitted to collect waste, and charge a fee, within the Concession area.<sup>69</sup>

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<sup>66</sup> Respondent also argues that the City "was prevented from taking action against" unauthorized waste collectors because several *piratas* filed *amparo* suits challenging the ordinances. Counter-Memorial, ¶ 17. The evidence submitted in support of this argument is at best weak. For instance, MX 01057 does not say what Respondent claims. The truth is that there were only a handful of *amparos*, and all were resolved in Respondent's favor. The evidence does not support Respondent's conclusion that the *amparos* meant that exclusivity could not be enforced. Counter-Memorial, ¶ 118. In any event, Respondent is responsible under NAFTA for the acts of the courts granting rights inconsistent with municipal law.

<sup>67</sup> An independent report in June 1996 demonstrates that the City was not enforcing its own laws. The report advised the City that "there needs to be a way of implementing municipal ordinances and regulations." The report also concluded that "the exclusivity of the concession area is not respected." Minutes of June 11, 1996 Meeting (Exhibit G-8) [MX 1474-1478].

<sup>68</sup> Memorial, ¶ 3.56; James Herak Statement (Exhibit A-4), ¶ 7.

3.56 The presence of City drivers within the Concession area frustrated Acaverde's ability to carry out its operations and realize the value of its investment. Residents were reluctant to use Acaverde knowing that cheaper alternatives existed. Other customers canceled contracts with Acaverde upon learning that Sanitation Department drivers charged less than Acaverde.<sup>70</sup> By early 1997, the Sanitation Department drivers began telling residents and businesses that Acaverde would be replaced and that the City would provide waste collection services.<sup>71</sup>

3.57 Acaverde complained consistently about the presence of City Sanitation Department trucks within the Concession area. With its Memorial, Claimant submitted 20 letters sent to the City between August 1995 and July 1997 complaining about Sanitation Department vehicles. The majority of these letters identified the specific truck involved, and the date and place of the unauthorized collection.<sup>72</sup> Acaverde also raised this issue during meetings with the Mayor of Acapulco and other City officials.<sup>73</sup> Unfortunately, the City failed to take action to stop Sanitation Department vehicles from collecting waste in the Concession area.

3.58 By directly competing with Acaverde for customers, the City Government broke the law and revoked the very rights it granted Claimant under the Concession.

3.59 Respondent admits that Sanitation Department trucks occasionally collected waste in the Concession area in violation of Article 16(1) and that certain municipal employees were disciplined.<sup>74</sup> Respondent simply argues that Claimant is exaggerating the severity of the problem, implying that the City's occasional violation of its own laws is somehow permissible. Claimant invites the Tribunal to weigh the evidence submitted by the parties on this issue.<sup>75</sup>

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<sup>69</sup> Francisco Larequi Statement (Exhibit A-5), ¶ 8 (Sanitation Department drivers told Acaverde's existing clients that they were not required to use Acaverde).

<sup>70</sup> Joseph Coradetti Statement (Exhibit A-6), ¶ 10 ("Many individuals and businesses canceled their contracts with Acaverde and informed Acaverde that the city drivers were performing the services for less money."); ¶ 11 ("City officials were telling people that they did not have to contract with Acaverde").

<sup>71</sup> Letter dated February 25, 1997 from Acaverde to Director of Basic Sanitation Services (Exhibit G-9) (informing the City that Sanitation Department drivers are improperly collecting waste and informing Acaverde's customers that Basic Sanitation would provide the service going forward).

<sup>72</sup> Letters from Acaverde to City concerning Sanitation Department Trucks (Exhibit D-20).

<sup>73</sup> Rod Proto Statement (Exhibit A-3), ¶ 13.

<sup>74</sup> Counter-Memorial, ¶ 131.

<sup>75</sup> In support of its position, Respondent submits a statement from Dr. Rubicel Frías, the Director of Basic Sanitation. Respondent claims that when presented with letters from

## **2. Government Offices Refused To Use And Pay For Acaverde's Services.**

3.60 The Concession provided that Acaverde also had the exclusive right to provide waste collection services for certain government offices. The Concession specifically listed "port services" and the "Naval base" as Acaverde's customers.<sup>76</sup> Under Articles 8 and 9 of the July 1995 Ordinances, those entities were required to use and pay for Acaverde's services.<sup>77</sup>

3.61 The City and Federal Governments violated Articles 8 and 9 by failing to use Acaverde's services. On September 12, 1995, the Mexican Navy, a department of the Federal Government, informed Acaverde that "there is no need to contract the services you are offering."<sup>78</sup> Similarly, the Acapulco Port Authority refused to use Acaverde's services and allowed unauthorized waste collectors to collect and dispose of its garbage.<sup>79</sup>

3.62 Given the Navy's and Port Authority's refusal to use and pay for Acaverde's services, it is not surprising that Acaverde had difficulty contracting with residents and businesses. Respondent's actions amount to a repudiation of Articles 8 and 9 of the July Ordinances, and in combination with the other activities described, ensured that Acaverde would never realize the rights and benefits granted under the Concession.

## **3. The City Government Continued To Issue Permits To Unauthorized Waste Collectors.**

3.63 Several unauthorized waste collectors were granted permits to provide waste collection services within the Concession area. Acaverde discovered that these permits had been issued by the City after the Concession was signed. The City never informed Acaverde that it would continue to issue permits to the private waste collectors. In fact, before the Concession was signed, the City assured Acaverde that it would revoke all existing permits.<sup>80</sup>

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Acaverde, Dr. Frías could not take any corrective action because (not surprisingly) the accused drivers denied that they violated the law. Counter-Memorial, ¶ 130 (citing Dr. Frías' Statement at ¶¶ 24-25). The witness statement does not say this. In any event, during negotiations to resolve its outstanding debt to Acaverde, the City acknowledged that its employees were collecting waste in the Concession area. Fax dated January 18, 1996 from Jaime Herrera to Rod Proto (Exhibit G-10) (stating that the City's proposal included a promise "not to use its personnel in the Concession area.").

<sup>76</sup> Concession (Exhibit B-1), Annex B, Section 2.1(g), (i).

<sup>77</sup> July 1995 Ordinances (Exhibit B-3), Articles 8, 9.

<sup>78</sup> Letter dated September 12, 1995 from Department of the Navy to Acaverde (Exhibit G-11).

<sup>79</sup> See Letter dated December 1, 1995 from Acapulco to Port Authority (Exhibit G-12) (instructing Port Authority only to release its garbage to authorized companies).

<sup>80</sup> Rod Proto Statement (Exhibit A-3), ¶ 15.

3.64 The City did not revoke permits as it promised. In fact, the City's Transportation Department continued to grant waste collection permits to other businesses through February 1996, almost one year after the Concession was granted.<sup>81</sup> In its Counter-Memorial, Respondent admits that the City did not revoke existing permits,<sup>82</sup> and offers no evidence to rebut Claimant's statement that the City continued to issue permits to unauthorized waste collectors after the Concession began.

3.65 By refusing to enforce its laws regarding exclusivity and the mandatory nature of Acaverde's services, and by actively violating its own laws, the City Government deprived Claimant of its economic rights under the Concession.

**G. The City Withheld Payment In Order To Force Renegotiations.**

3.66 Under the Concession, the City was obligated to pay a monthly fee for Acaverde's services. This monthly fee was designed simply to help Acaverde offset some of its operating costs.

3.67 Almost immediately after Acaverde began operations, the City Government fell behind on its payment obligations under the Concession. In fact, over the life of its operations, Acaverde sent 27 monthly invoices to the City, and the City (despite not rejecting any of them) only paid one invoice in full (December 1995) and two partially (January and February 1996).<sup>83</sup> Respondent does not deny these allegations.<sup>84</sup>

3.68 Respondent admits that the City Government could not meet its payment obligations and that shortly after Acaverde began operations, the City sought to renegotiate the terms of the Concession:

Shortly after the concession began to operate, the *Ayuntamiento* faced problems in the fulfillment of its payment obligations; this led to numerous meetings

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<sup>81</sup> Letter from Acaverde to Mayor of Acapulco dated February 17, 1996 (Exhibit D-22). A videotape made by Acaverde in November 1995 also shows that unauthorized collection vehicles possessed permits to operate within the Concession area. Videotape of Unauthorized Waste Collectors (Exhibit F-1) (showing permits).

<sup>82</sup> Counter-Memorial, ¶ 123 ("some independent waste collectors held pre-existing annual permits to operate their vehicles, which they used to resist fines and detention of their vehicles.").

<sup>83</sup> In addition, two checks written to Acaverde to cover monthly invoices were returned for insufficient funds. Letter dated January 25, 1996 (Exhibit G-13) (check presented on January 19, 1996 returned); Exhibit G-14 (check dated February 29, 1996 marked "insufficient funds").

<sup>84</sup> Memorial, ¶ 3.62; Counter-Memorial, Annex A.

between *Ayuntamiento* officials and Acaverde personnel. Shortly thereafter, a revision of the terms of the concession was sought.<sup>85</sup>

As early as January 1996, the parties met to discuss a solution to the City's past due amounts.<sup>86</sup>

3.69 In March 1996, the City proposed a 50% reduction in the monthly amounts it would owe Acaverde from 1996 through 1999. The City also proposed to expand the Concession area that Acaverde would exclusively serve.<sup>87</sup> Acaverde could not accept such a drastic reduction in the City's payment obligation but offered to continue talking about a possible solution. Acaverde made clear, however, that the City was still obligated to pay past due amounts and that, if the City did not pay, Acaverde would collect from Banobras under the Line of Credit Agreement.<sup>88</sup>

3.70 Acaverde's mention of the Line of Credit Agreement struck a nerve with the City Government. On March 15, 1996, Gilberto Polanco of the Municipal Department of Administration and Finance urged Acaverde not to draw down on the Line of Credit Agreement. According to Mr. Polanco, a "serious political problem would result" if Banobras was asked to pay the City's outstanding debt. Mr. Polanco also noted that Acapulco was in a dire financial situation because the City was only receiving a small fraction of the revenues it expected from the Federal Government.<sup>89</sup>

3.71 On April 6, 1996, Acapulco sent Acaverde another proposal to modify the City's past and future payment obligations. The City highlighted that the Federal Government had suspended payments to Acapulco due to the resignation of the Governor of Guerrero. As a result, the City said that it could not meet its payment obligations under the Concession. The City again proposed that: (a) the monthly fee owed to Acaverde be reduced by 50% for 1996 through 1999; and (b) the Concession area be expanded.<sup>90</sup>

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<sup>85</sup> Counter-Memorial, ¶ 16.

<sup>86</sup> Fax dated January 18, 1996 from Jaime Herrera to Rod Proto (Exhibit G-10) (summarizing discussions between the parties and noting meeting scheduled for January 26, 1996).

<sup>87</sup> Letter dated March 7, 1996 from Jaime Herrera to Mayor of Acapulco (Exhibit G-55) (summarizing proposal made by the City to resolve outstanding debt). That the City offered to enlarge the Concession area indicates that the City was not dissatisfied with Acaverde's performance.

<sup>88</sup> Letter dated March 7, 1996 from Jaime Herrera to Mayor of Acapulco (Exhibit G-55). Acaverde also made it clear that it would only renegotiate the City's payment obligations if the City began enforcing the exclusivity provisions in the July 1995 Ordinances.

<sup>89</sup> Letter dated March 16, 1996 from Francisco Larequi to Rod Proto (Exhibit G-53) (summarizing discussions with Gilberto Polanco).

3.72 On April 24, 1996, Acaverde responded in good faith to the City's April 6 proposal. Acaverde stated that it was willing to discuss modifications to the City's payment obligations, but that, until such changes were made, the City had to meet its existing obligations. Acaverde also noted that it had made many sacrifices to assist Acapulco during the economic crisis and that the Concession was signed and modified after the devaluation of the Mexican currency. During this time, Acaverde: had reduced its price to the City; had charged residents less than the rate permitted under the July 1995 Ordinances; did not charge interest on overdue amounts; reduced amounts owed by the City for work performed in 1995; and continued to collect waste from residents regardless of their payment status.<sup>91</sup>

3.73 The City withheld payment of monthly fees to Acaverde in the hope that Acaverde – already incurring significant operating losses because it lacked exclusivity – would renegotiate the City's payment obligation. The City essentially hoped that Acaverde would decide that "some money was better than no money."

3.74 Back in 1994, Acaverde anticipated that the City might face liquidity problems (or just not pay) and insisted on the Banobras guarantee. When it became apparent in June 1996 that the City would not honor its payment obligations, Acaverde turned to Banobras. On June 26, 1996, Banobras paid under the Line of Credit Agreement.<sup>92</sup>

3.75 By exercising its rights under the Line of Credit Agreement, Acaverde thwarted the City's attempt to use past due invoices as leverage to force renegotiations. The City then made certain this would not happen again.

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<sup>90</sup> Letter dated April 6, 1996 from Armando de Anda to Rod Proto (Exhibit D-28). Again, the offer to expand Acaverde's exclusive Concession indicates that Acaverde's performance was satisfactory.

<sup>91</sup> Letter dated April 24, 1996 from Rod Proto to Armando de Anda (Exhibit D-29). In addition, Acaverde noted that its costs rose with inflation and that the City failed to enforce Acaverde's exclusivity despite repeated promises to do so by the City. Acaverde also rejected the proposal to expand the Concession area stating:

Moreover, and thanking you for your intention of expanding our service area in the Municipality, in our opinion, and given the current situation prevailing in the concession zone, this would only worsen the situation, since we have no guarantee whatsoever that people would contract or pay for our services, or that "pirate" collectors would not invade our areas. On the other hand, rendering more service would surely cost us more.

<sup>92</sup> Counter-Memorial, ¶ 146. Banobras' payment covered invoices from January through April 1996. Memorial, ¶ 3.63. Before paying, Banobras wrote a letter to the Governor of Guerrero suggesting that the State Government directly pay the City Government's debt so that Banobras (the Federal Government) would not have to use the credit line. In this letter, Banobras noted that Acaverde was "fully entitled" to make demand on Banobras under both the Concession and Line of Credit Agreement. Letter dated June 20, 1996 from Mario Alcaraz Alarcón to Governor of Guerrero (Exhibit G-15).

## H. The City Threatened Acaverde And Banobras.

3.76 Less than two months after Acaverde accessed the Banobras credit line, the City threatened that Acaverde's investment would be significantly damaged if the Company did not renegotiate the City's payment obligations. On August 22, 1996, the City sent an evaluation of the Concession to Acaverde's attorney. After noting that the Concession was inexplicably favorable to Acaverde, the City concluded:

Based on an examination of the considerations described above and considering prevailing conditions in the Mexican economy, it is obvious that strict observance of the conditions reflected in the Concession Agreement and its annexes would lead inexorably to the City's defaulting on its financial terms, and subsequent injury to the licensee's [Acaverde's] interests. Therefore, if Acaverde is to continue as the provider of public cleaning services, the financial responsibilities imposed on the City must be reevaluated.<sup>93</sup>

3.77 But the City also knew that its threats were idle as long as Acaverde was able to access the Line of Credit Agreement. So the City turned its attention to Banobras. On September 11, 1996, the City instructed Banobras to reject any further payment requests by Acaverde.<sup>94</sup> The City also accused Banobras of paying Acaverde in June 1996 without authorization and reserved the right to assert claims against Banobras for its actions:

Furthermore, we declare our disagreement with the fact that, without our authorization or order, various bills have been paid to Acaverde, S.A. de C.V. from the [Line of Credit Agreement] granted to us by your institution, pursuant to the [Concession]; consequently, as of now, we reserve the right to make the appropriate claims.<sup>95</sup>

3.78 To understand the City's conduct, it is necessary to understand how the Line of Credit Agreement worked. If Banobras paid, the City was obligated to replenish the credit line by repaying Banobras. The State of Guerrero guaranteed the City's payment obligations. If the City did not repay Banobras within 90 days, Banobras had the right to enforce a lien on the State of Guerrero's share of federal revenues.<sup>96</sup>

3.79 Accordingly, Banobras' June 1996 payment to Acaverde had no immediate financial impact on the City. However, when the City did not repay Banobras within 90 days (by September 26, 1996), Banobras called on the State's guarantee and the line of credit was replenished with federal funds originally allocated to the State of Guerrero. The State of

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<sup>93</sup> Letter dated August 22, 1996 from City to Jaime Herrera (Exhibit G-16) (emphasis added).

<sup>94</sup> Letter dated September 11, 1996 (Exhibit D-36).

<sup>95</sup> *Id.* (emphasis added).

<sup>96</sup> Line of Credit Agreement (Exhibit B-2), Articles 6, 8, 13.

Guerrero then deducted this amount from Acapulco's municipal budget, and the effect on the City was immediate:

[T]his institution [Banobras] requested the assignment of the federal funds, as the state had signed the obligation as a guarantor. Said amount was deducted from the municipality's corresponding budgetary items for this month. Given that such a situation was unforeseen, it left us without financial liquidity, generating innumerable conflicts.<sup>97</sup>

3.80 As a result, the Mayor accused Banobras of violating the Line of Credit Agreement and demanded that Banobras reimburse the City the amounts paid to Acaverde (and withheld from Acapulco's budget).<sup>98</sup> Once again, the City claimed that Banobras paid Acaverde without authorization.<sup>99</sup> Lastly, the City repeated its demand that Banobras reject any further attempts by Acaverde to recover under the Line of Credit Agreement.

3.81 The City's message to Banobras was received loud and clear. Banobras never again honored its obligations under the Line of Credit Agreement. Indeed, after the City sent its September 11 and October 15 letters, Banobras for the first time informed Acaverde that it would not pay because the City objected to Acaverde's performance.<sup>100</sup> The City – acting in concert with Banobras – conspired to eliminate Acaverde's right to payment under the Line of Credit Agreement.

3.82 In the Counter-Memorial, Respondent attempts to explain why Banobras, after recognizing its obligation to pay in June 1996, suddenly changed its mind in October 1996. According to Respondent, Banobras: (a) was obligated to pay in June 1996 because the City approved the payment; and (b) was not obligated to pay thereafter because the City complained about Acaverde's performance. Both statements are false.

3.83 First, in paragraph 146 of the Counter-Memorial, Respondent argues that the City consented to Banobras' payment to Acaverde in June 1996. This is squarely contradicted by the City's letters of September 11 and October 15, 1996 – both of which accuse Banobras of paying

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<sup>97</sup> Letter dated October 15, 1996 from Mayor of Acapulco to Banobras CEO (Exhibit G-17), p. 3.

<sup>98</sup> *Id.*, p. 5 (“[W]e ask that you reimburse the Municipal Government for the amount of said payments.”).

<sup>99</sup> *Id.*, p. 2 (“[T]he concessionaire contacted the branch of your Institution in the state of Guerrero and submitted copies of unpaid invoices in the amount of [N\$4,947,811.40], which, without our order, was directly paid to said concessionaire”) (emphasis added).

<sup>100</sup> Although Banobras informed Acaverde in August 1996 that Banobras could not pay under the Line of Credit Agreement, Banobras stated that its inability to pay resulted from the City's failure to repay Banobras and replenish the credit line. Letter dated August 2, 1996 from Banobras to Acaverde (Exhibit D-37), p. 2.



Acaverde without the City's authorization.<sup>101</sup> Respondent does not explain this obvious inconsistency.

3.84 Second, Respondent argues that Banobras was under no legal obligation to pay Acaverde once the City objected and instructed Banobras not to pay.<sup>102</sup> This is inconsistent with Banobras' own admission in November 1996 that it had no legal right to withhold payment under the Line of Credit Agreement. In a letter dated November 15, 1996, Banobras informed the City that, under the terms of the Line of Credit Agreement, Banobras was obligated to pay Acaverde as long as the City, after receiving Acaverde's invoices, did not issue a counter-invoice.<sup>103</sup>

3.85 Thus, while rejecting Acaverde's requests for payment, Banobras admitted to the City that it had no basis for doing so. These arbitrary acts of bad faith deprived Acaverde of its right to payment under the Line of Credit Agreement.<sup>104</sup>

#### **I. The City Attempted Again To Force Renegotiations.**

3.86 By arbitrarily extinguishing Acaverde's third-party beneficiary rights under the Line of Credit Agreement, the City, State and Federal Governments prevented Acaverde from receiving a right granted by the Concession: the right to a guaranteed monthly income. Additionally, the City (by not enforcing the exclusivity requirements and other laws) had already substantially undermined Acaverde's ability to carry out its operations, and Acaverde was incurring significant operational losses. By the end of 1996, Acaverde's financial picture was bleak.<sup>105</sup>

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<sup>101</sup> See ¶¶ 3.68, 3.80 (*supra*).

<sup>102</sup> Counter-Memorial, ¶ 151.

<sup>103</sup> Letter dated November 15, 1996 from Banobras to the Mayor of Acapulco (Exhibit D-39) (if after 20 days the City has not issued a counter-invoice, "it will be understood that the bill is accepted in all its terms by the Town Hall, and the concessionaire or its representative will be entitled to execute the credit line for the total amount of the bill.") (emphasis added).

<sup>104</sup> Respondent notes that the version of the Line of Credit Agreement submitted with Claimant's Memorial is different than the version registered with the SCHP. Counter-Memorial, ¶ 54. This is a red herring. Respondent does not even suggest that there is any material difference between the two versions. In any event, Acaverde's version of the Line of Credit Agreement was the version quoted by the Mexican courts in the Banobras litigation proceedings. See Amparo award, No. DC. 5026/99 dated October 6, 1999, p. 23 (MX 00357) citing the second clause of the Line of Credit; *compare to* Exhibit B-2, p. 5 (showing identical clause).

<sup>105</sup> At best, Acaverde was collecting less than 50% of the published rates from 50% of potential customers, meaning that Acaverde was only realizing 25% of its expected revenues from residents and businesses. Memorial, ¶ 3.60.

3.87 Mindful of the long-term nature of the Concession, Acaverde kept performing its obligations and continued to discuss potential solutions with the City. Acaverde was also mindful that a newly-elected municipal administration, including a new Mayor, would take office beginning December 1, 1996.<sup>106</sup> Acaverde hoped that the new administration would abide by its payment obligations, enforce the July 1995 Ordinances and help restore the value of Acaverde's long-term investment. Unfortunately, Acaverde's hopes were too high.

3.88 Even before the new municipal administration took office, Acaverde learned that the Governor of Guerrero hired a former government official to initiate legal and political actions to terminate the Concession. The Governor planned to meet with the outgoing Mayor, the incoming Mayor and Guerrero officials for this purpose.<sup>107</sup>

3.89 After assuming office, the new City administration continued where the old administration left off. Exclusivity was not enforced; residents and businesses were not fined for refusing to use and pay for Acaverde's services; and the City sanitation trucks continued to collect waste within the Concession area. In fact, Sanitation Department drivers began advising Acaverde's customers to cancel their contracts because Acaverde would cease to exist soon.<sup>108</sup>

3.90 The new City administration also continued to use Acaverde's desperate financial condition as leverage to renegotiate the City's payment obligations.

3.91 In early 1997, the City sent a proposal to Acaverde's attorney regarding modifications to the Concession.<sup>109</sup> Among other things, the City proposed that:

- Acaverde collect and dispose of trash generated inside the Concession area, as well as in urban areas beyond the Concession area;<sup>110</sup>
- The City pay Acaverde N\$1 million for services in the Concession area and N\$500,000 for waste collection outside the zone. Acaverde would not apply any inflation adjustment to these amounts through 1997;
- The City make a request to Banobras to pay part (N\$8 million) of the City's pending debt from the Line of Credit Agreement;
- Acaverde forgive the remainder of the City's debt;<sup>111</sup>

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<sup>106</sup> Counter-Memorial, ¶ 162.

<sup>107</sup> Letter dated October 22, 1996 from Mauricio Arellano to Francisco Larequi (Exhibit G-18).

<sup>108</sup> Letter dated February 25, 1997 from Acaverde to Director of Basic Sanitation Services (Exhibit G-19).

<sup>109</sup> Letter from David Sotelo to Jaime Herrera (Exhibit G-19).

<sup>110</sup> Once again, the City's offer to expand the Concession area indicates that Acaverde's performance was satisfactory.

- Acaverde donate its mechanical street sweepers to the City, which would take charge of sweeping;
- The City help Acaverde increase its billings, both in the Concession area and in areas beyond the Concession area;<sup>112</sup>
- The City agree to remove unauthorized waste collectors from the Concession area.<sup>113</sup>

Acaverde rejected the City's proposal because, among other reasons, it was not convinced that the City would suddenly change its ways and begin enforcing its laws and the exclusivity provisions. In response, the City took additional measures to eliminate Acaverde.

#### **J. The City Deprived Acaverde Of Its Right To Landfill Revenues.**

3.92 The new City administration also prevented Acaverde from constructing the permanent landfill and, therefore, prevented Acaverde from receiving expected third-party revenues from landfill operations.<sup>114</sup> Specifically, the City failed to execute the Gratuitous Loan Agreement ("*contrato de comodato*"), which was necessary to give Acaverde the legal right to construct and operate the landfill.<sup>115</sup> The City also failed to issue a proper construction permit for the landfill site.<sup>116</sup>

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<sup>111</sup> By the end of 1996, the City's outstanding debt to Acaverde was approaching N\$15 million. See Monthly Invoices (Exhibit G-20).

<sup>112</sup> The City should have already been helping Acaverde with its billings by enforcing Articles 8 and 9 of the July 1995 Ordinances.

<sup>113</sup> That the City would include this as part of its proposal demonstrates that the unauthorized waste collector problem was significant and that the City was not effectively addressing the problem.

<sup>114</sup> Memorial, ¶¶ 3.66-3.68.

<sup>115</sup> The Gratuitous Loan Agreement was to be an agreement between Acapulco and Acaverde. Under the Gratuitous Loan Agreement, the City would convey title to the land for a fixed term (i.e., the duration of the Concession) so that Acaverde would have the exclusive right to develop, manage and operate the site. The City would convey the land for no fee (gratuitous), and the land would revert back to the City after the specified term. This agreement was required by the Concession. Memorial, ¶ 3.67; Concession (Exhibit B-1), Annex A, Article II, 2.4(c) (requiring a gratuitous loan agreement or "*contrato de comodato*"); Jaime Herrera Statement (Exhibit A-1), ¶ 18.

<sup>116</sup> Memorial, ¶ 3.66.

3.93 In response, Respondent argues that the City executed a usufruct contract with the *Ejido de Paso Texca* regarding the land for the permanent landfill site.<sup>117</sup> Acaverde was not a party to the usufruct contract, which conveyed title from the *ejido* to the City. The usufruct agreement between The City and the *ejido* did not provide Acaverde with the legal right to construct and operate a landfill. However, only a Gratuitous Loan Agreement with the City (now with title to the land) would have given Acaverde adequate legal protection.<sup>118</sup> Acaverde drafted the Gratuitous Loan Agreement, forwarded it to the City and asked on several occasions that it be signed.<sup>119</sup> For reasons that Respondent does not disclose, the City Government never signed the Gratuitous Loan Agreement. Respondent also does not explain why the City Government failed to issue a proper construction permit for the permanent landfill except to suggest that the paperwork may have been lost in the transition to the new municipal administration.<sup>120</sup>

3.94 After investing substantial sums in preparing to build the permanent landfill, Acaverde was deprived of a valuable right – revenues from third parties – because the City failed to deliver the Gratuitous Loan Agreement and a valid construction permit. This was just another in a gradually unfolding series of acts calculated to frustrate Acaverde's operations and destroy Claimant's investment. The final act was yet to come.<sup>121</sup>

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<sup>117</sup> Counter-Memorial, ¶ 156.

<sup>118</sup> An independent report in June 1996 supports Claimant's position that without the Gratuitous Loan Agreement, Acaverde lacked the legal right to construct the permanent landfill. The report, which was written 10 months after the City executed the usufruct contract with the *ejido* concluded that Acaverde "does not yet have title to the [landfill] property" and that "to date, the city council has not legally provided the land upon which the sanitary landfill will be built." Minutes of June 11, 1996 Meeting (Exhibit G-8) [MX 1477-1478].

<sup>119</sup> Letters dated August 2, September 17, December 20, 1996 and January 17, 1997 (Exhibits D-44 to D-47).

<sup>120</sup> Counter-Memorial, ¶ 162. Respondent appears to blame Claimant for this as well.

<sup>121</sup> In its Counter-Memorial, Respondent attacks Acaverde's construction and use of the temporary landfill. Counter-Memorial, ¶¶ 165-170. Under the Concession, Acaverde had the right to dispose of all waste collected in the City's existing open-air dumps until the permanent landfill opened. Rather than contribute to Acapulco's existing environmental problems, Acaverde instead designed, developed and paid for a state-of-the-art temporary landfill, which would be used until the permanent landfill was operational. David Harich Statement (Exhibit A-2), ¶¶ 5-11. The State Government authorized the construction of the temporary landfill. Letter dated November 28, 1995 from Francisco Larequi to the City (Exhibit G-21). The temporary landfill complied with all current Mexican regulations when it was built and had the appropriate environmental impact studies. David Harich Statement (Exhibit A-2), ¶ 8. Additionally, testing performed after Acaverde suspended operations shows that the landfill was closed in accordance with current environmental regulations. Report on Surface Water Sampling dated January 15,

## K. The City Lines Up Setasa And Ousts Acaverde.

3.95 The exclusivity problem and the City's (and Banobras') refusal to pay Acaverde's monthly invoices negated the possibility of any meaningful return on Claimant's investment. Accordingly, Claimant decided to consider selling Acaverde's shares. In February 1997, Claimant entered into discussions with Setasa, a subsidiary of Grupo ICA with experience in waste management in Mexico.<sup>122</sup>

3.96 On February 27, 1997, Setasa signed a Letter of Intent, which expressed Claimant's interest in selling Acaverde's shares to Setasa. In the Letter of Intent, Claimant agreed to supply Setasa with certain internal, confidential documents requested by Setasa and not to offer Acaverde's shares to any other purchasers for a 60-day period. Setasa agreed to keep confidential all information acquired from Claimant and Acaverde and to use the information only for purposes of evaluating the proposed purchase. It was expressly understood that: (a) Setasa could not share or disclose confidential information to third parties; (b) Setasa could not use the confidential information for any other purpose, including competition with Acaverde; and (c) Setasa could not meet with City officials without Claimant's prior consent.<sup>123</sup>

3.97 Over the next two months, Acaverde opened its books to Setasa and disclosed information concerning Acaverde's operational costs, and the equipment and personnel utilized by Acaverde in performing its obligations under the Concession. At Setasa's request, Claimant also disclosed Acaverde's revenues from its contracts with private citizens and businesses and provided a copy of the Concession, along with a customer list.<sup>124</sup>

3.98 After acquiring Acaverde's confidential information and executing a stock purchase agreement,<sup>125</sup> Setasa ultimately backed out of the deal and decided not to purchase the shares of Acaverde. Instead, Setasa entered into direct negotiations with the City to oust Acaverde.

3.99 In June 1997, Setasa held meetings with the City Government in violation of the letter of intent and the agreement with Acaverde.<sup>126</sup> The Mayor of Acapulco admitted that Grupo

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1999 (Exhibit G-22) (showing no contamination to the environment as a result of the landfill operations).

<sup>122</sup> Bill Johnson Statement (Exhibit A-7), ¶ 12; Letter of Intent dated February 27, 1997 (Exhibit G-23).

<sup>123</sup> Bill Johnson Statement (Exhibit A-7), ¶ 13.

<sup>124</sup> Bill Johnson Statement (Exhibit A-7), ¶ 14.

<sup>125</sup> Stock Purchase Agreement dated May 23, 1977 (Exhibit G-24).

<sup>126</sup> See Letter dated June 26, 1997 from Jaime Herrera to Setasa (Exhibit G-25); Bill Johnson Statement (Exhibit A-7), ¶ 15.

ICA at that time requested reports concerning Acaverde's concessions.<sup>127</sup> Clearly, the City Government and Setasa were talking about substituting Setasa for Acaverde.

3.100 In August 1997, the City made public its search for Acaverde's substitute. In an August 27, 1997 newspaper article, the Mayor called upon private companies to announce their interest in providing the services currently being provided by Acaverde.<sup>128</sup> The Mayor also admitted that Setasa was interested in the Concession, as long as the City terminated its relationship with Acaverde:

[The Mayor] noted that the Ingenieros Civiles Asociados (ICA) group has expressed an interest in the concession, provided that the commitment with Acaverde is broken off.

[The Mayor] once again voiced his dissatisfaction with the payment arrangement made in the agreement that the Municipality signed under the former administration. He also announced that next week the two parties will be meeting with the aim of definitely resolving their differences.<sup>129</sup>

3.101 Despite the City's public attempt to oust Acaverde, Claimant continued its operations. Even though Acaverde was not being paid by the City and was receiving approximately 25% of expected revenues from private customers, Acaverde continued to meet and exceed its obligations under the Concession.<sup>130</sup> Eventually, however, the City, State and Federal Governments' actions took their toll.

3.102 The combined effect of Respondent's arbitrary acts was to completely eliminate Acaverde's ability to realize its economic rights under the Concession. The City, State and Federal Governments effectively revoked the Concession, rendering profitable operations impossible. By the end of October, Acaverde was incurring monthly operating losses of approximately N\$860,000.<sup>131</sup> Also, by this time, Setasa was soliciting Acaverde's customers and had already started waste collection operations within the Concession area.<sup>132</sup> Claimant realized

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<sup>127</sup> Newspaper article dated June 27, 1997 (Exhibit G-26), ¶ 1 and ¶ 6 (Mayor was aware that ICA was interested in acquiring the Concession and had come to Acapulco to request information regarding its terms).

<sup>128</sup> Newspaper Article dated August 28, 1997, *Posible privatización de la recolección de basura* (Possible Privatization of Trash Collection) (Exhibit G-27).

<sup>129</sup> *Id.*

<sup>130</sup> Rod Proto Statement (Exhibit A-3), ¶ 20 ("Acaverde continued to meet and exceed its obligations until November 1997 when Acaverde was forced to suspend its operations.").

<sup>131</sup> Bill Johnson Statement (Exhibit A-7), ¶ 18.

<sup>132</sup> Bill Johnson Statement (Exhibit A-7), ¶ 15.

that its investment had been expropriated and that it could not continue operations. Accordingly, on October 28, 1997, Acaverde announced that it would suspend operations in two weeks.

3.103 In response to Acaverde's notice, the City made a final proposal to modify the Concession terms. The City's November 3 proposal was the last in a long series of arbitrary, bad faith acts designed to ensure Acaverde's failure. Among other things, the City proposed that:

- The City pay Acaverde N\$8,000,000 (in monthly installments) to resolve all of the City's outstanding debt to Acaverde;<sup>133</sup>
- Acaverde pay the City a concession fee of N\$84,000,000;
- Acaverde pay the City 10% of the revenues for services rendered to residents and businesses "for the enjoyment of the concession granted;" and
- The terms under which Acaverde would be paid, the amounts Acaverde would be paid, and the scope of its operations would be redefined and subject to unilateral amendment by the City.<sup>134</sup>

Acaverde rejected this "proposal" and suspended its operations on November 12, 1997. The City's invitation to Setasa to oust Acaverde – combined with the City's failure to enforce, and active violations of, its own laws – completely destroyed Claimant's investment.

3.104 In its Counter-Memorial, Respondent makes two arguments concerning Setasa's presence in the Concession area. First, Respondent argues that Acaverde had already suspended operations in Acapulco when Hurricane Pauline hit on October 9, 1997. Second, Respondent argues that Setasa was in Acapulco only to help with the emergency cleanup following Hurricane Pauline and that Setasa was asked to perform normal waste collection services only after Acaverde suspended operations. Neither argument has merit.

3.105 First, Claimant has already established that it continued operations, and met its obligations under the Concession, until November 1997.<sup>135</sup> Respondent's own damage expert, who reviewed Acaverde's operating data, concluded that "Acaverde continued operating in the concession area until November 1997."<sup>136</sup> Respondent's assertion that Acaverde did not participate in the emergency effort is also groundless. Acaverde provided financial assistance,

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<sup>133</sup> This figure represented approximately 10% of the City's outstanding debt to Acaverde.

<sup>134</sup> Letter and Proposal dated November 3, 1997 (Exhibit D-54).

<sup>135</sup> Rod Proto Statement (Exhibit A-3), ¶ 20. Furthermore, on November 12, 1997 (the day Acaverde suspended operations), the City Government asked Setasa to add a second shift along all of its routes. See Letter dated November 12, 1997 from the City to Setasa (Exhibit G-28) (translated copy). This demonstrates that Acaverde was still operating up until November 12; otherwise, there would have been no need for Setasa to add a second shift beginning that day.

<sup>136</sup> MX 2469, ¶ 28 (Exhibit G-29) (translated copy).

donated food and clothing, helped to remove mud and other debris from the streets, and leased equipment at its expense to aid in the relief effort.<sup>137</sup>

3.106 Respondent's assertion that Setasa just happened to have a significant amount of equipment and personnel near Acapulco when Hurricane Pauline struck is incorrect. It is undisputed that long before the hurricane, Setasa and the City held meetings in which the subject of Setasa providing waste collection services was discussed.<sup>138</sup> It is undisputed that before conducting those meetings, Setasa acquired confidential information concerning Acaverde's operations. It is undisputed that the Mayor of Acapulco publicly announced that Grupo ICA (i.e., Setasa) was interested in the Concession if the City terminated its relationship with Acaverde. It is undisputed that Setasa was soliciting Acaverde's customers long before Acaverde suspended operations. Contrary to Respondent's conclusion, there is plenty of evidence of a plan by the City and/or State Governments to oust Acaverde and replace it with another operator.

3.107 Contemporaneous accounts of the events surrounding Acaverde's departure support Claimant's position. On December 17, 1997, the following article appeared in *The Acapulco Sun*.<sup>139</sup>

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<sup>137</sup> Statement of Francisco Larequi (Exhibit H-1).

<sup>138</sup> Even Respondent's witnesses admit this. See Statement of Rogelio Morena, ¶ 21 (Exhibit G-30) (translated copy).

<sup>139</sup> Newspaper article dated December 17, 1997, *La Basura De La Basura* (The Dirt on the Trash) (Exhibit G-31) (emphasis added).



# THE DIRT ON THE TRASH

By Raúl PÉREZ GARCÍA

The closing of Acaverde, induced by the Municipality & ICA for economic reasons, could inhibit foreign investment in Acapulco, since the company affected by the shady dealings is a subsidiary of *USA Waste Service, Inc. (UWSI)* which recently merged into a single company with *Sanifill*, making it the world's third largest company in the field of trash collection and treatment.

With an operating presence in 48 states of the U.S. and the major cities of Puerto Rico and Canada, UWSI views its failure in Acapulco as a bad experience in Mexico, so bad, that when it closed down its subsidiary's operations in Acapulco, it decided to sell its concessions, equipment, and installations in Tijuana, Ensenada, and Mexicali, Baja California, as well as in Ciudad Juárez, Chihuahua.

Sources in high-level financial circles are saying that Alberto Santos is the one who bought the UWSI subsidiaries located in the above-mentioned cities of northern Mexico. Santos is a wealthy businessman from Monterrey, and also a politician in the PRI. He has been a federal legislator, and here in Acapulco is the co-owner of *Tres Vidas*, as well as an enormous landholding along the Coast that borders on the Golf Club.

Here in Acapulco, the one who ends up better off (We are reminded of the famous police novel, where, at the scene of the crime the detective asks, "Who's better off now?") on account of Acaverde's closure is "Setasa," an "ecological" technical treatment company and a subsidiary of the infamous ICA, which established its reputation by throwing trash into "open-air" dumps to the side of the Texca-Los Bajos del Ejido highway. A few days before the strike of the Acaverde workers, which seems to also have been instigated by the shady relationship between the City Council and ICA, it already had twelve trash collections trucks painted green (the favorite color of ecologists) and ready just in case. Opportunity

knocked when the waterspout from Hurricane Pauline raged through Acapulco, flooding the city and showering sand on the streets. The trash and ruins of the affected houses needed to be swiftly collected, so the whole world would know that Acapulco was "on its feet." And so, the Mexican political system worked its miracle, and the "green-ecological" trucks that toss garbage into dumps along the side of the road started collecting trash from the city streets, collecting sweepings, reluctant to accept the customary tips requested by the municipal cleaning service personnel. The public saw their good side, full of the best intentions, but their true objectives were hidden in the shadows: to win the concession, replacing Acaverde without going through the bidding process required by law.

People who claim to know the ins and outs of the financial relationship between the City Council and ICA have told us that the giant consortium founded by Bernardo Quintana was not only given an opportunity to receive the concession for collecting and treating the trash. The Commission on Potable Water and Sewers of the Municipality of Acapulco (CAPAMA) also granted it the privilege of operating its technical area as a first step towards being awarded the concession of CAPAMA's services when that semi-private company is privatized.

If these speculations are true, ICA would be the "favorite son" of the City Council presided over by Juan Salgado Tenorio, in the same position as Grupo Mexicano de Desarrollo under the administration of Rogelio de la O. Almazán.

Such is the state of affairs under the neo-liberal trend in the municipality. But getting back to the question of UWSI, what can the Secretary of Commerce under the Zedillo government say to them, after the low blow inflicted upon the Free Trade Agreement itself by our neo-liberal council members.

3.108 As this article states, Setasa was already positioned to provide waste collection services in the Concession area when Hurricane Pauline struck Acapulco. The City and State Governments conspired with Setasa to effectively revoke the Concession, remove Acaverde and destroy Claimant's investment.

**L. Acaverde Performed Its Obligations.**

3.109 Throughout the Counter-Memorial, Respondent argues that Acaverde's performance under the Concession was substandard in several areas.<sup>140</sup> The motive for making this assertion is obvious. Respondent hopes to create an appearance of poor performance to: (a) excuse its own arbitrary and expropriatory acts; and (b) reinforce its argument that the claims at issue are simply contractual disputes. Unfortunately for Respondent, Acaverde fully performed its obligations under the Concession.

**1. The City Never Fined Acaverde.**

3.110 The details of Acaverde's performance are set forth in paragraphs 3.39 through 3.52 of the Memorial and in the supporting witness statements. Claimant will not repeat those facts here. Instead, Claimant invites the Tribunal's attention to those portions of the Concession and the July 1995 Ordinances relating to Acaverde's performance obligations.

3.111 Recognizing that Acaverde's investment reflected a long-term commitment, the Concession contained provisions designed to give the concessionaire an opportunity to correct deficiencies or irregularities in service.<sup>141</sup> Acaverde was subject to a fine if, after receiving notice in writing of a deficiency, Acaverde did not correct the deficiency within 24 hours.<sup>142</sup> The Concession also provided that the City could cancel the Concession for material service deficiencies if, and only if, the City notified Acaverde in writing and gave Acaverde 30 days to correct the situation.<sup>143</sup>

3.112 Similarly, the July 1995 Ordinances set forth procedures and penalties in the event of poor performance by Acaverde:

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<sup>140</sup> Respondent goes so far as to claim that the quality of Acaverde's performance was inferior to the service provided by the City before the Concession was granted. Counter-Memorial, ¶ 67.

<sup>141</sup> In general, the Concession obligated Acaverde to use its "best efforts" to provide the services in question. Memorial, ¶¶ 3.20-3.21. For street sweeping, the Concession specified that Acaverde was to provide 20 manual sweepers, three mechanical sweepers and two supervisors. Concession (Exhibit B-1), Annex A, Article II.3, List No. 1. During its operations, Acaverde employed more than three times the required number of street sweepers. In September 1996, Acaverde added an additional 20 manual sweepers. Letter dated September 4, 1996 from Francisco Larequi to Mayor of Acapulco (Exhibit G-32).

<sup>142</sup> Concession (Exhibit B-1), Annex B, Article VII.

<sup>143</sup> Concession (Exhibit B-1), Condition Fourteenth.

**ARTICLE 26.- Sanctions for the concessionaire:**

**III.-** The City Council, through the Department of Municipal Public Services, will inform the Concessionaire of any differences existing in the rendering of the service concession awarded so that it may be corrected within the 24 hours after the Concessionaire receives a written complaint. In the event the Concessionaire fails to fulfill its obligations with its users, it must pay a fine of up to 200 times the current minimum wage in the region.

**IV.-** In the event the areas specified in Article 7 of this Regulation are not swept and cleaned, such as the manual and mechanical sweeping, due to reasons attributable to the Concessionaire, a sanction will be imposed, which will be from 200 to 500 times the current minimum wage in the region.<sup>144</sup>

Thus, the July 1995 Ordinances echoed what the Concession established: Acaverde had 24 hours to remedy any minor deficiencies in service, and the City could levy fines against Acaverde if those deficiencies continued.

3.113 During the 27 months that Acaverde operated, the City never fined Acaverde for deficiencies (even minor ones) in service.<sup>145</sup> Additionally, Acaverde never received written notification from the City that its service was materially deficient or otherwise a cause for termination of the Concession.<sup>146</sup> The absence of fines and notifications of material deficiencies speaks volumes about the quality of Acaverde's performance under the Concession.

**2. Contemporaneous Accounts Of Acaverde's Performance.**

3.114 Newspaper articles from November and December 1997 contradict Respondent's current claim that Acaverde's performance was poor. In fact, these objective accounts demonstrate that: (a) Acaverde's service was excellent, and (b) the City, State and Federal Governments' treatment of Acaverde would have a chilling effect on future foreign investment. On December 16, 1997, the following article appeared in *The Acapulco Sun*:<sup>147</sup>

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<sup>144</sup> July 1995 Ordinances (Exhibit B-3), Article 26.

<sup>145</sup> Joseph Coradetti Statement (Exhibit A-6), ¶ 16; Francisco Larequi Statement (Exhibit A-5), ¶ 20.

<sup>146</sup> Rod Proto Statement (Exhibit A-3), ¶ 20.

<sup>147</sup> Newspaper article dated December 16, 1997, "*Ahi Viene el Carreton de la Basura*" (Here Comes the Garbage Truck) (Exhibit G-33).

## HERE COMES THE GARBAGE TRUCK!

By Augusto SAGAON NOGUEIRA

I guess I'll be a rebel until the day I die. I just can't close my eyes and my mouth when I think someone's not right, at least not as I define what's right...

A few short months ago, or perhaps a few years ago, the Acaverde matter became a burning issue, especially for the tourist area of the city, where, for the first time, a private company was granted a concession for a service that up until then had been the responsibility of the municipality. Due to the city's irregular growth pattern, the balance had been lost between the demand for the indispensable trash collection service and the economic capacity of our City Council. As a result, it was necessary to resort to the methods of the First World, where each user makes a direct contribution in order to receive the trash collection services. Needless to say, the change was not well received by the public, basically for two reasons: The first reason was the error committed by our authorities in not knowing how to motivate the core public affected by the changes and try to use the weight of its authority to obligate them. The other reason was that the company providing the service failed to take the overall economic situation into account and tried to set arbitrary rates over and above the charges for property taxes. As a result, they thus met with the adamant opposition of the public. Yet with the passage of time and the holding of dispute resolution conferences, the mistakes were corrected. An agreement was reached that was not prejudicial to either party, and we started to contract and receive a service that frankly left us quite satisfied on account of its efficiency and consistency. Now it turns out that the same authorities who got us into this mess in the first place are doing an elegant disappearing act to avoid fulfilling the economic commitments they made. All of a sudden, they have left us without the comfortable, consistent residential trash collection to which we had so easily become

accustomed. But the damage doesn't stop there. You see, everyday Mexicans, like you and me, dear reader, are used to suffering on account of the irresponsible abuses inflicted by the authorities. But on this occasion, the international reputation of our country, or at least of our municipality ended up getting smeared. By refusing to fulfill a contractual commitment to a multinational company, it is instilling distrust among the major investors of the future.

Today, we are hearing "*Las Golondrinas*" ["The Wanderers"] being played for Acaverde, the company that was teaching us to live like civilized people. Perhaps that song will keep on playing as future investments are canceled, investments that could have helped us reduce crime and create jobs with dignity for many of our countrymen who today are so needy that they are committing crimes. For the meantime, we will once again be hearing the chiming of the bell that announces, "Here comes the garbage truck!"

3.115 Other articles contain similar praise for Acaverde's service.<sup>148</sup> Claimant's witness statements and these third party accounts demonstrate that Acaverde's performance was effective and efficient.

3.116 Respondent alleges non-performance by Acaverde as a desperate attempt to justify its arbitrary and expropriatory conduct. Respondent's allegation is discredited by: (a) the City's failure to fine Acaverde for service deficiencies; (b) the City's failure to notify Acaverde of material performance issues; and (c) the city's repeated offers to expand Acaverde's Concession area. Those contemporaneous acts (or lack thereof) are a better indicator of Acaverde's performance than the arguments currently made by Respondent to avoid liability under NAFTA.

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<sup>148</sup> Newspaper article dated November 17, 1997, "*Enfoque corporativo*" (Corporate Focus) (Exhibit G-34) ("we were able to verify that ever since Acaverde started operating, those who have received their services, including private parties serviced at their residences, have had no complaints about the high quality of the services, which are incomparable to those they received when the service was provided directly by the municipality."); newspaper article dated November 17, 1997, "*Alertaron sobre una extensa capa de humo que aparece cada mañana sobre los cerros de la zona conurbada*" (Alert regarding a thick cloud of smoke that appears each morning over the hills of the metropolitan area) (Exhibit G-35) (stating that one of the effects of Acaverde's departure is a thick cloud of smoke caused by residents burning trash).

## CHAPTER FOUR

### RESPONDENT'S CONDUCT VIOLATED ARTICLES 1110 AND 1105 OF NAFTA

4.1 As explained by the *Metalclad* panel, the “[u]nderlying objective of NAFTA is to promote and increase cross-border opportunities and ensure the successful implementation of investment initiatives.”<sup>149</sup> Section 1110 gives effect to this objective by declaring that no NAFTA member state “may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment” except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and Article 1105(1), and on payment of just compensation.<sup>150</sup> Article 1105(1) requires that NAFTA member states “accord to investments of investors of another party treatment in accordance with international law, including fair and equitable treatment and full protection and security.” Together, these provisions, Articles 1110 and 1105, prohibit NAFTA member states from engaging in a course of conduct that has the cumulative effect of completely frustrating the operation of a valid concession and negating the possibility of any meaningful return on an alien’s investment in that concession.<sup>151</sup>

4.2 This arbitration presents the very factual scenario that Chapter 11 of NAFTA was intended to remedy. As detailed in Claimant’s Memorial and the factual discussion in Chapter Three, Respondent is liable under Articles 1110 and 1105 of NAFTA for the following pattern of actions (and refusals to act) which completely frustrated the operation of Acaverde’s Concession for waste management services:

- The City, State and Federal Government of Mexico had agreed with Claimant on a Concession predicated on the passage and enforcement of laws (a) requiring inhabitants of the Concession area to use and pay for Acaverde’s waste collection services, and (b) prohibiting others from collecting waste in the Concession area. Although such laws were passed, the City refused to enforce them -- publicly allowing inhabitants of the Concession area, including the City Port Authority and the Mexican Naval Base, to use other companies to collect waste. The City not only refused to enforce these laws, but itself violated them by allowing its own employees to use the City’s equipment to collect waste in the Concession area.
- By withholding monthly payments to Acaverde for services rendered, the City (with the cooperation of the State and Federal Governments) forced Claimant to renegotiate the terms and conditions of the Concession. The City told Claimant that its investment would be destroyed if it did not modify the Concession on terms acceptable to the Mexican Governments.

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<sup>149</sup> *Metalclad*, ¶ 75.

<sup>150</sup> NAFTA, Art. 1110(1).

<sup>151</sup> *Metalclad*, ¶ 113

- The City, State and Federal Governments conspired to deny Acaverde its third-party beneficiary rights under the Line of Credit, which was created specifically to protect Acaverde against non-payment by the City. In furtherance of this conspiracy, the City, State and Federal Governments took inconsistent and manipulative legal positions in domestic Mexican legal proceedings with the sole intention of preventing Acaverde from realizing its legal rights.
- Finally, the City and the State conspired together to replace Acaverde with Setasa as the waste collector for the Concession area, notwithstanding the valid Concession.

Taken together, these actions (and refusals to act) by the City, State and Federal Governments breached Respondent's duty under international law to act in good faith with foreign investors, and destroyed Claimant's investment in the Concession without compensation.

4.3 In its discussion of "Legal Issues,"<sup>152</sup> Respondent attempts to distract the panel from these fundamentally undisputed facts by (1) making irrelevant (and unfounded) allegations regarding Claimant's acquisition of Acaverde,<sup>153</sup> and (2) weakly challenging the legal basis for the relief Claimant seeks. Having addressed in Chapter Three Respondent's factual contentions, Claimant turns in this Chapter to Respondent's "legal" arguments.

4.4 Respondent's legal challenge boils down to two principal assertions. First, Respondent maintains that Claimant has alleged nothing more than a simple breach of contract which does not rise to the level of a violation of international law.<sup>154</sup> Second, Respondent argues that because Claimant's allegations involve merely a breach of contract dispute, they should (and could) have been resolved in Mexican arbitration proceedings. According to Respondent, such proceedings were fully available to Claimant, but were abandoned.

4.5 This Chapter demonstrates that Respondent's arguments are both legally unsound and factually misleading. Notwithstanding Respondent's simplistic attempt to label the expropriation of a Concession as a mere breach of contract,<sup>155</sup> Claimant will demonstrate that

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<sup>152</sup> Counter-Memorial, ¶¶ 193 to 314.

<sup>153</sup> Counter-Memorial, ¶¶ 280 to 314. It appears that the only purpose of these "implications" and "inferences" is to create a smoke screen of extraneous issues, in which, among other things, Respondent questions the ethics and integrity of certain individuals affiliated with Waste Management and Acaverde, particularly Mr. Proto. Claimant does not intend to dignify these allegations with a response in this Reply. They are not only irrelevant, they are spurious. Claimant is prepared, however, to address any questions that the Tribunal may raise.

<sup>154</sup> Counter-Memorial, ¶ 228.

<sup>155</sup> The Tribunal in the *Azinian* case soundly criticized this litigation technique: "Labeling is, however, no substitute for analysis." *Robert Azinian et al. v. United Mexican States*, ICSID

Respondent violated well-settled responsibilities under NAFTA Articles 1110 and 1105(1). Indeed, as the Mexican Governments consistently argued in domestic Mexican judicial and arbitration proceedings, Acaverde's Concession was a public investment agreement predicated on the City taking specified sovereign acts. By first refusing to carry out its sovereign responsibilities under the Concession, then engaging in a scheme to prevent Acaverde from realizing its remedies under the Concession, the Mexican Governments destroyed the value of Claimant's investment, and thereby violated Article 1110. Moreover, in violation of Article 1105(1), the Mexican Governments' pattern of willful misconduct unacceptably subjected Claimant to unjust and arbitrary treatment in violation of established international norms, and resulted in a complete denial of justice.

**A. Contrary To Respondent's Assertions, Claimant States A Valid Claim Of Expropriation Which Has Not Been Abandoned.**

4.6 Respondent does not deny that a long-term Concession was duly awarded to Acaverde by lawful authority of the City, State and Federal Governments of Mexico.<sup>156</sup> Instead, Respondent argues that Acaverde's Concession was essentially an ordinary service contract – "a partial concession for waste collection and landfilling in the municipality of Acapulco, consisting of street sweeping and the garbage collection in a delimited area, and the disposal of municipal waste in a site provided by the *Ayuntamiento*."<sup>157</sup> Respondent maintains that the City's non-performance of its obligations under this "partial concession" gave rise only to an action for breach of contract in Mexico, not an international claim under NAFTA. Moreover, Respondent falsely states that the Mexican Governments were willing to allow a domestic Mexican body hear Claimant's substantive allegations.

4.7 Acaverde's Concession was no ordinary contract, and the Mexican Governments engaged in no ordinary pattern of non-performance. Rather, as detailed in Claimant's Memorial and below, the Mexican Governments' refusals to fulfill their sovereign responsibilities under the Concession, coupled with their consistent efforts to prevent Acaverde from realizing the domestic legal remedies afforded to it by the Concession, effected an expropriation of Claimant's investment for which NAFTA provides the appropriate remedy.

**1. As the Mexican Governments Previously Argued in Mexican Courts, the Concession Is No "Mere Contract."**

4.8 A fundamental, but flawed, premise in Respondent's Counter-Memorial is the argument that Acaverde's Concession was a simple services contract. In reality, the Mexican Governments themselves have recognized that the Concession implicated substantial governmental authority, requiring the City to utilize its legislative and executive powers for Acaverde's benefit. The Concession also contemplated that Acaverde would make a substantial

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ARB(AF)/97/2 (Award, Nov. 1, 1999) at ¶ 90. Respondent even cites this same passage in paragraph 3 of its Counter-Memorial.

<sup>156</sup> Counter-Memorial, ¶ 48.

<sup>157</sup> Counter-Memorial, ¶ 256.



investment in the City's long term development. For these reasons, the Mexican Governments had, until their Counter-Memorial here, taken the position that the Concession was not an ordinary contract at all, but a public contract subject to special protection under international and Mexican law. As this section demonstrates, the Concession was, indeed, a public contract subject to special protection under international law.

**a. Until This Arbitration Proceeding, the Mexican Governments Had Maintained That The Concession Was a Public Contract.**

4.9 In January 1998, Acaverde instituted a domestic arbitration proceeding before the Permanent Commission of Arbitration of the National Chamber of Commerce of Mexico City ("Permanent Commission").<sup>158</sup> Although the Mexican Governments had previously taken the position in Mexican judicial proceedings that Acaverde's claims belonged in arbitration (leading Acaverde to commence the proceeding before the Permanent Commission), the City argued from the outset of the arbitration that the Permanent Commission did not have authority over the dispute because the Concession was "an administrative instrument governed by provisions of public law," not a traditional commercial contract.<sup>159</sup> In briefing to the Permanent Commission, the City carefully explained how Acaverde's Concession was different from commercial contracts:

PUBLIC SERVICES, IN THEIR CREATION, MODIFICATION, OPERATION, AND TERMINATION, ARE SUBJECT TO A SPECIAL REGIME OF PUBLIC LAW, AS OCCURS IN THE LEGISLATION OF THE STATE OF GUERRERO, WHERE THE ORGANIC LAW OF THE FREE MUNICIPALITY OF THE STATE OF GUERRERO, AS WELL AS THE REGULATIONS FOR THE PROVISION OF PUBLIC CLEANING SERVICES GRANTED THROUGH CONCESSIONS, REGULATE THE PROVISION OF PUBLIC CLEANING SERVICES, AS WELL AS THE POSSIBILITY OF GRANTING CONCESSIONS THEREON TO PRIVATE PARTIES FOR REASONS OF SOCIAL INTEREST.

In cases where public services are granted under a concession to private parties, the State enshrines them with the same security and prerogatives as were applied to said services under Public Administration, given the enormous interest involved, due to society's need for complete and timely services.<sup>160</sup>

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<sup>158</sup> Commencement of the arbitration was fully consistent with the Concession's arbitration clause. Indeed, the Permanent Commission's Rules and Regulations were incorporated as an attachment to the February 9, 1995 Modified Concession Clause Three (MX0037).

<sup>159</sup> Exhibit G-36, p. 2. The City also objected to the arbitration because the City could not afford it. The City made this objection almost one year before Acaverde complained of the exorbitant arbitration fees that had been assessed by the Permanent Commission. Thus, the suggestion by Respondent in paragraphs 32 and 86 of its Counter-Memorial that Acaverde was the first party to complain of the high costs associated with the domestic arbitration is disingenuous, at best.

4.10 After the Permanent Commission denied the City's request to dismiss Acaverde's arbitration,<sup>161</sup> the City sued both the Permanent Commission and Acaverde in Guerrero State Court for a judgment declaring all proceedings of the Permanent Commission null and void,<sup>162</sup> and awarding damages from both Acaverde and the Permanent Commission for the institution and continuation of the arbitration.<sup>163</sup> In a brief to the Guerrero State Court, the City reiterated its argument that the Concession was a public contract not subject to arbitration as a traditional commercial contract:

THE APPLICABILITY OF THE LAW OF ADMINISTRATIVE JUSTICE AND THE ADMINISTRATIVE LAW COURTS OF THE STATE OF GUERRERO IS INDISPUTABLE, JUST AS IT IS INDISPUTABLE THAT THE PROVISION IN QUESTION IS ONE OF PUBLIC LAW, GIVEN THAT THE MATTER AT HAND INVOLVES THE CONCESSION OF A PUBLIC SERVICE GRANTED BY THE CITY COUNCIL OF THE MUNICIPALITY OF ACAPULCO TO A COMPANY. THIS POSSIBILITY CANNOT EVEN BE CONCEIVED OF AS A MIXED ACT, AS WE INSIST THAT THIS IS A CONCESSION OF A PUBLIC SERVICE, WHOSE NATURE IS ADMINISTRATIVE.

...

GIVEN THE SITUATION DESCRIBED ABOVE, FROM A STRICTLY LEGAL POINT OF VIEW, THE AGREED-UPON ARBITRATION CLAUSE CANNOT, UNDER ANY LOGICAL OR LEGAL ARGUMENT, PROVIDE A BASIS FOR THE COMPETENT JURISDICTION OF THE ARBITRATION PANEL, ESPECIALLY IF ONE TAKES INTO ACCOUNT THAT THE DISPUTE IN QUESTION IS NOT COMMERCIAL OR MERCANTILE IN NATURE.<sup>164</sup>

4.11 Thus, the Mexican Governments themselves recognized that the Concession was a unique public contract, in which the City conceded to Acaverde the right to provide public services over an extended period, in exchange for permanent investments in a landfill. In light of these positions – taken both before a Mexican arbitration body and a Mexican court – the following representation of Respondent to this Tribunal is nothing less than remarkable:

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<sup>160</sup> Exhibit G-37 (courtesy translation) (capitalization in original), p. 6.

<sup>161</sup> Exhibit G-38. The Permanent Commission noted that the City had been directed three months earlier to designate its arbitrator pursuant to the Permanent Commission's regulations and had been given an extension until June 1 by the Permanent Commission, "which demonstrates the goodwill of this Administrative body. However, in the opinion of this Permanent Arbitration Commission, its goodwill has been used to delay and hinder the establishment of the Arbitration Tribunal." *Id.* (courtesy translation ), p.2. Compare the Permanent Commission's conclusion with Respondent's statement that the City fully cooperated with the domestic arbitration from the very beginning. Counter-Memorial, ¶ 32.

<sup>162</sup> Exhibit G-39 (courtesy translation), p.2.

<sup>163</sup> *Id.*, pp.8-9.

<sup>164</sup> Exhibit G-40 (courtesy translation) pp.7-8, and 10. (capitalization in original)

Since the beginning of the exchange of correspondence between the Claimant and the Respondent, when the Claimant sought to establish the first NAFTA Chapter Eleven tribunal, the Respondent has consistently expressed the view that this claim raised only issues of Mexican law arising out of a contractual relationship between the *Ayuntamiento* and Acaverde, and accordingly the proper forum for resolving the alleged breaches of the concession was the domestic arbitration pursuant to the Title of Concession.<sup>165</sup>

Indeed, Respondent's position is disingenuous, and reflects the willingness of the Mexican Governments to do or say whatever is necessary to avoid rectifying their mistreatment of Claimant. In addition to the substantive consequences of this duplicity under Article 1105, this blatant contradiction severely undermines the legitimacy of Respondent's current argument equating the Concession to a simple contract.

**b. International Law Affords Special Protections to Long Term Development Contracts and Other Public Agreements.**

4.12 Claimant respectfully submits that the City accurately described the Concession as a public contract subject to unique treatment under international law.<sup>166</sup> Arbitral panels, including tribunals constituted under NAFTA, have long afforded special protections to those that are party to concessions granted by governments for long-term development projects, such as the development of a country's natural resources or the construction of major infrastructure projects.<sup>167</sup> Such long-term development agreements often require public acts of a sovereign and depend upon substantial up-front investment that the foreign investor anticipates recouping over an extended period of time. In many instances, long-term development agreements require the investor to act on the government's behalf, either exploiting natural resources that belong to the public, or providing services on behalf of the government to the public at large. Contrary to

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<sup>165</sup> Counter-Memorial, ¶ 193, footnote omitted.

<sup>166</sup> Claimant does not concede, however, that the public nature of the Concession rendered the arbitration clause within it invalid. As discussed in detail in Section C of this Chapter, that clause was rendered ineffective only by the concentrated and bad faith efforts of the Mexican Governments to prevent any impartial body from reviewing the substance of Claimant's allegations.

<sup>167</sup> See, e.g., *Revere Copper and Brass, Inc. v. Overseas Private Investment Corp.*, 56 I.L.R. 258, 259 (1978); *Texaco Overseas Petroleum Company ("TOPCO") and California Asiatic Oil Company v. the Government of the Libyan Arab Republic*, 53 I.L.R. 389, 456 (1977); *Libyan American Oil Company ("LIAMCO") v. the Libyan Arab Republic*, 62 I.L.R. 141, 169 (1977); Louis B. Sohn and R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT. L. 545, 574 (1961) (explaining that long-term international development agreements, calling for the expenditure of large sums of money and the performance of many obligations by both the state and the alien, are very different from simple contracts of sale); [Volume 1 Peace, Part 2 to 4] OPPENHEIM'S INTERNATIONAL LAW, 927 (Robert Jennings, QC and Arthur Watts KG, QC eds., 9th ed., Longman).

Respondent's depiction of the Concession, each of these factors found in other long term development agreements – the exercise of sovereign responsibilities for the benefit of the concessionaire, substantial up-front investment by the concessionaire, and the expectation of profit recovery over a substantial period – are all present in Acaverde's Concession.

4.13 From Respondent's description of the Concession one might think that Claimant was obligated only to collect trash and haul it to a landfill provided by the City. But as the City argued in the Mexican Arbitration, the Concession imposed on the City specific legislative and executive responsibilities, the fulfillment of which would secure regular revenues for Acaverde.<sup>168</sup> In exchange for these revenues, Acaverde would make a substantial investment in a permanent landfill, and provide world-class waste collection services with an immediacy that the City desperately needed but could not procure from other sources.<sup>169</sup> Additionally, the landfill that Acaverde was to construct would have ten years of useful life remaining after the Concession expired, which would provide the City with long-term benefits. This combination of the City's performing sovereign acts in exchange for a major infrastructure development renders the Acaverde Concession indistinguishable from other long term development agreements protected under international law.

4.14 Long term development agreements that require the exercise of sovereign authority are typically afforded special treatment under international law. As the Restatement Third on Foreign Relations explains: "Breaches of development or concession contracts are similar to, and often allied with, expropriations... and international law tends to treat the two similarly."<sup>170</sup> For example, in *Revere Copper* the concession obligated the Government of Jamaica to take all necessary steps to facilitate the foreign investor's ability to build its bauxite processing plant and take advantage of its concession, including granting necessary permits and making land available.<sup>171</sup> When, among other things, the government failed to fulfill its affirmative responsibilities, and even interfered with the investor's ability to realize the profits anticipated from the concession, the tribunal did not declare that the government was simply in breach of a simple contract. Instead, the tribunal found that the government's acts resulted in a breach of the concession, a violation of international law, and an expropriation.<sup>172</sup>

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<sup>168</sup> Exhibit G-37. The City could even enforce the July 1995 Ordinances by the imposition of fines or the seizure of property, which would involve the exercise of its sovereign police authority.

<sup>169</sup> See Exhibit B-1 to Memorial, Exhibit A.

<sup>170</sup> RESTATEMENT (THIRD) OF THE LAW OF FOREIGN RELATIONS OF THE UNITED STATES §712 (1986).

<sup>171</sup> See 56 I.L.R., ¶¶ 262 -263.

<sup>172</sup> See *id.*, ¶ 259. In reaching this conclusion, the tribunal emphasized that:

4.15 Acaverde's Concession imposed the clear and unequivocal obligation on the City to exercise its sovereign powers (legislative and executive) to implement the Concession. The most significant of the City's obligations involved the enforcement of the July Ordinances, especially the provisions setting forth the exclusivity rights of Acaverde and requiring all citizens in the Concession Zone to solicit services from Acaverde and to pay Acaverde for those services. Respondent would have this Tribunal conclude that, notwithstanding these non-commercial responsibilities, the Concession was simply a contract for the provision of services. But neither NAFTA itself, nor a single arbitral decision cited by Respondent, supports that result.

4.16 The Concession is also entitled to special treatment based on Claimant's responsibilities to invest in the construction of a landfill for the City. Indeed, this major infrastructure project is no different than the major development work required of the concessionaire in *TOPCO*,<sup>173</sup> or the substantial investment required for the investor to log and recover timber in *LETCO*.<sup>174</sup> Each of these projects required the concessionaire to invest substantial revenues upfront in exchange for an extended revenue stream that would allow recovery of the initial investment at a profit over the life of the agreement. Just like those foreign investors, Claimant expended considerable revenues upon receipt of the concession – both to establish its system for providing waste concession services in the Concession area and to prepare for construction of the permanent landfill.<sup>175</sup> Claimant invested these funds based on the assurances of the Mexican Governments that Claimant would receive a steady stream of revenue from waste collection services in the Concession area. Although it is true that the Concession was called a "Partial Concession," in that it provided Claimant with exclusivity in a defined geographical area of the City, all concessions are in this sense "partial." Indeed, the timber concession granted to the

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Under international law the commitments made in favor of foreign nationals are binding notwithstanding the power of Parliament and other governmental organs under the domestic Constitution to override or nullify such commitments. Any other position would mean in this case that Jamaica could not in the exercise of its sovereign powers obtain foreign private capital to develop its resources or attract foreign industries. To suggest that for the purposes of obtaining foreign private capital the government could only issue contracts that were non-binding would be meaningless. *Id.*, ¶ 284.

<sup>173</sup> *TOPCO*, 53 I.L.R. 389.

<sup>174</sup> *Liberian Eastern Timber Corporation ("LETCO") v. The Government of the Republic of Liberia*, 26 I.L.M. 647 (1987).

<sup>175</sup> It should be noted that Mexico cites the decisions in both *TOPCO* and *Aramco* to support its argument that there is no analogy between mining concessions and Acaverde's Concession. Counter-Memorial, ¶ 257. In reality, in explaining why long-term development agreements are not treated as mere contracts, the Tribunal in *TOPCO* states that: "[such contracts] are not concerned only with an isolated purchase or performance, but tend to bring to developing countries investments and technical assistance, particularly in the field of research and exploitation of mineral resources, or in the construction of factories on a turnkey basis." 53 I.L.R., ¶ 456. The same words could be used to describe Claimant's construction of a state-of-the-art landfill to be operated for a number of years by Acaverde and then turned over to the City for its continued use after the Concession expires.

foreign investor in *LETCO* did not grant the investor rights to all the timber in Liberia, only to the timber found in a specified geographic area.<sup>176</sup> Likewise, oil exploration concessions are uniformly defined by geographic limits. Accordingly, the fact that the Concession at issue here was limited in geographic scope in no way alters its status as a long term development agreement.

4.17 In summary, Respondent's assertion in its Counter-Memorial that Claimant's Concession does not have the same "character, order and magnitude" as the investment agreements afforded protection by previous international tribunals is more labeling, not analysis. Because Acaverde's Concession was awarded by the Mexican Governments in connection with a long-term development project (the permanent landfill), because Acaverde's Concession obligated the City Government to exercise its rights as a sovereign on behalf (and for the benefit) of Acaverde, and because the City admitted that Acaverde's Concession was a public contract, and, thus, not a proper subject for commercial arbitration, Respondent's assertion in its Counter-Memorial that Acaverde's Concession is a "mere contract" should be summarily rejected.

**2. Contrary to Respondent's Assertion, Mexico Did Not Provide a Forum for Claimant's NAFTA Claims, and At Any Rate, the Mexican Governments Repeatedly Denied Acaverde the Opportunity to Resolve Disputes in Mexico.**

4.18 Respondent also argues that any dispute involving Acaverde's Concession should have been resolved in the domestic arbitration authorized by the Concession, and represents to this Tribunal that such arbitration was available to Claimant at all times.<sup>177</sup> But this argument is flawed for two principal reasons. First, as discussed in Section 3 below, Claimant has alleged violations of international law for which this Tribunal provides the only appropriate forum. Second, Respondent has egregiously misrepresented the Mexican Governments' willingness to allow the domestic arbitration proceedings in Mexico to proceed on the merits. Indeed, all three levels of the Mexican Government acted in concert to deny Acaverde any judicial or administrative remedies in the domestic fora of Mexico, arguing before Mexican courts that disputes under a public contract like the Concession should be arbitrated, and arguing before Mexican arbitrators that disputes under a public contract like the Concession were not subject to arbitration. Although this scheme has important substantive consequences in Subchapter C of this Chapter (discussing Respondent's violations of NAFTA Art. 1105), it is also relevant to the credibility of Respondent's position that this dispute is properly subject to resolution in a Mexican forum.

4.19 At the outset, it is important to emphasize that Claimant's allegations before this Tribunal are broader than – and proceed on a different legal theory from – the claims that could have been asserted by Acaverde in the domestic arbitration proceeding authorized by the Concession. Here, Claimant argues that the Mexican Governments' actions (and refusals to act) collectively resulted in the expropriation of Claimant's investment under Article 1110 of

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<sup>176</sup> See *LETCO*, 26 I.L.M., 647.

<sup>177</sup> Counter-Memorial, ¶¶ 194-96.

NAFTA and a denial of access to justice and proper treatment under Article 1105 of NAFTA. Neither of these international claims could have been addressed in the domestic arbitration. But they are appropriately addressed by this Tribunal, duly constituted in accordance with NAFTA Article 1121.<sup>178</sup> Thus, the fundamental premise of Respondent's theory that Claimant's allegations should have been raised in the domestic arbitration is simply not correct.

4.20 In addition to this legal flaw, Respondent's contention that the Mexican Governments were willing to resolve in Mexico the merits of Acaverde's claims is patently false. As discussed in the preceding section, the Mexican Governments in fact argued to the Permanent Commission that the Concession was a public contract not subject to domestic arbitration. This position was but one part of a complex scheme by the Mexican Governments to deprive Claimant of any forum in which to present its substantive claims.

4.21 The Mexican Governments' scheme is perhaps best illustrated by the varying positions that the respective governments took during Acaverde's domestic suits against Banobras.<sup>179</sup> For instance, in *Banobras I* all three Mexican Governments argued that the proper forum for resolving the dispute was domestic arbitration. Even three months after the City had challenged the Permanent Commission's right to continue the arbitration, Banobras still argued in *Banobras II* that the court should dismiss Acaverde's claim because Acaverde should have raised it in domestic arbitration brought pursuant to the arbitration clause in the Concession.<sup>180</sup> On January 12, 1999, over four months after the City had filed a lawsuit in Guerrero State Court to terminate the domestic arbitration, the federal court in *Banobras II* accepted the arguments of

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<sup>178</sup> Citing *Oppenheim's International Law*, Respondent suggests in ¶¶ 205 and 206 that Claimant's recourse to this Tribunal is somehow inappropriate. Counter-Memorial, ¶¶ 205-06. But *Oppenheim's* expressly recognizes that recourse to international arbitration is appropriate when, as in the *Lighthouses Case*, arbitration is called for "by virtue of an agreement between the state allegedly in breach of its contractual obligations and the state of which the alien is a national." *Oppenheim's International Law*, 9th Ed. 1996, p. 927. Here, both Mexico and the United States are parties to NAFTA, and Claimant states claims not for breach of contract, but for violations of Articles 1110 and 1105 of the NAFTA.

<sup>179</sup> Acaverde ultimately filed two separate lawsuits against Banobras for its refusal to honor its obligations under the Line of Credit. Both were filed in federal court. *Banobras I* was instituted on January 27, 1997 and involved the City's payment obligations for the second half of 1996. The second suit ("*Banobras II*") was instituted on July 31, 1998 and involved the City's payment obligations for 1997. Acaverde's complaint in *Banobras I* is attached as Exhibit G-41 and Acaverde's complaint in *Banobras II* is attached as Exhibit G-42. The responses of Banobras to the two lawsuits are attached, respectively, as Exhibit G-43 and Exhibit G-44. In both cases, Banobras added the City and the State as defendants, and their response to *Banobras I* is attached as Exhibit G-45. It is in this document that both the City and the State urged the federal court to dismiss Acaverde's lawsuit on the ground that any dispute under the Line of Credit should be resolved in arbitration pursuant to the arbitration clause of the Concession. Banobras made the same argument in Exhibit G-43, p.4.

<sup>180</sup> Exhibit G-44 (courtesy translation), p.6-7.

Banobras, and dismissed Acaverde's lawsuit on the ground that the proper venue for Acaverde's claim was the domestic arbitration.<sup>181</sup>

4.22 Wherever Claimant turned for relief in Mexico, the Mexican Governments pointed to a different forum and said, "Go over there." Respondent is making the same argument in its Counter-Memorial, arguing that Acaverde should have pressed its claims in the domestic arbitration.<sup>182</sup> The simple fact is that Claimant had no meaningful remedy in Mexico. Certainly, Mexico could not have provided a forum for the international claims raised by Claimant before this Tribunal.

**3. The Mexican Governments' Actions (and Failures to Act) Constituted an Expropriation of Claimant's Investment under Article 1110 of NAFTA.**

4.23 As developed in Claimant's Memorial,<sup>183</sup> NAFTA Article 1110 by its terms prohibits not only express acts of nationalization, but also "indirect" acts of expropriation, and even acts "tantamount to expropriation." Thus, the Article plainly redresses not only explicit acts of expropriation or nationalization, but also "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state."<sup>184</sup> That is not to say that NAFTA allows foreign investors to seek

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<sup>181</sup> Exhibit G-46 (courtesy translation), p.20.

<sup>182</sup> See Counter-Memorial, ¶ 193.

<sup>183</sup> Memorial, ¶¶ 5.6 to 5.7.

<sup>184</sup> *Pope & Talbot*, ¶ 99. See also *Metalclad*, ¶ 105 (recognizing that an expropriation exists "when a state prevents or unreasonably interferes with the effective enjoyment of an alien's property."); *Mondev*, ¶ 98. (observing that the prohibition against expropriation in Article 1110 extends to intangible property interests, including contract claims); *S.D. Myers (Partial Award)*, ¶ 283 (recognizing that expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economics rights). As explained by the concurring opinion in *S.D. Myers*, allegations pursuant to NAFTA Art. 1110 requires that a panel consider the totality of a government's conduct, and the impact of that conduct on an alien's investment:

The phrase "tantamount to expropriation" in Article 1110 does, however, require a tribunal to take a hard look at whether governmental conduct amounts *in substance* to an expropriation. The protection offered by Article 1110 does not cease to apply merely because an expropriation is dressed up in a more innocuous form, or accomplished by subtle or indirect means. The real purpose and real impact of a measure must be considered, not merely the official explanations offered by the government or the technical wrapping in which the measure is cloaked. . . . A government might proceed with a gradually unfolding series of disparate measures; none of them individually may amount to expropriation, but the whole series might in some case be substantially equivalent to an expropriation.



international arbitration every time a signatory party breaches a contractual obligation.<sup>185</sup> Rather, it is a recognition that in the modern world, expropriations often occur in stages, and that the modern definition of "expropriation" must be broad enough to encompass every course of sovereign conduct that unfairly destroys a foreign investor's contractual rights as an asset. Here, the Mexican Governments' consistent and conscious refusal to exercise their sovereign responsibilities under the Concession to enforce Acaverde's exclusivity rights and protect its revenue stream, coupled with their conspiracy to prevent Claimant from exercising its rights and remedies under the Concession, effectively destroyed Claimant's substantial investment in the Concession. Although the Mexican Governments did not pass a decree expropriating Claimant's contractual rights, their egregious pattern of sovereign misconduct effected the same result. As discussed below, this "creeping expropriation" of Claimant's investment violated established international law and NAFTA Article 1110.<sup>186</sup>

4.24 The "creeping expropriation" analysis in *Metalclad*, in which a tribunal found that Mexico violated NAFTA Article 1110(1) through a series of acts (and failures to act) by a municipality and state government that destroyed an investor's rights to build a landfill, bears important similarities to this case.<sup>187</sup> In *Metalclad*, the Municipality of Guadalcázar, the State of San Luis Potosí, and the federal government authorized the investor to construct and operate a landfill. Just as the City in this case passed the necessary regulations to allow Claimant to begin work under the Concession, in *Metalclad* the Mexican Federal Government had granted the

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*S.D. Myers (Partial Award)*, Separate Opinion by Dr. Bryan Schwartz, November 12, 2000, ¶ 217.

<sup>185</sup> See *Azinian* ¶ 87.

<sup>186</sup> See, e.g., *TOPCO*, 53 I.L.R. at 456 and 462; *LIAMCO*, 62 I.L.R. at 169; *Phillips Petroleum Co. v. The Islamic Republic of Iran*, 21 Iran-U.S. Cl. Trib. Rep. 79 (1989) Award 425-39-2 (June 29, 1989), ¶ 76 (noting that the tribunal has held in a number of cases, all involving different forms of expropriation, that expropriation by (or attributable) to a state of the property of an alien gives rise under international law to liability for compensation whether such expropriation is de facto or formal and whether the property is tangible or intangible, including the contract rights involved in a concession); *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, 10 Iran-U.S. Cl. Trib. Rep. 121, 130 (1987) ("The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact."); *BP Exploration Corporation (Libya) Limited v. the Government of the Libyan Arab Republic*, 53 I.L.R. 297, 329 (1973) (noting that Libya's nationalization of the concession is a fundamental breach of the contract because it amounted to a complete repudiation of the agreement and the government's obligations thereunder and this is a clear violation of public international law); RESTATEMENT (THIRD) OF THE LAW OF FOREIGN RELATIONS OF THE UNITED STATES §712, comment h (1986) (giving the example that a breach of contract by a state is a "creeping expropriation" if the breach makes the continued operation of the subject of the contract impossible).

<sup>187</sup> *Metalclad Corporation v. United Mexican States*, ICSID (W. Bank) No. ARB(AB)/97/1 (Final Award, Sept. 2, 2000).

federal construction permits necessary for the investor to believe that it would be able to operate a hazardous waste site.<sup>188</sup> Both Claimant and the investor in *Metalclad* committed valuable resources anticipating future revenues. But in both cases, the Mexican Governments engaged in a series of actions that destroyed the investor's ability to recover future revenues. The acts of expropriation in *Metalclad* included (i) a public campaign by government officials that interfered with the investor's rights,<sup>189</sup> (ii) refusal by the public authorities to undertake executive acts anticipated by the investor, and (iii) refusal by government officials to work in good faith with the investor to facilitate completion of the investment.<sup>190</sup> The *Metalclad* tribunal found that this conduct effectively expropriated the investor's right to build and operate its landfill in violation of NAFTA Article 1110(1).<sup>191</sup>

4.25 As in *Metalclad*, the Mexican Governments deprived Claimant in this case of the value of its investment through a series of affirmative acts and failures to undertake executive responsibilities. The City's Mayor in this case publicly encouraged inhabitants in the Concession area to interfere with Acaverde's rights under the Concession.<sup>192</sup> Moreover, the City refused to fulfill its executive responsibilities to enforce Acaverde's (i) exclusivity rights, or (ii) its rights to generate and collect revenue from all citizens in the Concession area.<sup>193</sup> Finally, the Mexican Governments conspired together to ensure that Acaverde had no meaningful legal remedy for this misconduct in Mexico. As in *Metalclad*, this pattern of conduct, for which Respondent bears responsibility, prevented Claimant not only from realizing any return from its investment, even recouping the cost of its investment. This misconduct, therefore, constitutes an expropriation of Claimant's investment.

4.26 The conduct of the Mexican Governments in this case also resembles the expropriation found in *LETCO*.<sup>194</sup> As described in detail in Claimant's Memorial,<sup>195</sup> the Liberian

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<sup>188</sup> See *Id.*, ¶¶ 29 - 36.

<sup>189</sup> See *Id.*, ¶ 37. As the Claimant began its construction work in *Metalclad*, the Governor of the State began a public campaign denouncing the hazardous waste landfill. This had the effect of fostering public distaste for the investment opportunity.

<sup>190</sup> See *Id.*, ¶¶ 45 to 51.

<sup>191</sup> *Id.*, ¶ 104. In addition to these acts that amounted to an "indirect expropriation" of the investor's property, the tribunal in *Metalclad* identified as an additional ground for its expropriation holding a decree that had the effect of barring the investor from operating its landfill. See *id.*, ¶ 109. But the tribunal explained that this further ground for finding an expropriation was not necessary to its finding of an indirect expropriation. See *id.*

<sup>192</sup> See, *supra*, ¶¶ 3.44.

<sup>193</sup> See, *supra*, ¶¶ 3.46-3.53.

<sup>194</sup> 26 I.L.M. 647.

Government there took actions remarkably similar to the actions (and refusals to act) of the Mexican Governments in this case. Respondent's attempts to distinguish *LETCO* in any meaningful way do not withstand analysis. First, the *LETCO* tribunal's discussion of Liberian law is of little consequence because that tribunal emphasized that "that the rules and principles of Liberian law which it [took into] account are in conformity with generally accepted principles of public international law governing the validity of contracts and the remedies for their breach."<sup>196</sup> Moreover, contrary to Respondent's suggestion, the presence of a "stabilization clause" in the *LETCO* concession is of no consequence for this proceeding.<sup>197</sup> The presence or absence of a "stabilization clause" intended to protect the investor area political is not determinative of whether an agreement is a long-term development agreement. And, at any rate, Claimant secured protection from future vacillations of the City, State and Federal Governments through other means – such as the Federal guarantees.<sup>198</sup>

4.27 The recent decision in *Vivendi*<sup>199</sup> also holds that the breach of a concession can amount to expropriation under international law. In that case the ICSID Annulment Committee

<sup>195</sup> Memorial, ¶¶ 5.14 to 5.24.

<sup>196</sup> *LETCO*, 26 I.L.M., p. 658. Respondent makes a similar argument in attempting to distinguish several other cases cited by Claimant, and the tribunal in those cases made similar statements that their conclusions were in conformity with customary rules of international law. See, e.g., *Anglo-Iranian Oil Co. Case (United Kingdom v. Iran)*, 1952 I.C.J. 93, at ¶¶ 6 and 10 (Preliminary Objection, July 22, 1952); *Saudi Arabia v. Arabian American Oil Co. ("Aramco")*, 27 I.L.R. 117, p.173 (1958). Although Respondent claims that Claimant's citation to the *Anglo-Iranian Oil Co. Case* is not authoritative because the case was dismissed for a lack of jurisdiction, it should be noted that the tribunal in *Revere Copper* cites the case for the same issue. See *Revere Copper*, 56 I.L.R., pp. 272, 273.

<sup>197</sup> The tribunal in *LETCO* noted that "stabilization clauses" are often included in long-term development Agreements to avoid arbitrary acts on the part of the contracting government. 26 I.L.M., pp. 666 - 667.

<sup>198</sup> See, *supra*, ¶ 4.9. Respondent attempts to distinguish several other cases cited by Claimant based on the presence of a stabilization clause; in each case, however, the tribunal's discussion of the stabilization clause does not offer a base for distinguishing the relevant analysis. See, e.g., *Revere Copper and Brass, Inc.* 56 I.L.R. at 271-272; *LIAMCO*, 62 I.L.R., p.169; *Sapphire International Petroleum Ltd. v National Iranian Oil Company*, 35 I.L.R., p. 171. Notwithstanding Respondent's contentions to the contrary, *Sapphire* continues to provide guidance on international legal standards for a breach of a long-term development contract resulting in an expropriation for two reasons. First, the Iranian court set aside the tribunal's decision because the court found that it should have applied Iranian law instead of international law; the Iranian court did not find that the tribunal erred in its interpretation of international law. See *Iranian Court Decision on Arbitral Award in Dispute Between Sapphire International Petroleum Ltd. and the National Iranian Oil Company*, 9 I.L.M. 1118 (1970). Second, international arbitral tribunals continue to cite to *Sapphire* even after the award was set aside. See, e.g., *Revere Copper* 56 I.L.R., p. 282.

annulled the decision of the tribunal on the grounds that it failed to consider the investor's allegations that the acts of the provincial government put the federal government in breach of the France-Argentina Bilateral Investment Treaty ("BIT").<sup>200</sup> The investor there had alleged, among other things, that the provincial government breached the BIT when its legislators and others encouraged customers not to pay water bills, made unauthorized tariff changes, and blamed the investor for the "black water" problem that was, in fact, not the investor's fault.<sup>201</sup> In reversing the tribunal's decision, the ICSID Annulment Committee concluded that, taken together, this course of conduct had the effect of putting the investment to an end, and, if proved, would have amounted to an expropriation under the terms of the BIT.<sup>202</sup> These facts are similar to those at issue in the present case. Specifically, the fact that City refused to enforce the July Ordinances and even encouraged its citizens not to contract with Acaverde made Claimant's investment valueless.<sup>203</sup>

4.28 Finally, it is important to emphasize that accepting Respondent's argument that Claimant alleges a simple breach of contract would force the reversal of all arbitral decisions in which expropriations were found based upon conduct by a government that effectively destroyed an investment, but also breached a concession or long term development agreement. For example, in *Revere Copper*<sup>204</sup> the Government of Jamaica concluded a concession for processing bauxite-aluminum with the foreign investor.<sup>205</sup> Notwithstanding terms in the concession that prohibited the Government of Jamaica from taking actions that would reduce the value of the concession, the Government of Jamaica passed legislation causing an increase on the royalties charged to Revere. The tribunal found that Jamaica effectively expropriated the claimant's concession rights by, *inter alia*, increasing the government's levy and royalties and inhibiting the claimant's ability to make long-term decisions concerning the operation of the concession. Yet,

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<sup>199</sup> *In the Matter of the Annulment Proceeding in the Arbitration between Compania De Aguas Del Aconquija S.A. and Vivendi Universal (formerly Companie Generale des Eaux) v. Argentine Republic*, ICSID No. ARB/97/3, September 2000.

<sup>200</sup> *See id.*, ¶ 115.

<sup>201</sup> *Id.*, ¶ 106.

<sup>202</sup> *Id.*, ¶ 112-114. Article 5 of the BIT contains the same prohibition against expropriation as that contained in Article 1110(1) of NAFTA. *See id.*, ¶ 58. Note that jurisdiction under this section of the BIT is different from jurisdiction under NAFTA because the investor may allege that the dispute relates to an investment made under the BIT while jurisdiction under NAFTA requires an allegation that the respondent Party has violated its obligations under NAFTA. *Id.*, ¶ 55. But, as previously stated, the substantive provision of the BIT at issue in *Vivendi* is that same as the NAFTA provision at issue.

<sup>203</sup> *See, supra*, 3.44.

<sup>204</sup> *Revere Copper and Brass, Inc. v. Overseas Private Investment Corp.*, 56 I.L.R. 258 (1978).

<sup>205</sup> *See Memorial*, ¶¶ 5.36 to 5.37 for a detailed discussion of the facts of this case.

if taken independently, the acts that supported the Tribunal's finding of expropriation also constituted breaches of the concession agreement.<sup>206</sup>

4.29 That the *Revere Copper* case and many other cases involving the expropriation of rights under a concession or long term development agreement were not handled as breach of contract actions in domestic courts severely undermines Respondent's theory that a breach of contract never treated as a violation of international law. Indeed, it simply cannot be the case that when acts of expropriation also constitute breaches of a concession agreement they no longer provide a basis for finding violations of international law. Otherwise, governments would simply insulate themselves from exposure under international law by including catch-all provisions in their concession agreements that prohibit the government from violating international law, or perhaps a specific agreement, like NAFTA. Indeed, inserting a clause in concession agreements requiring adherence to all principles set forth in Chapter 11 of NAFTA would render Article 1110 inapplicable to any investment governed by that concession. Although Respondent's reasoning would support this result, it is plainly not the state of international law.

4.30 As in each of the cited cases, Claimant in this case lost the value of its investment as a result of actions (or failures to act) on the part of the Mexican Governments. Refusing to enforce the July Ordinances, the City allowed pirates to operate within Acaverde's Concession area, thus enabling Acaverde's customers to avoid their obligations under the July Ordinances. The Mayor even went so far as to encourage citizens within the Concession area to refuse to contract with Acaverde. Although these actions (and inactions) violated the Concession – their cumulative impact was much broader. Indeed, the cumulative effect of the Mexican Governments' sovereign misconduct was to destroy the value of Claimant's investment, an impact no different than if the City had simply passed new legislation sharply decreasing the area of Acaverde's Concession.<sup>207</sup> Such action constitutes an expropriation in violation of NAFTA Article 1110(1).

**B. The Mexican Governments' Actions (and Failures to Act) With Respect to Claimant's Investment Also Violate NAFTA Article 1105.**

4.31 Article 1105(1), which requires NAFTA Parties to accord to foreign investors "treatment in accordance with minimum standards of international law, including fair and equitable treatment and full protection and security," provides a second basis for Claimant's

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<sup>206</sup> The tribunal engages in an eight page discussion of why international law applies to this breach of a long-term development agreement. See *Revere Copper and Brass, Inc.*, 56 I.L.R., 271-279. In finding that the Jamaican Government expropriated the investor's bauxite plant, the tribunal notes that the Jamaican Government violated international law, which is an expropriation within the meaning of the contract with OPIC. See *id.*, p.295.

<sup>207</sup> Indeed, the practical effect of the City's failure to enforce its laws was to reduce Acaverde's revenues to 25% of what they were anticipated to be when the Concession was agreed upon. In other words, the Mexican Governments' actions (or lack of actions) deprived Acaverde of approximately 75% of its anticipated revenues.

recovery of damages in this case. As the tribunal in *S.D. Myers* explained, Article 1105 “establishes a floor below which the treatment of foreign investors must not fall, even if the government was not acting in a discriminatory way.”<sup>208</sup>

4.32 Tribunals and commentators alike have struggled conceptually with how to define “minimum standards of international law.” The recent NAFTA Free Trade Commission interpretation of Article 1105, together with recent tribunal decisions analyzing the provision, clarify that “minimum standards” of treatment for foreign investors are defined by customary international law. But shaping such standards is not an exercise in abstract thinking, rather it is a fact-intensive exercise dependent on consideration of all the circumstances surrounding a particular case.<sup>209</sup> In this case, consideration of the totality of the circumstances demonstrates that the Mexican Governments’ treatment of Claimant’s investment falls well below any reasonable statement of fair and equitable treatment. First, Claimant’s investment (Acaverde) was subjected to arbitrary acts of the Mexican Governments, which ultimately rendered the investment valueless. Second, Claimant’s investment was subjected to a denial of justice at the hands of the Mexican Governments, which conspired with one another to obstruct Acaverde’s access to judicial and arbitral forums to resolve its claims under the Concession. These circumstances support the finding that Respondent violated Article 1105(1) in its treatment of Claimant’s investment.

**1. The Arbitrary Actions (and Failures to Act) of the Mexican Governments Constituted An Abrogation of Claimant’s Rights Under the Concession in Violation of Article 1105.**

4.33 Arbitrary conduct that deprives an investor of rights under a concession is not treatment in accordance with minimum standards of law.<sup>210</sup> As explained in ¶ 5.49 of Claimant’s Memorial, the *ELSI* case provides important guidance on the definition of arbitrary conduct, describing it as “a willful disregard of due process of law, . . . which shocks, or at least surprises, a sense of judicial propriety.”<sup>211</sup> Although Respondent’s Counter-Memorial criticizes Claimant’s reliance on the *ELSI* standard for arbitrariness in the context of NAFTA Art. 1105, Respondent had previously acknowledged that *ELSI* is “instructive as to the standard of review that the international tribunal must employ when examining whether a state has violated the international minimum standard [of treatment under Article 1105]”<sup>212</sup> Indeed, whenever a government acts

<sup>208</sup> *S.D. Myers (Partial Award)*, ¶ 259.

<sup>209</sup> See *Mondev*, ¶ 118 (emphasizing that “judgment of what is ‘fair and equitable’ cannot be reached in the abstract,” but instead “depends on the facts of a particular case.”)

<sup>210</sup> See *Aramco*, ¶ 205 (explaining that among the fundamental principles of public international law incorporated into the concept of “fair and equitable treatment” is the principle of respect for acquired rights of exclusivity).

<sup>211</sup> *Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)*, ICJ Reports 1989, ¶ 128.

<sup>212</sup> Article 1128 Submission of the United Mexican States in the Matter of *Mondev International, Ltd. v. United States*, 23 July 2002, p. 17 (as cited in *Mondev*, ¶ 108).

capriciously and without due process of law to deprive an investor of all rights under a concession, that government has not afforded the investor treatment in accordance with minimum international standards.

4.34 Claimant in this case was arbitrarily deprived of the value of its Concession by concerted efforts of the Mexican Governments that were inconsistent with notions of due process of law. During Concession negotiations, all three levels of the Mexican Governments enticed Claimant to invest in the Acapulco Concession.<sup>213</sup> But none of the three Mexican Governments felt bound by their word. For example, although the City and Federal Governments agreed to the terms and conditions of the Concession, neither saw any difficulty in not living up to its obligations. Although the City agreed to enforce Acaverde's exclusivity rights, it never did. Although Banobras agreed to guarantee the City's payment obligations, it refused to do so at the first instance of opposition from the City and the State. In short, the Mexican Governments made agreements with a foreign investor with which they had no intention of complying. By arbitrarily granting and denying their assurances to Claimant, the Mexican Governments failed to give Claimant's investment fair and equitable treatment in accordance with minimal standards of international law.

4.35 A similar pattern of arbitrary acts was found to violate Article 1105 in the *Metalclad* case. The *Metalclad* tribunal found that the Mexican Governments violated Article 1105(1), in part, for failing to ensure the necessary "transparency" of all local laws applicable to the investor's project:

Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.<sup>214</sup>

The *Metalclad* tribunal was most troubled by repeated and calculated decisions by the Federal Government of Mexico not to honor its representations under an agreement with the investor, notwithstanding the investor's reasonable reliance on those representations. For example, the tribunal noted that "Metalclad was led to believe, and did believe, that the federal and state

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<sup>213</sup> Statement of H. Steven Walton, attached as Exhibit H-3.

<sup>214</sup> *Metalclad*, ¶ 99. See also *Metalclad*, ¶ 88. Claimant is aware of a recent decision by Canada's Supreme Court of British Columbia sustaining a challenge to the tribunal's decision in *Metalclad* that Mexico had violated Article 1105 by violating NAFTA's transparency provisions. Claimant notes that this decision has been uniformly criticized by noted international scholars. See, e.g. Todd Weiler, *Metalclad v. Mexico: A Play in Three Parts*. At any rate, it is well settled that "[a]n international tribunal is not bound to follow the result of a national court." Excerpts of the Award on the Merits in Arbitration Between *Amco Asia Corp. et al and Republic of Indonesia*, 24 I.L.M. 1022 (1985) at ¶ 177.

permits allowed for the construction and operation of the landfill.”<sup>215</sup> Reasonably relying on these representations, Metalclad started to construct its landfill.<sup>216</sup> By consciously rescinding these representations on which Metalclad had relied in making its investment, the *Metalclad* tribunal held that Mexico had subjected the claimant to arbitrary treatment in violation of Article 1105. Like the investor in *Metalclad*, Claimant in this case suffered unfair and inequitable treatment as a result of arbitrary acts by the Mexican Governments.

4.36 Finding a violation of Article 1105 is fully consistent with the recent standards announced by the NAFTA Free Trade Commission (“FTC”) and the most recent Article 1105 decision, *Mondev International, Ltd. v. United States of America*.<sup>217</sup> On July 31, 2001, the NAFTA FTC issued an interpretation on Article 1105(1) pursuant to Article 2001(2)(c) of NAFTA, stating as follows:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. 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 the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).<sup>218</sup>

4.37 Three conclusions can be drawn from the *Mondev* tribunal’s discussion of Article 1105 in the aftermath of the FTC’s interpretation. First, the term “customary international law” used in paragraphs (1) and (2) of the FTC’s interpretation refers to customary international law in existence right before NAFTA was agreed to.<sup>219</sup> Second, the concepts of minimum standard of treatment extend to rights of contract and property, not just to persons.<sup>220</sup> Third, it is appropriate to refer to decisions involving BITs to determine the minimum standard of treatment, even

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<sup>215</sup> *Mondev*, ¶ 85.

<sup>216</sup> *Mondev*, ¶ 86. See also *Mondev*, ¶ 89 (“Metalclad was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill.”)

<sup>217</sup> Case No. ARB(AF)/99/2, October 11, 2002.

<sup>218</sup> Notes of Interpretation of Certain Chapter 11 Provisions (NAFTA Free Trade Commission, July 31, 2001).

<sup>219</sup> See *Mondev*, ¶ 122.

<sup>220</sup> See *Mondev*, ¶ 98.



though not every country has one.<sup>221</sup> Because customary international law plainly bars arbitrary acts of a government that are inconsistent with due process of law, a finding that Article 1105 has been violated in this case is appropriate.

**2. The Mexican Governments' Conspiracy to Obstruct Acaverde's Access to the Mexican Courts and the Domestic Arbitration Proceeding Created a "Denial of Justice" Which Violates Article 1105.**

4.38 The *Mondev* case involved allegations by a Canadian investor that a decision by the Massachusetts Supreme Judicial Court amounted to a "denial of justice," and thus violated Article 1105(1) of NAFTA. The tribunal articulated the following standard for determining whether a 'denial of justice' occurred.

In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.<sup>222</sup>

The *Mondev* standard accords with Professor Brownlie's statement that a "denial of justice" exists:

when there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice, or a manifestly unjust judgment.<sup>223</sup>

4.39 Claimant submits that the *Mondev* rule for evaluating an Article 1105(1) "denial of justice" should be used by this Tribunal. Where *Mondev* involved a single judicial decision, this case involves a number of legal dispute resolution proceedings in which the behavior of the executive branches of the Mexican Governments should be evaluated to determine whether their

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<sup>221</sup> The standard of treatment in Article 1105 is to be found by reference to normal sources of international law. See *Mondev*, ¶ 120. In light of this, it is perfectly appropriate for this Tribunal to evaluate the treatment afforded to Claimant by reference to the standard employed in other investment decisions, as well as other NAFTA rulings. For this reason, there is no basis for Respondent's assertion that "none of the cases relied upon by Claimant are similar to the present case." Counter-Memorial, ¶ 242.

<sup>222</sup> *Mondev*, ¶ 127.

<sup>223</sup> *Principles of Public International Law* at 532 (citing Article 9 of the Harvard Research draft). Similarly, the Tribunal in *Azinian* outlined four actions that could form the basis for a "denial of justice" claim. The investor could have been (1) denied access, (2) subjected to undue delay, (3) administered justice in a seriously inadequate way, or (4) subjected to a clear and malicious misapplication of the law. *Azinian*, ¶¶ 102-103.

actions "were clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment."

4.40 Claimant submits that the facts of this case clearly constitute a "denial of justice." The Mexican Governments acted together to funnel all litigation involving Acaverde's claims under the Line of Credit to the domestic arbitration proceeding, with the clear objective of denying Acaverde its day in court. This technique worked. Acaverde was never able to obtain any decision on the merits of its damage claim against Banobras.<sup>224</sup> Contrary to Respondent's assertion, the Mexican courts addressed only procedural, not substantive, issues.<sup>225</sup> By denying Acaverde the opportunity to obtain timely payment from Banobras, the judicial decisions delaying a resolution on the merits accelerated the deterioration of Acaverde's financial condition, at the very time that the Mexican Governments were forcing Acaverde to renegotiate the Concession.

4.41 A more direct example of "denial of justice" was presented in the Mexican domestic arbitration. In that proceeding, the City sought to deny Acaverde access to a dispute resolution mechanism which the City itself had required Acaverde to agree to use. The City's actions fall directly into the definition of "denial of justice" set forth in the Restatement (Third) on Foreign Relations, where a state commits itself to a special forum for dispute resolution and then denies the foreign investor access to it.<sup>226</sup> What makes the City's actions so egregious is that the City had argued in the *Banobras I* litigation that Acaverde's claim should be pursued in the

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<sup>224</sup> The decision in *Banobras II* held that Acaverde's claim should be instituted in the domestic arbitration; no decision was made that Acaverde had not performed under the Concession or that it was not entitled to payment from Banobras or the City. The decision in *Banobras I* was also a procedural one. The court declared that Acaverde could not maintain its claim against Banobras for two reasons. First, Acaverde had not demonstrated that the City faced problems of liquidity. Second, despite submitting documentary evidence of the invoices submitted to the City and to Banobras, the court accepted the Banobras argument that Acaverde's evidence was not sufficient to prove that Acaverde sent the invoices to the City and Banobras. Again, there was no finding that Acaverde had not performed its obligations under the Concession or that it was not entitled to payment for its services. When the Constitutional Amparo court reviewed the decision in *Banobras I*, it struck down that part of the decision regarding the liquidity issue. However, on a narrow and unsupported technical point of insufficient evidence, it too declined to allow Acaverde to pursue its claim against Banobras. As a factual aside, it should be noted that Respondent acknowledges receipt of the invoices on behalf of Banobras and the City in ¶ 25 of the Counter-Memorial.

<sup>225</sup> Respondent asserts in ¶¶ 89,152-153 of its Counter-Memorial that Acaverde's claims were heard on the merits. However, Respondent more accurately describes the purely procedural nature of the cases in ¶¶ 90-92 and 152 of its Counter-Memorial.

<sup>226</sup> Section 712 of the Restatement (Third) of Foreign Relations provides that a state is responsible under international law for a repudiation or breach of a contract with a national of another state if, *inter alia*, the foreign national is not given access to an adequate forum for dispute resolution.

domestic arbitration proceeding. However, once Acaverde instituted that arbitration, the City threatened the Permanent Commission (and Acaverde) with damages if they continued the arbitration and filed a separate lawsuit to stop it.<sup>227</sup> In short, the City used all its efforts to obstruct Acaverde's access to the very forum that the City had insisted upon when the Concession was granted.

4.42 A final "denial of justice" is the City's continuing efforts to collect on the 6 million peso performance bond that was posted by Acaverde.<sup>228</sup> The City has filed two separate lawsuits against Acaverde's Mexican bonding company, seeking to collect on the bond on the ground that Acaverde failed to perform its obligations under the Concession.<sup>229</sup> The first suit was dismissed on technical grounds in 2000. In 2001, the City instituted a second lawsuit against the bonding company, which in turn added Acaverde as a third-party witness. In this capacity, Acaverde has no right to present legal arguments in its defense, even though an adverse decision against the bonding company could result in Acaverde's loss of approximately \$1.25 million.<sup>230</sup> Thus, a judicial proceeding is taking place today in Mexico in which Acaverde has been denied the opportunity to defend itself.

4.43 In summary, this is not a case, like Azinian, where the foreign investor had its "day in court" and seeks to get a different result elsewhere. Nor is Claimant asking the Tribunal to reverse any particular decision of a Mexican Court.<sup>231</sup> Instead Claimant is requesting the Tribunal to find that the "denial of justice" by the Mexican Governments violates Article 1105.

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<sup>227</sup> See discussion, *supra*, ¶ 4.10.

<sup>228</sup> The City filed its first claim seeking payment of the bond in August 1998 during the same time it was preparing to sue in state court to block the arbitration. The bond company, Banorte, rejected the claim due to the pending litigation. The City submitted a new claim in October 1999, and represented to Banorte that all the litigation on the dispute had concluded as evidenced by the final decision of *Banobras II*, which had dismissed the judicial action so that it could be placed in arbitration.

<sup>229</sup> Exhibit G-47 and 48.

<sup>230</sup> Exhibits G-48 and G-49.

<sup>231</sup> Claimant recognizes that a NAFTA Tribunal does not sit as a court of appeals in which investors can seek to reverse decisions in the host country that they do not like. *Mondev*, ¶ 126, quoting *Azinian*, ¶ 99.

## CHAPTER FIVE

### COMPENSATION

5.1 By revoking the Concession and expropriating Acaverde's interest, Respondent deprived Claimant of the possibility of any meaningful return on its investment. Under NAFTA, Claimant is entitled to recover the damages incurred as a result of Respondent's expropriatory and arbitrary conduct. The challenge, according to Respondent, is determining what compensation methodology is appropriate in this particular case.<sup>232</sup>

5.2 The fundamental difference between the parties' positions concerns whether or not the impact of Respondent's conduct should be considered by the Tribunal in determining compensation. Claimant argues that any compensation award must undo the effect of the expropriation by putting Claimant in the position it would have occupied but for Respondent's conduct. Respondent argues that damages should be based on Acaverde's actual financial condition as it existed in November 1997. The problem with Respondent's analysis is that by November 1997, Acaverde had already been severely damaged by Respondent's expropriatory and arbitrary acts. Not surprisingly, the clear language of NAFTA and the weight of authorities support Claimant's position.

5.3 Claimant seeks compensation based on Acaverde's "fair market value," which could be calculated by determining either: (1) the net present value of profits Acaverde would have realized but for Respondent's conduct; or (2) the value of Acaverde pursuant to the formula set forth in the Concession.<sup>233</sup> Both are appropriate measures of compensation in light of Respondent's violations of Articles 1110 and 1105. Below, Claimant discusses both compensation measures, updates its previous damage calculations and demonstrates the flaws in Respondent's damage model.

#### A. Lost Profits Is The Appropriate Measure Of Damages.

5.4 Claimant calculates the "fair-market value" of its investment by determining the lost profits Acaverde would have earned over the life of the Concession. This methodology is consistent with NAFTA Article 1110(2), which reads in part:

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

By the express terms of Article 1110, the fair market valuation of an investment should not reflect a change in its value caused by an impending or ongoing expropriation.

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<sup>232</sup> Counter-Memorial, ¶ 339.

<sup>233</sup> Memorial, ¶¶ 6.4-6.11.

5.5 The language of Article 1110(2) is further supported by general principles of international law. It is well established that compensation awards "must, as far as possible, wipe out all the consequences of an illegal act and reestablish the situation which would, in all probability, have existed if the act did not occur."<sup>234</sup> The methodology applied by the Tribunal to calculate the award must be designed to undo the material harm inflicted by Respondent's breach of its international obligations.<sup>235</sup> The fair market value of Claimant's investment can only be determined by analyzing the profits Acaverde would have realized had Respondent not undertaken its series of expropriatory acts.

5.6 Arbitration panels reviewing cases outside of NAFTA have held that the fair market value of the investment must be based on its value before it is diminished by acts of expropriation. For example, in *Starrett Housing*, Judge Holtzman noted that international law requires that an expert exclude from a calculation of the fair market value any diminution in value attributable to a government's wrongful acts.<sup>236</sup> If the diminution in value were included in the calculation, it would allow a government to avoid compensation by slowly ruining a company before effectively expropriating it.<sup>237</sup>

5.7 Claimant's methodology is particularly appropriate in cases of "creeping expropriation," where like this case, the government engages in a series of acts designed to slowly diminish and ultimately destroy an investment. In contrast, Respondent's "actual financial condition" methodology would create a perverse incentive of encouraging "creeping expropriations." If a government expropriated an investment in a single act, it would have to pay the full value of the investment. But, under Respondent's methodology, a government could slowly decrease the value of the investment through a series of acts and thereby decrease the damages assessed when the final act of expropriation occurs. Through such "creeping expropriation," a government could "purchase" an investment for pennies on the dollar.

5.8 The Tribunal should reject Respondent's compensation methodology and award damages based on the profits Acaverde would have realized but for Respondent's conduct.

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<sup>234</sup> *Chorzow Factory Case*, P.C.I.J., Series A, No. 17, at ¶ 47 (1928). The language in the *Chorzow Factory Case* has been relied upon by tribunals awarding damages under NAFTA. See *S.D. Myers* (Partial Award), ¶ 311; *Metalclad*, ¶ 122 (2000).

<sup>235</sup> *S. D. Myers*, ¶ 315

<sup>236</sup> This is especially true when the Government impedes the Claimant's work and eventually paralyzes the project. See *Case Concerning Starrett Housing Corp and the Government of the Islamic Republic of Iran*, 23 I.L.M. 1090, 1133 (1984) (Holtzman, concurring).

<sup>237</sup> See *Sedco, Inc. and National Iranian Oil Company, and Iran*, 25 I.L.M. 629, 639 (1986) (Brower, concurring); *Chorzow Factory Case* at ¶ 50 (refusing to use an offer to sell a corporation to determine damages when the offer was made out of fear of an imminent expropriation); Memorandum of the Dept of State Legal Advisor on the Application of the Treaty of Amity to the Expropriation in Iran, (1983) 22 I.L.M. 1406, 1408.

## B. Claimant's Lost Profits Are Significant.

5.9 If lost profits can be reasonably estimated, they should be awarded since only lost profits place the Claimant in the position it would have occupied but for the expropriation.<sup>238</sup> Using the lost profits methodology is particularly appropriate in this case because Acaverde's expected revenues under the Concession can be calculated with reasonable certainty. Under the Concession, Acaverde's revenue stream had two components: (1) a fixed payment from the City with monthly adjustments based on an inflation index; and (2) monthly payments from private residents and businesses for waste collection.<sup>239</sup> The first component is clearly quantifiable. In addition, Acaverde's expected revenues from private customers can be calculated with reasonable certainty.

5.10 Acaverde's expected revenues from private customers depended upon the percentage of potential customers who used and paid for Acaverde's services ("number of customers")<sup>240</sup> and the rates paid by those customers ("rate per customer"). These components can be quantified because the following municipal laws were in effect during Acaverde's operations:

- All residents and businesses within the Concession area were required to use Acaverde's services [(July 1995 Ordinances (Exhibit B-3), Article 8)];
- All residents and businesses within the Concession area were required to pay the published rates to Acaverde [(July 1995 Ordinances (Exhibit B-3), Article 9)]; and
- No other waste collectors could operate within the Concession area [(July 1995 Ordinances (Exhibit B-3), Article 16(1))].

5.11 Had the City Government enforced the July 1995 Ordinances, Acaverde would have serviced 100% of the potential customers (9,164) at 100% of the published rate. These are the revenues from private customers Acaverde would have received but for Respondent's (a) failure to enforce the laws, (b) Respondent's affirmative violations of the law, and (c) other arbitrary and expropriatory acts.

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<sup>238</sup> Memorial, at ¶6.8; *American Independence Oil (Aminoil) v. Government of the State of Kuwait*, 21 I.L.M. 976, 1038 (1982); *Phillips Petroleum Co. v. Iran*, 21 Iran-U.S. Cl. Trib. Rep. 79, 123 (1989); *LETCO*, 26 I.L.M. 647; *Sapphire*, 35 I.L.R. at 188.

<sup>239</sup> Acaverde also was entitled to collect landfill revenues from third parties. However, no allowance is made for that revenue because the landfill never was built.

<sup>240</sup> Both damage experts in this case agree that there were 9,164 potential customers in the Concession area. Supplemental Report of Daniel Slottje ("Supplemental Slottje Report") (Exhibit H-1), Table 1C; DPIESA Report (Exhibit G-29), ¶ 54 (translated).

5.12 In its Memorial, Claimant submitted a fair market valuation based on Acaverde's lost profits.<sup>241</sup> With this Reply, Claimant updates its original calculation and submits a sensitivity analysis to show how the fair market valuation of Claimant's investment varies with different assumptions about the number of Acaverde's customers. These scenarios are described below:

- *Actual 1997 Customers* – This scenario is the one utilized by Professor Slottje in his initial report and reflects the most conservative approach. The scenario starts with the number of customers who had actually contracted with Acaverde by 1997 (5,143) and keeps that number constant (i.e., assumes no customer growth) for the remainder of the Concession term. Essentially, this scenario assumes that the City would do no more to enforce exclusivity than it was doing in 1997. Under this scenario, Acaverde's fair market value is \$23.6 million.<sup>242</sup>
- *Actual 1997 Customers with Growth Rate* – This scenario considers the assumption in the DPIESA Report that Acaverde's customer base would have grown by .30% per month so that by the end of the Concession, roughly 90% of potential customers would use and pay for Acaverde's services.<sup>243</sup> Under this scenario, Acaverde's fair market value is \$26.7 million.<sup>244</sup>
- *95% of Potential Customers* – In this scenario, the assumption is that the City enforces exclusivity and Articles 8 and 9 of the July 1995 Ordinances, resulting in 95% of potential customers using Acaverde's services and paying the published rates. Accordingly, this scenario best depicts the revenues from private customers Acaverde would have received but for Respondent's expropriatory and arbitrary acts. Under this scenario, Acaverde's fair market value is \$39.2 million.<sup>245</sup>

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<sup>241</sup> Memorial, ¶ 6.8-6.11.

<sup>242</sup> Supplemental Slottje Report (Exhibit H-1), ¶ 60, Tables 3A, 3B and 3C. If interest is compounded annually, total damages equal \$24.7 million. *Id.*

<sup>243</sup> The growth rate assumption in the DPIESA Report implicitly assumes that the City Government would gradually enforce the exclusivity laws over the remaining 13 years of the Concession.

<sup>244</sup> Supplemental Slottje Report (Exhibit H-1), ¶ 61, Tables 4A and 4B. If interest is compounded annually, total damages equal \$27.9 million. *Id.*

<sup>245</sup> *Id.*, ¶ 62, Tables 5A, 5B and 5C. If interest is compounded annually, total damages under this scenario equal \$41.0 million. In addition, Professor Slottje calculated the fair market value of Claimant's investment assuming 75% of potential customers used and paid for Acaverde's services (i.e., the City did a better job of enforcing its laws). Under that scenario, the fair market value equals \$31.4 million (simple interest) or \$32.8 million (compounded annually). *Id.*, ¶ 62 fn. 98, Tables 6A and 6B).

5.13 The Tribunal should value Claimant's investment under the "95% of Potential Customers" scenario described above. By doing so, the Tribunal would restore Claimant to the position it would have been but for Respondent's violation of NAFTA.<sup>246</sup>

5.14 Respondent argues that lost profits should not be awarded to Claimant because they are too speculative. Respondent also argues that if lost profits are awarded, they should be based on Acaverde's actual revenues in 1997.<sup>247</sup> Both arguments should be rejected.

5.15 The lost profits in question can be calculated with reasonable certainty and are not speculative. Acaverde's expected revenues from private customers depended on two known quantities – the number of customers and the rates per customer. The first is undisputed, and the second is codified in Acapulco's municipal laws.<sup>248</sup> The only speculative element is the degree to which Respondent would have enforced its municipal laws over the life of the Concession – a consideration that is irrelevant for purposes of this compensation analysis.

5.16 Respondent's argument that lost profits should be based on Acaverde's actual revenues in 1997 is also erroneous. As noted above, this argument completely ignores the effect of Respondent's own conduct. By 1997, Acaverde's financial picture was bleak only because it was the victim of Respondent's "creeping expropriation." To allow Respondent to benefit from a "creeping expropriation" – by ignoring the effect of its conduct and thereby limiting Acaverde's damages – would contradict well-established compensation rules.

**C. Alternatively, Compensation Should Be Based On The Parties' Own Prior Estimate Of Acaverde's Fair Market Value.**

5.17 The Tenth Condition of the Concession provides an alternative means of calculating Acaverde's value as a "going concern." That clause contains a payment formula that would be applied if Respondent engaged in "an action or series of actions" that "prevent[ed] or inhibit[ed]" Acaverde from receiving its "rights or benefits" under the Concession.<sup>249</sup>

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<sup>246</sup> Tribunals have awarded lost profits in similar cases. For instance, in *Benvenut et Bonfanti v. People's Republic of the Congo*, the claimant invested substantial resources in a bottling factory and received a 40% interest in the company. However, only months after production began, the government began interfering with the claimant's investment. The government improperly lowered the selling prices of the bottles, created agencies to interfere with the management of the company, and later permanently fixed the prices at which the company could sell bottles – the final act of expropriation. Even though the company had never shown a profit, was just beginning to produce bottles, and had low revenues, the tribunal awarded lost profits. The damages awarded were based on the profits that would have resulted if "the contract had been executed as expected." *Id.* at 759.

<sup>247</sup> Counter-Memorial, ¶ 327.

<sup>248</sup> July 1995 Ordinances (Exhibit B-3), Article 9.

<sup>249</sup> Memorial at ¶ 6.5; Concession (Exhibit B-1), Tenth Condition.



5.18 The penalty clause reflects the parties' own expectations and understandings regarding Acaverde's potential profits. It is a formula agreed to by the City, State and Federal Governments – each of which approved the Concession – for valuing Claimant's investment in the event of expropriatory action. Accordingly, it is an appropriate method of determining the "going concern" value of Claimant's investment and compensating Claimant for Respondent's NAFTA violations.<sup>250</sup>

5.19 Professor Slottje calculated Acaverde's "going concern" value based on the penalty clause to be \$35 million.<sup>251</sup> As with lost profits, this calculation is extremely conservative because it is based on the assumption that Acaverde would only service 50% of potential customers in the Concession area.<sup>252</sup> If one assumes that Respondent enforced Acaverde's exclusivity rights and Acaverde serviced 95% of potential customers, damages under the penalty clause increase to \$46.6 million.<sup>253</sup>

5.20 In response, Respondent argues that Claimant's penalty clause calculation is flawed because it is based on the published rates set forth in the July 1995 Ordinances rather than the actual rates Acaverde charged its customers in 1997. This is simply another example of Respondent's trying to avoid the effect of its expropriatory acts. The laws in Acapulco required residents and businesses to pay the published rates for Acaverde's services.<sup>254</sup> The reason Acaverde was forced to charge less than the published rates was because the City: (a) refused to enforce this law; (b) refused to enforce Acaverde's exclusivity; and (c) competed against Acaverde for business within the Concession area.

5.21 Clearly, at the time the Concession was signed, the parties anticipated that the revenues used in the penalty clause formula would be based on the rates published in the Concession and the July 1995 Ordinances. Therefore, Claimant's calculation of the penalty clause provision is an appropriate measure of compensation in this case.

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<sup>250</sup> Respondent cannot object to the Tribunal's use of the penalty clause since the laws of Mexico favor the application of damages calculated by a concession. Kossick, Robert M. Jr. *Structuring Private Equity Transactions in Mexico*, 6 NAFTALBRA 105, 154 (Spring, 2000) citing "Codigo de Comercio," D.O., Oct. 17, 1889, arts. 1840-1844.

<sup>251</sup> Supplemental Slottje Report (Exhibit H-1), ¶ 64, Table 9A. If interest is compounded annually, the damages total \$36.7 million. *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*, ¶ 64, fn. 101, Table 9B. If interest is compounded annually, the damages total \$48.7 million. *Id.*

<sup>254</sup> July 1995 Ordinances (Exhibit B-3), Article 9.

**D. Respondent's Damage Analysis Is Defective in Several Respects.**

5.22 In addition to not accounting whatsoever for the effect of Respondent's expropriatory acts, the DPIESA Report submitted with the Counter-Memorial contains numerous errors.

**1. Respondent's Estimation Of Net Present Value.**

5.23 In addition to the fundamental mistakes described above, the DPIESA Report contains the following errors in its net present value calculation: (1) the Report uses an improper discount rate of 28% instead of the appropriate 18%; (2) the Report improperly mixes real income streams with a nominal discount rate; and (3) the Report excludes relevant data like prior damages and interest from its calculations.<sup>255</sup> These errors substantially undermine the relevance and credibility of DPIESA's results.

**2. Respondent's Asset Replacement Analysis.**

5.24 Respondent attempts to limit damages to Acaverde's cost of investments in fixed assets net of depreciation plus certain operation costs and administrative expenses.<sup>256</sup> As explained above, because this analysis does not provide a measure of the value of Acaverde's business but for Respondent's conduct, this methodology should be rejected.

5.25 In any event, Respondent's analysis of the asset replacement value is also flawed. In the Memorial, Claimant demonstrated that it invested more than \$12 million in the acquisition of property, plant, and equipment and in operating expenses.<sup>257</sup> Respondent claims that Professor Slottje improperly included a \$5 million dollar payment to Sun Investment Company in his calculation of Claimant's total investment.<sup>258</sup>

5.26 This is a misrepresentation. Professor Slottje did not include such a payment in his calculation of Claimant's total investment costs. Tables 7 and 8 in the original Slottje Report (Exhibit C-1) show Claimant's investment (broken down by category) and include no such figure. Furthermore, the investment costs listed in Tables 7 and 8 are supported by documents that: (a) were produced to Respondent and (b) were attached by Respondent itself to the Counter-Memorial.<sup>259</sup>

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<sup>255</sup> Supplemental Slottje Report (Exhibit H-1), ¶¶ 25(b), 41-45 (discount rate discussion); ¶¶ 25(a), 38-40 (discussing mismatching of real income streams with nominal discount rate); ¶¶ 46-49.

<sup>256</sup> Counter-Memorial, ¶ 334-337.

<sup>257</sup> Original Slottje Report (Exhibit C-1), ¶ 15, Tables 7 and 8.

<sup>258</sup> Counter-Memorial, ¶¶ 335-337.

<sup>259</sup> See MX 2021 (support for the property, plant and equipment figures in Table 7 to Exhibit C-1); MX 2023 (support for the Net Operating Expense figures in Table 7 to Exhibit C-1).

### 3. Setasa's Offer As A Measure of Damages.

5.27 The DPIESA Report states that the proposed sale of Acaverde's shares to Setasa in May 1997 indicates Acaverde's value as a going concern in November 1997. This conclusion is wrong for two reasons. First, Setasa made its offer to purchase Acaverde's shares after Respondent had already diminished Acaverde's value through a "creeping expropriation." Accordingly, the Setasa offer is meaningless for determining what Acaverde would have been worth to a potential buyer in November 1997 but for Respondent's conduct.<sup>260</sup> If anything, the Setasa offer (when compared with the anticipated profits reflected in the Concession's penalty clause) shows the substantial diminution in the value of Acaverde's investment that resulted from Respondent's "creeping expropriation."

5.28 Second, the DPIESA Report misstates the value of Setasa's offer. Although Setasa offered 37.6 million pesos (\$4.5 million dollars) for Acaverde's shares, the proposed agreement specified that Claimant would retain the right to monies then owed by the City.<sup>261</sup> As of May 1997, the City owed Acaverde approximately 15.2 million pesos (approximately \$1.8 million), meaning that Acaverde was worth considerably more than the amount offered by Setasa.<sup>262</sup> The DPIESA Report fails to take this into account in assessing the Setasa offer.

5.29 Although the DPIESA Report attempts to criticize Professor Slottje's report in other respects, such criticisms are unfounded. In his supplemental report, Professor Slottje demonstrates that each of these criticisms, with one minor exception, is invalid.<sup>263</sup>

#### E. Claimant Is Also Entitled To Recover Its Costs And Interest.

5.30 Claimant is also entitled to recover additional costs in order to put it in the position it would have been but for Respondent's expropriatory and arbitrary conduct. Such costs include Claimant's attorney fees and costs,<sup>264</sup> which to date exceed \$1.7 million.<sup>265</sup>

5.31 Claimant is also entitled to an award of interest in addition to the damages resulting directly from the expropriation.<sup>266</sup> Although Respondent requests a simple interest rate,

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<sup>260</sup> In fact, the Tribunal in *Chorzow Factory* at p.50 refused to use an offer to sell as a measure of damages because the value of the offer, "...is probably to be explained by the fear of measures such as those which the Polish Government in fact adopted afterwards against the Chorzow undertaking."

<sup>261</sup> Stock Purchase Agreement dated May 23, 1997 (Exhibit G-24).

<sup>262</sup> See Monthly Invoices (Exhibit G-20).

<sup>263</sup> Supplemental Slottje Report (Exhibit H-1), ¶¶ 27-52.

<sup>264</sup> See *Letco*, 52-53, 26 ILM at 675-76. See also *Sapphire*, 35 I.L.R. at 190.

<sup>265</sup> Witness Statement of J. Patrick Berry (Exhibit H-4).

interest should be compounded under NAFTA.<sup>267</sup> Even if the Government of Mexico prohibited compound interest on damage awards, which it does not, NAFTA provisions provide an independent reason for awarding compound interest that takes precedence over national laws favoring simple interest.<sup>268</sup> In fact, the relevant inquiry for the Tribunal is not whether to award compounded versus simple interest, but whether to compound interest annually or quarterly. At the very least, Claimant is entitled to interest compounded annually.<sup>269</sup>

## CHAPTER SIX

### SUBMISSIONS

- 6.1 Claimant requests that the Tribunal make the following determinations:
1. That Claimant is an investor protected by NAFTA.
  2. That Claimant's investments protected under NAFTA include the value of Acaverde as an enterprise.
  3. That Mexico is responsible for the actions of Banobras, the State of Guerrero, and the City of Acapulco that violate Chapter Eleven of NAFTA.
  4. That the actions of Banobras, the State of Guerrero, the City of Acapulco amount to a violation of NAFTA Article 1110.
  5. That the actions of Banobras, the State of Guerrero, and the City of Acapulco constitute violations of NAFTA Article 1105.
  6. That the Government of Mexico shall pay Claimant \$48.7 million for the fair market value of Acaverde as a going concern.
  7. That the Government of Mexico shall pay Claimant its costs incurred with respect to this proceeding, which currently exceed \$1,750,000.
  8. That the Government of Mexico shall pay for the Tribunal's costs in this proceeding and the costs incurred by ICSID.

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<sup>266</sup> NAFTA Article 1104(1).

<sup>267</sup> See *Pope & Talbot, Inc. and the Government of Canada*, (2002) 41 I.L.M. 1347 at ¶ 89; *S.D. Myers* (Second Partial Award) at ¶ 306; *Metalclad*, ¶ 128 (all awarding compound interest under NAFTA).

<sup>268</sup> See *Pope & Talbot*, ¶ 89

<sup>269</sup> The Supplemental Slottje Report (Exhibit H-1) calculates damages using both simple and compound (annually) interest.

Dated: January 22, 2003

Signed: 

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