No. L002904
Vancouver Registry

SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF AN ARBITRATION PURSUANT TO CHAPTER ELEVEN OF THE NORTH AMERICAN FREE TRADE AGREEMENT ("NAFTA") BETWEEN METALCLAD CORPORATION AND THE UNITED MEXICAN STATES, ICSID ADDITIONAL FACILITY CASE NO. ARB (AF)/97/1

BETWEEN:

THE UNITED MEXICAN STATES

PETITIONER

AND:

METALCLAD CORPORATION,

RESPONDENT

AND:

ATTORNEY GENERAL OF CANADA and
LA PROCUREURE GENERALE DU QUEBEC
ON BEHALF OF THE PROVINCE OF QUEBEC,

INTERVENORS

PETITIONER'S OUTLINE OF ARGUMENT

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OUTLINE OF ARGUMENT

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I. NATURE OF APPLICATION

A. This is an Application to Review an Arbitration Award Made in an Arbitration Under Chapter Eleven of the NAFTA

1. This is an application brought by the United Mexican States to review an arbitral award made August 30, 2000 in International Centre for Settlement of Investment Disputes (Additional Facility) ("ICSID Additional Facility"), Case No. ARB(AF)/97/1 (the "Award") in favour of Metalclad Corporation.

2. The place of the arbitration was Vancouver, British Columbia and this Court has jurisdiction to review the Award. This application is made under:

(a) the *Commercial Arbitration Act*, R.S.B.C. 1996, c. 55, ss. 30 and 31 (the "CAA"); or

(b) the *International Commercial Arbitration Act*, R.S.B.C. 1996, c. 233, s. 34 (the "ICAA").

3. This is a case of first impression.

4. It is the first court application to review an arbitration award made under Chapter Eleven of the North American Free Trade Agreement ("NAFTA").[1]

5. Under Chapter Eleven, non-parties to the NAFTA ("investors") are given direct but limited access to arbitration against the sovereign States who are the NAFTA Parties. The jurisdiction of those tribunals is prescribed by Chapter Eleven. This right of access does not extend to all the obligations of the NAFTA but is limited to the substantive obligations of Section A of Chapter Eleven. The Parties did not consent to investor-State arbitration of any other NAFTA obligations.

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[1] An electronic searchable NAFTA is available at the following URL http://www.nafta-sec-alena.org/english/index.htm

6. Arbitrations under Chapter Eleven are conducted before ad hoc arbitral tribunals. The prospect of review in the courts (or in an ad hoc review tribunal, depending upon the choice of the arbitral rules governing the arbitration) is also provided for in Chapter Eleven: an award is not enforceable until after a court has resolved an application to set aside an award and there is no further appeal.

1. The Parties to the Arbitration

7. The Petitioner, the United Mexican States ("Mexico" or "the Federal Government"), is a Party to the NAFTA.

8. The Respondent, Metalclad Corporation ("Metalclad"), is a company incorporated pursuant to the laws of Delaware. Metalclad wholly owns Eco-Metalclad Corporation ("Eco-Metalclad"), a company incorporated pursuant to the laws of Utah. Eco-Metalclad, in turn, wholly owns Ecosistemas Nacionales, S.A. de C.V. ("ECONSA"), a company incorporated pursuant to the laws of Mexico, and Confinamiento Tecnico de Residuos Industriales, S.A. de C.V. ("COTERIN"), a company incorporated pursuant to the laws of Mexico. Metalclad also owns or owned Ecosistemas del Potosi, S.A. de C.V. ("ECOPSA"), Quimica Omega, S.A. de C.V., Consultoria Ambiental Total, S.A. de C.V. ("CATSA"), Descontaminadora Industrial de Veracruz, S.A. de C.V. ("Descontaminadora"), Eliminación de Contaminantes, S.A. de C.V. ("Eliminación") and various other Mexican ventures. A reference herein to Metalclad includes references to Eco-Metalclad, ECONSA, COTERIN and the other companies as the case may be.

2. The Hazardous Waste Transfer Station and Landfill in La Pedrera

9. In 1990, COTERIN operated a hazardous waste transfer station (the "Transfer Station") at La Pedrera, Mexico.

10. La Pedrera is located in the Municipality of Guadalcazar (the "Municipality"), within the State of San Luis Potosi ("SLP"), Mexico. Approximately 800 people live within ten kilometers of COTERIN's site, which is approximately 70 kilometers by road from the town of Guadalcazar.

11. The Transfer Station was authorized by the Federal Government in 1990.

12. By 1993, COTERIN had received the following permits relating to a proposed hazardous waste landfill at La Pedrera:

(a) in January, 1993, the National Institute of Ecology ("INE"), an agency of the federal Secretariat of the Environment, National Resources and Fishing ("SEMARNAP") of Mexico granted COTERIN an environmental impact authorization in respect of the proposed construction;

(b) on August 10, 1993, the INE granted COTERIN an environmental impact authorization in respect of the operation of the landfill with a capacity of approximately 33,500 tonnes per year;

(c) on May 11, 1993, SLP granted a land use permit.

13. In 1991 and 1992, the Municipality had declined COTERIN's application for a permit to construct the landfill. On December 5, 1995, as noted below, a second municipal construction permit application, made by COTERIN, when owned by Metalclad, was also denied. No permit was ever granted by the Municipality authorizing COTERIN to construct or operate the landfill.

3. Metalclad's Acquisition of COTERIN

14. On April 23, 1993, Metalclad entered into an option agreement (the "Option Agreement") to purchase COTERIN, and the permits it held respecting the landfill. The Option Agreement was amended on September 9, 1993 (the "Amended Option Agreement").

15. On September 19, 1993, Metalclad exercised its option under the Amended Option Agreement and acquired COTERIN and its permits.

4. Metalclad's Construction of the Landfill and the Denial of the Municipal Permit

(a) Construction of the Landfill

16. In May, 1994, after receiving an eighteen month extension of the federal permit issued by the INE in January 1993, Metalclad commenced construction of the landfill.

17. Metalclad continued construction of the landfill through October, 1994.

18. On October 26, 1994, the Municipality ordered Metalclad to cease constructing the landfill due to the absence of a municipal permit. Construction of the landfill was halted temporarily.

19. On November 15, 1994, although it did not have a municipal permit, Metalclad resumed construction of the landfill. Metalclad applied for a municipal permit on that same day.

20. Without any municipal permit, Metalclad continued construction of the landfill, completing it by March, 1995.

(b) Attempted Opening of the Landfill

21. When Metalclad attempted to hold an "inauguration" of the landfill in March, 1995, demonstrators blockaded the landfill. The demonstrators dispersed after several hours.

(c) Denial of the Municipal Permit Application

22. On December 5, 1995, the Municipality denied COTERIN's November 1994 application for a construction permit for the landfill. The Municipality noted, *inter alia*, that

(a) it had denied similar applications by COTERIN in 1991 and 1992;

(b) COTERIN had actually commenced construction of the landfill prior to receiving a municipal permit;

(c) the contamination from COTERIN's operation of the Transfer Station had not been remediated;

(d) there was local opposition to the construction and operation of the landfill; and

(e) there were concerns regarding the environmental impact of the landfill.

(d) Judicial Review of the Permit Denial

23. In April 1996, the Municipality rejected COTERIN's request that the Municipality reconsider the rejection of its permit application. COTERIN initiated judicial review (an *amparo* proceeding) challenging the permit denial. These domestic judicial proceedings were initially unsuccessful and later abandoned in favour of negotiations with the Municipality.

(e) Federal Government's Representations to Metalclad

24. Metalclad asserted that, at various stages throughout the negotiation of the Option Agreement, the acquisition of COTERIN, and the construction of the landfill, it was informed by representatives of the Federal Government that:

(a) no permits from the Municipality were required in order to construct and operate the landfill; or

(b) the Municipality would issue any necessary permit as a matter of course; and

(c) Metalclad should simply apply for a municipal permit in order to foster positive relations with the Municipality.

25. Mexico denied that any federal officials made such representations to Metalclad. Mexico asserted that Metalclad knew that the Municipality required it to obtain a municipal permit.

(f) SLP's Representations to Metalclad

26. Metalclad asserted that, at various stages throughout the negotiation of the Option Agreement, the acquisition of COTERIN, and the construction of the landfill, it was informed by representatives of SLP, including the Governor, that SLP supported the construction and operation of the landfill provided that environmental studies confirmed that the site was suitable, and that its environmental impact was consistent with Mexican standards.

27. Mexico denied that SLP supported the construction and operation of the landfill.

(g) Municipal Permits in Mexican Domestic Law

28. Mexico presented two expert reports on Mexican law. The expert reports filed by Mexico indicated that a municipal permit was required for the lawful construction and operation of the landfill, and that the Municipality was entitled to review the project's impact on the local environment, health and safety concerns, previous unauthorized conduct of the applicant, and the social interests of the Municipality as evidenced by residents' opposition.

29. Expert evidence presented by Metalclad advanced the proposition that the Municipality's jurisdiction was limited. According to these experts, the Municipality only had the authority to address issues arising from the physical structure of the project when determining whether to grant a construction permit.

5. The *Convenio* and the *Amparo* Proceedings

(a) The *Convenio*

30. On November 25, 1995, Metalclad and the Federal Government (acting through the INE and the Federal Attorney General's office for the Protection of the Environment ("PROFEPA"), both sub-agencies of the federal environmental agency SEMARNAP) entered into an agreement (the "*Convenio*") pursuant to which Metalclad would, *inter alia*:

(a) complete a site remediation plan for the landfill site, monitored by an appointed Technical-Scientific Monitoring Committee and a Supervisory Citizens Committee;

(b) conduct remediation simultaneously with commercial operation of the landfill for three years;

(c) be permitted to operate the landfill for an initial period of five years, renewable upon mutual agreement;

(d) designate 34 hectares of the site as a buffer zone for the conservation of endemic species, including cacti;

(e) contribute to the Municipality two pesos per ton of hazardous waste it received;

(f) process hazardous waste generated within SLP at a 10% discount;

(g) provide to the residents of the Municipality one day per week of free medical advice;

(h) employ residents of the Municipality to perform manual labour, and give preference to them for technical training;

(i) consult with government authorities on the remediation of hazardous waste sites; and

(j) provide two publicly-accessible courses annually regarding the management of hazardous waste.

31. Representatives of SLP and the Municipality were not involved in the negotiations that resulted in the *Convenio*.

(b) The Municipality's *Amparo* Proceeding

32. The Municipality filed an administrative complaint with SEMARNAP challenging the *Convenio*.

33. SEMARNAP denied the Municipality's complaint.

34. On January 31, 1996, the Municipality filed an *amparo* proceeding in a Federal Court, challenging SEMARNAP's dismissal of its complaint and seeking an interlocutory injunction against the receipt of new hazardous waste.

35. On February 6, 1996, the Court granted the Municipality's application for an injunction.

36. The Federal authorities contested the Municipality's *amparo* and in May, 1999, the *amparo* proceeding was dismissed, and the injunction was dissolved.

6. The Ecological Decree

37. In September 1997, the Governor of SLP issued an Ecological Decree declaring that a very large area in which the landfill was located would become an ecological preserve. The primary focus of the Ecological Decree was to protect species of cacti in the area.

7. The Arbitration Proceedings

38. Metalclad complained that:

(a) the Municipality's denial of its application for a construction permit; and

(b) the injunction obtained by the Municipality;

constituted violations of Mexico's international obligations under Chapter Eleven:

(a) to accord the investment of an investor the minimum standard of treatment in international law, including fair and equitable treatment (Article 1105); and

(b) not to expropriate without compensation (Article 1110).

39. In the Award, the Tribunal found that Metalclad's investment was not accorded the minimum standard of treatment required by international law. In reaching this conclusion, the Tribunal based its decision on its findings of lack of "transparency" in Mexican domestic law and its finding of "improper" (by Mexican domestic law) permit denial by the Municipality.

40. The Tribunal held that:

(a) Metalclad was led to believe by federal officials that it did not require a permit from the Municipality in order to construct and operate the landfill;

(b) the term "transparency" "includes the idea" that when the authorities of the "central government" of any Party to the NAFTA become aware of any scope for misunderstanding or confusion as to the relevant legal requirements for initiating, completing and successfully operating investments, that Party has a "duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that

they are acting in accordance with all relevant laws". There should be "no room for doubt or uncertainty on such matters";

(c) the "absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA";

(d) even if a permit from the Municipality were required, a permit application could only be denied under Mexican domestic law for reasons relating to the physical construction or defects in the site and the denial of the permit by the Municipality by reference to environmental considerations was outside its jurisdiction and therefore "improper"; and

(e) the "totality of the circumstances", including the denial of the permit by the Municipality, the Municipality's administrative complaint challenging the *Convenio* and the subsequent proceedings and injunction, indicated that Metalclad was not treated in accordance with the minimum standard of treatment in international law.

41. The Tribunal held that expropriation under Article 1110 of the NAFTA:

> ... includes ... covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in 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.
>
> Award, paragraph 103

42. The Tribunal accepted Metalclad's claim that Mexico had expropriated Metalclad's investment holding that:

(a) Mexico's permitting or tolerating the conduct of the Municipality and thus "participating or acquiescing" in the denial of the "right to operate the landfill" was a measure "tantamount to" expropriation; and

(b) the Municipality's denial of the permit, without any basis in the proposed physical construction, together with the federal representations, and the Municipality's actions against the *Convenio*, and the absence of a timely or orderly denial, amounted to an "indirect expropriation".

43. With respect to the Ecological Decree, the Tribunal did not consider it to be of "controlling importance" and said:

> Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal's finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.
>
> Award, paragraph 111

44. The Tribunal ordered that Mexico pay the value of Metalclad's expenditures on the landfill, less certain deductions, including an allowance for the costs of remediation of the contamination, which will be borne by Mexico, and that, upon receiving payment from Mexico, COTERIN must relinquish all claim, title and interest in the Transfer Station and landfill to Mexico.

B. Relief Sought

45. Mexico seeks an order setting aside the Award.

C. Bases for Seeking Relief

46. Mexico submits that the Tribunal exceeded the jurisdiction conferred upon it:

(a) by linking its findings of breach of Article 1105 and Article 1110 of the NAFTA to alleged breaches of the transparency objectives and provisions set forth in other parts of the NAFTA when it only had jurisdiction to consider alleged breaches of Section A of Chapter Eleven;

(b) by legislating new transparency obligations not agreed to by the Parties when it had no jurisdiction to add to the obligations negotiated by the Parties;

(c) by applying Article 1105 and Article 1110 in such a fashion as to equate an alleged violation of domestic law with a violation of international law, ignoring Mexican judicial decisions and deciding issues of Mexican domestic law as if it were a Mexican court of appeal;

(d) by exceeding the jurisdiction conferred by Article 1110 to extend that Article to measures affecting property;

(e) by making patently unreasonable findings by failing to have regard to relevant evidence; and

(f) by failing to address all of the questions presented to it for resolution, in particular questions relating to Metalclad's *bona fides* and improper acts, as required by Article 53 of the ICSID Arbitration (Additional Facility) Rules.

47. Mexico submits that the Tribunal erred in law in its interpretation and application of Articles 1105 and 1110, as follows:

(a) in Article 1105, by finding that the international minimum standard of treatment imposes a duty on central governments to remove all doubt and uncertainty in the relevant legal requirements applicable to investors;

(b) in Article 1110, by finding that expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in 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.

48. Finally, Mexico submits that the Award is contrary to public policy.

D. Material to be Relied Upon

49. The arbitral tribunal that issued the Award (the "Tribunal") was formed as follows:

(a) on October 2, 1996, Metalclad filed a Notice of Intent to Submit a Claim to Arbitration in accordance with NAFTA, Article 1119;
[Record, Vol. 1, p. C12]

(b) on January 2, 1997, Metalclad filed a Notice of Claim with the ICSID Additional Facility in accordance with NAFTA, Article 1120 requesting the Secretary-General of ICSID to approve and register its application and permit access to the ICSID Additional Facility;
[Record, Vol. 17, p. C22]

(c) on January 13, 1997, the Secretary General of ICSID issued a Certificate of Registration of the Notice of Claim and permitted Metalclad access to the Additional Facility;
[Record, Vol. 17, p. C33]

(d) on May 19, 1997, the Tribunal was deemed by the Secretary-General of ICSID to have been constituted (the Tribunal comprised Messrs. Lauterpacht, Civiletti and Siqueiros) and the arbitration proceedings were deemed to have begun;
[Record, Vol. 17, p. C70]

(e) on July 15, 1997, the Tribunal determined the place of the arbitration as Vancouver, British Columbia, Canada;

(f) between October 14, 1997 and May 4, 1999, the parties filed and exchanged written submissions, witness statements and exhibits;

(g) Her Majesty the Queen in Right of Canada ("Canada") filed a written submission with the Tribunal on July 28, 1999;
[Record, Vol. 19, p. C1292]

(h) the Tribunal conducted a hearing in Washington, District of Columbia, United States of America, between August 30, 1999 and September 9, 1999, and representatives of Canada and the United States of America attended;

(i) the United States of America filed a written submission with the Tribunal on November 9, 1999;
[Record, Vol. 20, p. C1656]

(j) Mexico and Metalclad filed and exchanged post-hearing written submissions on November 9, 1999.

Mexico's Post-hearing Submission [Record, Vol. 14, p. 12,395]

Metalclad's Post-hearing Submission [Record, Vol. 14, p. 12,512]

50. In its Award, the Tribunal awarded Metalclad damages (including pre-Award interest compounding annually) in the amount of U.S. $16,685,000 on the basis of violations of Articles 1105 and 1110.

51. The Tribunal ordered that sum to be paid within 45 days of the Award being rendered, following which interest shall accrue at the rate of 6% per annum, compounded monthly. Thus, interest of approximately U.S. $85,758 per month was ordered to accrue.

52. In the course of this application, Mexico will refer to the Award and to portions of the pleadings, exhibits and proceedings referred to in the arbitration. The record will be filed with the Court.

II. THIS IS A CASE OF FIRST IMPRESSION

53. This is a case of first impression in a number of respects:

(a) it is the first court application to review an award made in an investor-State arbitration under Chapter Eleven of the NAFTA conducted under the ICSID Arbitration (Additional Facility) Rules [Mexico's Authorities, Tab 85] and thus, the first to consider whether the ICAA or the CAA applies to that review;

(b) whichever statute applies, it is the first case in North America to consider review of an investor-State arbitration arising out of an international treaty (as opposed to private international commercial arbitrations arising out of commercial agreements, made between private parties or between private parties and governments (e.g. concession contracts));

(c) it arises from the first arbitration of any kind to be initiated under the ICSID Arbitration (Additional Facility) Rules.

54. All of these factors must be considered for their impact on the grounds of review open to this Court and the standard of review to be applied to those grounds. New questions will be posed by this application, and existing analogous authorities must be considered in light of those new questions.

55. Because this is a case of first impression it is also necessary to set out in some detail the relevant obligations and procedures of the NAFTA, and the relevant provisions of the CAA and the ICAA.

56. The length of these submissions should not obscure a fundamental point: arbitral tribunals have no inherent jurisdiction. The jurisdiction of any consensual tribunal is limited by the parties' agreement. A tribunal's disregard of the limits of this agreement constitutes an excess of jurisdiction.

57. There are different bases of review available to set aside Chapter Eleven arbitral awards, varying with the system of arbitration adopted by the parties and the law governing the reviewing body, whether that body is a national court or an ICSID ad hoc committee.[2] These variations can be important and will be discussed below, but review for excess of jurisdiction is common to all.

58. Investors are afforded limited substantive rights in NAFTA Articles 1101 to 1114 and are granted limited access to challenge alleged breaches of these provisions by arbitration under Section B of Chapter Eleven. The NAFTA stipulates in Article 1117 that a Tribunal established under Chapter Eleven may consider a claim that the Party has "breached an obligation under Section A" of Chapter Eleven. Jurisdiction of a Chapter Eleven dispute tribunal is limited to the obligations set out in Section A of Chapter Eleven.

59. In Mexico's submission the Tribunal exceeded its jurisdiction. It did not restrict its analysis to the obligations contained in Section A of Chapter Eleven but rather linked its findings to alleged violations of obligations found in other chapters of the NAFTA, most notably the transparency obligations set out in Chapter Eighteen and elsewhere. The Tribunal incorporated "transparency" into Article 1105 and then legislated transparency standards not agreed to by the NAFTA Parties to find Mexico in breach of such standards.

60. It was not open to the Tribunal to expand its terms of reference beyond Section A of Chapter Eleven. Of the 295 articles of the NAFTA set out in 22 chapters, a Chapter Eleven tribunal has jurisdiction to determine a violation only of the 14 articles set out in Section A, which include one subparagraph of two articles of Chapter Fifteen, but which do not include the NAFTA's transparency obligations.

61. A tribunal must apply the *Vienna Convention on the Law of Treaties* when it interprets the NAFTA. Article 102:2 of the NAFTA requires the Parties to interpret and apply

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[2] An "ad hoc committee" reviews awards made by tribunals established under the ICSID Convention in what is known as an "annulment proceeding". An annulment proceeding is not available in this case because Mexico is not a signatory to the ICSID Convention and the arbitration was conducted under the ICSID Arbitration (Additional Facility) Rules.

the Agreement "in accordance with applicable rules of international law" and it is widely accepted that the *Vienna Convention* sets out the applicable rules. It is appropriate to look at the context of the NAFTA and to have regard to its objectives. What is not appropriate for a tribunal of limited jurisdiction to do is to import into the obligations over which it has jurisdiction treaty obligations and concepts that lie outside of its jurisdiction under the rubric of contextual interpretation. If anything, the context, including the other parts of the NAFTA, show that transparency obligations are dealt with outside, not inside, Chapter Eleven.

Vienna Convention on the Law of Treaties [Mexico's Authorities, Tab 94]

62. This excess of jurisdiction formed the basis of the Award under both Article 1105 and Article 1110.

63. These were not the only jurisdictional lapses committed by the Tribunal. The Tribunal also exceeded its jurisdiction by ignoring Mexican judicial decisions which upheld the denial of the municipal permit. It treated itself as a Mexican appellate court equating its view of violation of Mexican domestic law with a violation of Mexico's international responsibilities.

64. The Tribunal made further jurisdictional errors. Mexico presented a lengthy defence to the Claimant's allegations which were based primarily on the documents of Metalclad's own making. Mexico made its defence with the legitimate expectation that the Tribunal, as required by Article 53 of the governing arbitration rules, would address all questions submitted to it for consideration. According to arbitral practice under the ICSID Convention, from which the governing arbitral rules were derived, a "question" is a legal or factual issue, the consideration of which could affect the outcome of the proceeding.

65. The Award failed to deal with all questions addressed to the Tribunal. One full year after the oral hearing, the Award disposed of the case in 32 double-spaced pages (after a 10-page recitation of the procedural aspects of the claim). Questions involving the site's prior contamination as a result of illegal dumping of hazardous waste, and the legitimate opposition that that engendered, the consideration of which clearly could have led to a different result, were not mentioned or addressed in the Award.

66. With respect to Metalclad's factual allegation of lack of transparency in the Mexican legal system, Mexico filed the company's own Amended Option Agreement, by which it purchased COTERIN, in which, having done due diligence, it agreed that three-quarters of the purchase price was conditional upon COTERIN receiving the State Governor's permission to commence construction and the issuance of the municipal permit or a court order holding that the permit was not required. These sections of the Amended Option Agreement were not mentioned or addressed in the Award.

67. In and of itself, this evidence of Metalclad's own making, had it been addressed by the Tribunal, could have been sufficient to refute the essence of Metalclad's claim of opacity in the Mexican legal system and its belief that a municipal permit was not required.

68. Mexico also filed two expert reports from Marcia Williams, a former senior official of the U.S. Environmental Protection Agency (EPA), who testified that the problems of local and non-governmental organizations opposition that Metalclad encountered in SLP were common and would be expected by any experienced hazardous waste operator. Mexico filed extensive evidence of Metalclad's own making showing that the Mexican hazardous waste business was a new line of business for the company and that it was, in the company's own words, "speculative". Mexico analyzed the company's SEC filings and found that it made representations to investors about the project's status that were not true and that none of Metalclad's other Mexican projects announced prior to COTERIN's acquisition had ever been constructed. It did so to explain why this company persisted in building at La Pedrera when the evidence was that it was repeatedly warned by state officials that the site's prior contamination had created social and legal problems. Mexico also filed Metalclad's own documents showing an improper relationship between the company and a former federal official who filed two witness statements on the company's behalf.

69. None of this evidence was mentioned or addressed in the Award.

70. In its review of the Tribunal's patently unreasonable findings Mexico will show that the Tribunal made findings of fact that Metalclad did not even allege, as well as findings

apparently taken from Metalclad's first pleading (its Memorial) which Metalclad subsequently admitted were not true in its second pleading (its Reply).

III. A GENERAL INTRODUCTION TO INVESTOR-STATE ARBITRATION, AND THE PARTICULAR OBLIGATIONS AND PROCEDURES OF CHAPTER ELEVEN OF THE NAFTA

A. Introduction to the NAFTA's Investment Chapter: The Investor-State Arbitration Mechanism[3]

71. Section A of Chapter Eleven contains the NAFTA Parties' investment obligations. As is the case with virtually all of the other obligations contained in the NAFTA, an alleged violation of the Section A obligations may also be the subject of Party-to-Party dispute settlement under Chapter Twenty of the NAFTA.

> Articles 1115-1117 and 2004

72. Generally, international law provides that only sovereign States have the legal personality and right to enforce the international treaty obligations that exist *inter se*. However, States can by treaty grant rights of access to tribunals (both arbitral and judicial) to natural or legal persons who are then given the right to enforce obligations otherwise enforceable only by States.

73. This was done in Section B of Chapter Eleven. A qualifying "investor of a Party" may in specified circumstances commence an arbitral claim against another Party (but not its own) for damages for an alleged breach of the obligations set out in Section A. A claim may allege a breach only of those obligations set out in Section A (and two obligations expressly incorporated from Chapter Fifteen).

> Articles 1116-1117 (In addition, for the special case of financial services delivered through an investment, Article 1410:2 expressly incorporates certain of Chapter Eleven's rights and obligations into that chapter.)

74. Investor-State arbitration was not included as a dispute settlement mechanism under NAFTA's predecessor, the Canada-United States Free Trade Agreement ("FTA"). Any

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[3] See generally J.C. Thomas, "Investor-State Arbitration Under NAFTA Chapter 11" (1999) Cdn. Y.B. of Intl. Law 99 [Mexico's Authorities, Tab 127]; H.C. Alvarez, "Arbitration Under the North American Free Trade Agreement" (2000) 16 Arbitration International 393 [Mexico's Authorities, Tab 96].

breach of the FTA's investment obligations was subject only to general Party-to-Party dispute resolution under Chapter Eighteen of the FTA.

> See Article 1608:4 and Part Six: Institutional Provisions, Chapter Eighteen of the Canada-United States Free Trade Agreement, (1989) 27 I.L.M. 281 [Mexico's Authorities, Tab 83]

75. Investor-State arbitration was the object of the 1965 ICSID Convention, which provided for consensual arbitral proceedings against a State Party to the Convention in respect of "any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State), and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre".

> ICSID Convention, Done at Washington, D.C., March 18, 1965; entry into force October 14, 1966; published in 575 U.N.T.S. 159. Article 25 defines the *Centre's jurisdiction [Mexico's Authorities, Tab 86].*

76. The ICSID Convention is supplemented by the ICSID Additional Facility Rules, which can apply where States have not acceded to the ICSID Convention. Neither Mexico nor Canada has acceded to the ICSID Convention.

B. Jurisdiction of Arbitral Tribunals and Consent to Arbitration Generally

77. A cornerstone of the law of arbitration is the requirement that the parties consent to the arbitration. That consent must comprehend not only the fact of arbitration but also the specific issues to be resolved by arbitration and may stipulate the governing law. An arbitration tribunal only has jurisdiction over those specific issues that the parties have agreed to submit and any award that goes beyond those issues will be susceptible to challenge.

78. Redfern and Hunter, *Law and Practice of International Commercial Arbitration*, state:

> An arbitration agreement does not merely serve to evidence the consent of the parties to arbitration and to establish the obligation to arbitrate. It is also a basic source of the powers of the arbitral tribunal...

> Finally, it is the arbitration agreement that establishes the jurisdiction of the arbitral tribunal. The agreement of the parties is the only source from which this jurisdiction can come.
>
> Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration*, 3rd ed. (Street & Maxwell: London, 1999) [Mexico's Authorities, Tab 120] at pp. 3-8.

79. Redfern and Hunter's comments on jurisdiction are reflected in arbitral rules, including the ICSID Convention and the ICSID Arbitration (Additional Facility) Rules. Consent is expressly required by Article 25 of the ICSID Convention and was described as the "cornerstone of the jurisdiction of the Centre" in the Report of the Executive Directors that accompanied the Convention when it was submitted to the governments of member States of the World Bank.

> Report of the Executive Directors on the Convention on Settlement of Investment Disputes Between States and Nationals of Other States, 1965, reproduced at 1 ICSID Reports 23 [Mexico's Authorities, Tab 90].

80. The requirement for consent to arbitration applies equally to an ICSID Additional Facility arbitration, like the instant arbitration. In another NAFTA Chapter Eleven proceeding, it was held that:

> The essential constituent elements which constitute the institution of arbitration are the existence of a conflict of interests, and an agreement expressing the will of the parties or a legal mandate, on which the constitution of an Arbitral Tribunal is founded. This assertion serves to confirm the importance of the autonomy of the will of the parties, which is evinced by their consent to submit any given dispute to arbitration proceedings. Hence, it is upon that very consent to arbitration given by the parties that the entire effectiveness of this institution depends.
>
> *Waste Management, Inc.* v. *The United Mexican States*, ICSID Case No. ARB(AF)/98/2, Arbitral Award, June 2, 2000, § 16 [Mexico's Authorities, Tab 69]

81. The requirement of consent to arbitral jurisdiction where a sovereign State is involved was commented on by the ICSID tribunal decision in *Southern Pacific Properties*

(Middle East) Limited v. *Arab Republic of Egypt*.[4] In its Decision on Jurisdiction dated 14 April 1988, the Tribunal said:

> 63. ...there is no presumption of jurisdiction – particularly where a sovereign State is involved – and the Tribunal must examine Egypt's objections to the jurisdiction of the Centre with meticulous care, bearing in mind that jurisdiction in the present case exists only insofar as consent thereto has been given by the Parties. This is not to say, however, that there is a presumption against the conferment of jurisdiction with respect to a sovereign State or that instruments purporting to confer jurisdiction should be interpreted restrictively. Judicial and arbitral bodies have repeatedly pronounced in favor of their own competence where the force of the arguments militating in favor of jurisdiction is preponderant ... Thus, jurisdictional instruments are to be interpreted neither restrictively nor expansively, but rather objectively and in good faith, and jurisdiction will be found to exist if – but only if – the force of the arguments militating in favor of it is preponderant. [Emphasis added]
>
> 3 ICSID Reports 112 [Mexico's Authorities, Tab 62] at 143-144

C. Chapter Eleven is One of Twenty-Two Chapters of the NAFTA

82. Chapter Eleven is situated within a broader agreement containing extensive disciplines on trade in goods and services. NAFTA has a preamble and twenty-two chapters dealing with different aspects of trade in goods and services (tariff reduction, rules of origin, safeguards, technical standards, government procurement, trade in services, administration of antidumping and countervailing duty law, etc.), the cross-border movement of natural persons, and investment.

83. Much of the NAFTA incorporates provisions and concepts derived from the 1947 General Agreement on Tariffs and Trade (GATT 1947) [Mexico's Authorities, Tab 84]. The three Parties, all of which were contracting parties (signatories) to the GATT, resolve in the preamble to build on their respective rights and obligations under the GATT. Trade agreements traditionally have dealt exclusively with "trade in goods" issues. The NAFTA is lengthier and

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[4] The Tribunal was chaired by Dr. Jimenez de Arechaga, Mr. Robert F. Pietrowski and Dr. Mohamed Amin El Mahdi.

more complicated than the Canada-US FTA or the GATT 1947. Some chapters differ substantially in form and substance from other chapters.

84. Chapter Eleven, for example, is derived, not from the GATT, but rather from bilateral investment treaties that the NAFTA Parties, especially the United States, have with other countries. The NAFTA was the first free trade agreement to include separate investment obligations enforceable by investor-State arbitration.

85. As noted above, investor-State arbitration is available only for a narrow aspect of the NAFTA. Virtually all of the NAFTA's obligations are subject to dispute settlement directly between the Parties at the State-to-State level, including the obligations in Chapter Eleven.[5] As an international agreement between sovereign States, the international obligations owed by each Party to each of the others are enforceable in Party-to-Party dispute settlement proceedings for an alleged breach of the Agreement.

86. The investor-State arbitration mechanism set out in Chapter Eleven's Section B is an exception to the rule that NAFTA dispute settlement can be initiated only by a Party to the Treaty.

D. Structure of Chapter Eleven

87. Chapter Eleven is divided into three parts, two of which are material to this Petition.

88. Section A entitled "Investment" (which contains Articles 1101-1114) sets out the scope and coverage of the chapter and the substantive obligations including national treatment, most-favored-nation treatment, the minimum standard of treatment in international law,

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[5] There are some limited exceptions to this rule. Chapter Nineteen sets out a special dispute settlement mechanism for binational panel review of the decisions of national investigating authorities in antidumping and countervailing duty cases. Article 2004, which defines the scope of NAFTA's general Party-to-Party dispute settlement mechanism, specifically excludes "the matters covered in Chapter Nineteen" from general dispute settlement under Chapter Twenty. Article 1501 and Annex 1138.2 are also excluded from dispute settlement. Investment disputes arising under Chapter Fourteen on Financial Services have specific settlement procedures, which include part of Chapter Eleven.

including fair and equitable treatment, and a prohibition against expropriation without compensation.

89. Section B entitled "Settlement of Disputes between a Party and an Investor of Another Party" (which contains Articles 1115-1138) sets out the basis upon which the Parties are prepared to submit to investor-State arbitration for alleged breaches of the obligations contained in Section A.

1. The Substantive Obligations Agreed to be Subject to Investor-State Arbitration

90. An investor cannot under Chapter Eleven allege a breach of any article of the NAFTA other than those set out in Articles 1116 or 1117 (depending upon which article the investor proceeds under).

91. Article 1116 states in this regard:

> 1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:
>
> (a) Section A [of Chapter Eleven] ...[6]

92. Similarly, Article 1117 permits an investor of a Party to make a claim on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls, again based upon an alleged breach of Section A of Chapter Eleven (and two subparagraphs from Chapter Fifteen) only.

93. An investor may not allege a breach of any other article of the NAFTA in a Chapter Eleven proceeding except the two subparagraphs expressly referred to (Articles 1503(2) and 1502(3)(a)). This express reference to NAFTA articles located outside of Chapter Eleven demonstrates that the drafters knew how to incorporate other obligtions into Chapter Eleven proceedings where that was intended. Only a NAFTA Party has the necessary standing to allege

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[6] Article 1116:1 (a) and (b) includes two sub-paragraphs from Chapter Fifteen which also may be taken to investor-State arbitration. Article 1117 does likewise.

breaches of the remainder of the NAFTA and such a dispute would take place in a Chapter Twenty State-to-State proceeding.

> Article 2004 of the NAFTA.

94. The agreed upon balance for dispute settlement was mirrored in the Canadian legislation implementing the NAFTA. The North American Free Trade Implementation Act, S.C. 1993, c. 44, states in section 6:

> 6. (1) No person has any cause of action and no proceedings of any kind shall be taken, without the consent of the Attorney General of Canada, to enforce or determine any right or obligation that is claimed or arises solely under or by virtue of Part I or any order or regulation made under Part I.
>
> (2) Subject to Section B of Chapter Eleven of the Agreement, no person has any cause of action and no proceedings of any kind shall be taken, without the consent of the Attorney General of Canada, to enforce or determine any right or obligation that is claimed or arises solely under or by virtue of the Agreement.

95. The effect of this, and similar provisions implementing the Canada-United States Free Trade Agreement (S.C. 1988, c. 65, s. 5) and the World Trade Organization Agreement (S.C. 1994, c. 47, ss. 5, 6) was commented on in *Pfizer Inc.* v. *Canada*, [1999] 4 F.C. 441 (T.D.) (appeal dismissed October 14, 1999, Docket A-469-99 (F.C.A.)) [Mexico's Authorities, Tab 50] at paragraphs 55-57:

> What Parliament is saying is that these international trade agreements are matters of public law concerning public rights, rights affecting Canada as a sovereign state. They are not matters of private economic or commercial rights giving rise to causes of action and legal proceedings. These sections do not eliminate any private rights; they do not extinguish rights; Parliament is simply saying no such rights arise.
>
> Parliament's concern relates to the very nature of international trade agreements between sovereign states and the mechanisms for dispute settlement and the enforcement of panel or arbitration rulings.
>
> The WTO Agreement provides for such mechanisms. Parliament did not want private parties except where it may be appropriate, to

initiate private actions which would disrupt or adversely affect the agreed to equilibrium for dispute settlement.

2. The Difference Between General Dispute Settlement and Chapter Eleven Arbitration

96. The limitation discussed above is of central importance in defining the jurisdiction of Chapter Eleven arbitration tribunals. Mexico has not consented to investor-State arbitration of the provisions of NAFTA except for alleged breaches of Section A of Chapter Eleven. Since alleged breaches of NAFTA articles other than those set out in Section A cannot form the basis for a Chapter Eleven claim, it shall be argued that the Tribunal exceeded its jurisdiction by basing its decision on the transparency obligations of the NAFTA, which are not included in Chapter Eleven, when it only had jurisdiction to enforce the obligations contained in Chapter Eleven.

97. In this respect, a NAFTA Chapter Eleven tribunal is very different from a NAFTA Chapter Twenty panel. As long as the complainant State has specified the matter in dispute, a Chapter Twenty panel has the jurisdiction to determine a breach of the relevant obligations anywhere in the Agreement (except those expressly stated to be excluded from general dispute settlement).

> NAFTA Article 2004
>
> *In the Matter of the U.S. Safeguard Action Taken on Broom Corn Brooms from Mexico,* (USA-97-2008-01), 30 January 1998 [Mexico's Authorities, Tab 15]

98. In Chapter Eleven, however, Articles 1116 and 1117 expressly confine the jurisdiction of a Chapter Eleven tribunal to Section A (and two articles from Chapter Fifteen).

3. A Chapter Eleven Tribunal's Governing Law Does Not Include Domestic Law

99. Article 1131, Chapter Eleven's governing law provision, includes applicable rules of international law. The commonly recognized sources of international law are set out in the

Statute of the International Court of Justice. Article 38.1 of the Statute[7] provides that the International Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

> (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
>
> (b) international custom, as evidence of a general practice accepted as law;
>
> (c) the general principles of law recognized by civilized nations;
>
> (d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

100. Review for excess of jurisdiction extends to the parties' agreement on the applicable rules of law. In the leading ICSID ad hoc annulment committee decision in *MINE* v. *Guinea* that committee said:

> ... the parties' agreement on applicable law forms part of their arbitration agreement. Thus, a tribunal's disregard of the agreed rules of law would constitute a derogation from the terms of reference within which the tribunal has been authorized to function. Examples of such a derogation include the application of rules of law other than the ones agreed by the parties, or a decision not based on any law unless the parties had agreed on a decision *ex aqueo et bono*. If the derogation is manifest, it entails a manifest excess of power.
>
> Disregard of the applicable rules of law must be distinguished from erroneous application of those rules which, even if manifestly unwarranted, furnishes no ground for annulment ...
>
> ICSID Case No. ARB/84/4, Ad Hoc Committee Decision of December 22, 1989, 5 ICSID Rev. FILJ 95 (1990) [Mexico's Authorities, Tab 38] at paragraphs 5.03 and 5.04

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[7] Reprinted in Supplement to: *International Law Chiefly As Interpreted and Applied in Canada* (5th ed.) [Mexico's Authorities, Tab 93], p. 40.

101. The stipulation of the governing law of a Chapter Eleven tribunal in NAFTA Article 1131 differs from the usual governing law in an investor-State arbitration under the ICSID Convention. In the absence of an agreement to the contrary, ICSID Convention tribunals apply the domestic law of the host state as supplemented by applicable rules of international law. According to Article 42 of the ICSID Convention, an ICSID Convention tribunal:

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

102. For example, in *Liberian Eastern Timber (LETCO)* v. *Government of the Republic of Liberia*, an ICSID tribunal considered a dispute arising from a concession contract. The ICSID tribunal found that Liberian law applied to the contractual dispute and, by virtue of Article 42 of the Convention, "such rules of international law as may be applicable". Given a jurisdiction that encompassed national and international law, the ICSID tribunal's award turned principally on a finding of a breach of contract under Liberian domestic law.

> *Liberian Eastern Timber (LETCO)* v. *Government of the Republic of Liberia*, 2 ICSID Reports 343 [Mexico's Authorities, Tab 34] at 358.

103. The stipulation of domestic law as the governing law for certain NAFTA tribunals does occur in Article 1904. Chapter Nineteen of the NAFTA replaces domestic judicial review of antidumping and countervailing duty determination with binational panel review by five member arbitral panels of trade experts. The panels are effectively surrogates for the federal courts and are required to apply the substantive antidumping and countervailing duty laws of the nation in which the trade remedy action under review was brought, such law consisting of "the relevant statutes, legislative history, regulations, administrative practice and judicial precedents ... that a court of the importing Party would rely on ... in reviewing a final determination of the competent investing authority."

104. This is not the case for Chapter Eleven tribunals. This is important to the present Petition because it will be seen that the Tribunal based its finding of breach of the Treaty upon its own determination of the legal correctness of the Municipality's permitting jurisdiction under

Mexican law. There was no decision of a Mexican court impugning the Municipality's denial of the municipal permit. Indeed, a domestic legal challenge of the permit denial was taken by Metalclad and dismissed on jurisdictional grounds. At Mexican law, on the facts of this case, the assertion of a municipal permitting jurisdiction and the permit's denial remained unimpeached and lawful. Further domestic remedies were available to Metalclad but it chose not to pursue them.

105. Here, it will be argued that the Tribunal arrogated to itself powers of supervision to act as if it were a Mexican court of appeal, and, ignoring the fact that the permit denial was not impeached under Mexican law, held that it was "improper". The Tribunal then equated its views of a violation of Mexican law with violation of international obligations.

E. Chapter Eleven Permits Non-Disputing Parties to Participate in a Claim

106. Under Article 1127, a disputing NAFTA Party must serve both of the other NAFTA Parties with the written notice of a claim and copies of all pleadings filed in an arbitration against it.

107. If a Party wishes to obtain further documents filed in a claim against another, Article 1129 permits it to request a copy of the "evidence that has been tendered to the Tribunal" and "the written argument of the disputing parties".

108. Reflecting the long-term interest that each Party has in the legal basis of claims brought against the others, Article 1128 permits a NAFTA Party "on written notice to the disputing parties", to "make submissions to a Tribunal on a question of interpretation" of the NAFTA. In the arbitration under review, both Canada and the United States of America exercised this right.

IV. JURISDICTION OF COURT TO REVIEW THE AWARD

109. This Court's jurisdiction to review the Award will be canvassed in this section.

A. The Rules Governing this Arbitration: The ICSID Additional Facility Rules

110. An investor must invoke one of three sets of arbitral rules when it submits a claim to arbitration under Chapter Eleven of NAFTA:

(a) the ICSID Convention, provided that both the disputing Party and the Party of the investor are Parties to the Convention (Mexico is not a Party[8] so the Convention was inapplicable here);

(b) the ICSID Additional Facility Rules, provided that either the disputing Party or the Party of the investor, but not both, is a Party to the ICSID Convention (invoked here); or

(c) the UNCITRAL Arbitration Rules (not invoked here).

Article 1120, NAFTA

111. Metalclad invoked the ICSID Additional Facility Rules when it filed its Notice of Claim on January 2, 1997. The ICSID Additional Facility is a forum established by the World Bank to facilitate the resolution of disputes between foreign investors and a host State, like Mexico, that is not a signatory to the ICSID Convention.

Notice of Claim, January 2, 1997 [Record, Vol. 17, p. C23]

B. Judicial Review of an ICSID Additional Facility Award is Governed by the Law of the Place of Arbitration

112. The Additional Facility differs from the ICSID itself. An ICSID arbitration is subject to an internal review mechanism known as an "ad hoc annulment committee". Article 53(1) of the Convention states that an award "shall not be subject to any appeal or to any

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[8] For that matter, neither is Canada.

other remedy except those provided for in this Convention". The annulment remedy is set out in Article 52.

113. In contrast, the setting aside of an award made pursuant to the ICSID Arbitration (Additional Facility) Rules is governed by the law of the forum in which the award is made, including applicable international conventions.

Additional Facility Rules, Article 3 [Mexico's Authorities, Tab 85]

114. Aron Broches, the former general counsel to the World Bank, Secretary-General of the ICSID, and the principal drafter of the ICSID Convention and the ICSID Additional Facility Rules, in "The 'Additional Facility' of the International Centre for Settlement of Investment Disputes (ICSID)" (1979) Y.B. Comm. Arb. 373 [Mexico's Authorities, Tab 101], refers to Article 3 of the ICSID Additional Facility Rules, at 376:

> This is an explicit reminder that the provisions of the Convention [which provide for internal review of ICSID Convention awards by ad hoc annulment committees] are not applicable to Additional Facility proceedings. With respect to arbitration proceedings this means, e.g., that awards, unlike awards rendered pursuant to the Convention, are not insulated from national law and that their recognition and enforcement will be governed by the law of the forum, including applicable International Conventions.

115. Review of a Chapter Eleven award is an integral part of Chapter Eleven. Under Article 1136(3), a disputing party may not seek enforcement of a Chapter Eleven award until after a court has resolved an application to set aside an award and there is no further appeal.

C. The Place of Arbitration was Vancouver, British Columbia

116. A tribunal constituted to hear a claim pursuant to the ICSID Arbitration (Additional Facility) Rules must determine the place of arbitration, which must be in the territory of a NAFTA Party that is a signatory to the *New York Convention*, after consultation with the parties and the ICSID Secretariat. An award is deemed to be made at the place of arbitration.

NAFTA, Article 1120

Arbitration (Additional Facility) Rules, Article 21

Award, paragraph 11

117. In this connection, Gerold Herrmann, Secretary-General of the United Nations Commission on International Trade Law ("UNCITRAL"), in "The UNCITRAL Model Law – it's background, salient features and purposes" explains the legal significance of the place of arbitration at p. 25:

> If an award is set aside (at the place of origin), it prevents enforcement of that award in all other countries (under Article V(1)(e) of the 1958 New York Convention and article 36(1)(a)(v) of the model law) and thus "kills the award at the root".[9]
>
> See also *Baker Marine (NIG.) Ltd.* v. *Chevron (NIG.) Ltd.*, 191 F. 3d 194 (U.S.C.A. 2nd Cir. 1999) [Mexico's Authorities, Tab 8]
>
> Gerold Herrmann, "The UNCITRAL Model Law – its background, salient features and purposes", (1985) 1 Arb. Int'l 6 [Mexico's Authorities, Tab 109]
>
> See also *Analytical Commentary on the Draft Text of a Model Law on International Commercial Arbitration, Eighteenth Session of the United Nations Commission on International Trade Law*, supplement *Canada Gazette*, Part I (Ottawa: Queens Printer, 1986) at 105 ("*Analytical Commentary*") [Mexico's Authorities, Tab 82] p. 161, paragraph 8

D. This Court's Jurisdiction as the Place of Arbitration

118. This Court's supervisory jurisdiction arising from the place of arbitration being Vancouver, British Columbia, is conferred by one of the following sources:

(a) the CAA, or

(b) the ICAA,

together with the inherent jurisdiction of the Court.

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[9] Some commentators are of the view that setting aside an award at the arbitral situs does not necessarily destroy the award's international enforceability since the separate issues of setting aside and enforcement will be dealt with by different systems of law. The authors of *International Chamber of Commerce Arbitration* (W. Lawrence Craig, William W. Park and Jan Paulsson) 3rd ed. (Oceana Publications, Inc.: Dobbs Ferry, N.Y.) [Mexico's Authorities, Tab 104] state at pp. 499-500:

> The practical importance of the arbitral situs rests on a twofold reality: (i) most national arbitration statutes provide some grounds for setting aside awards made within their territory, and (ii) annulment at the arbitral situs gives the loser a powerful argument for resisting the award's enforcement. As the place where an award is "made" for purposes of the New York Convention's enforcement scheme, the arbitral situs by vacatur of an award can impair, though not necessarily destroy, the award's international currency. [Footnotes omitted.]

Commercial Arbitration Act, R.S.B.C. 1996, c. 55;
International Commercial Arbitration Act, R.S.B.C. 1996, c. 253;
Supreme Court Act, R.S.B.C. 1996, c. 443, s. 9.

V. WHETHER THIS COURT'S JURISDICTION IS GOVERNED BY THE COMMERCIAL ARBITRATION ACT OR THE INTERNATIONAL COMMERCIAL ARBITRATION ACT

A. *Introduction*

119. This question is important for consideration of this Court's jurisdiction to substitute its views on a correctness standard in respect of pure questions of law. For Mexico's submissions on excess of jurisdiction, it does not matter which legislation applies since excess of jurisdiction is a common ground for setting aside available under both statutes.

B. The CAA

120. The CAA was enacted in British Columbia in 1986.[10] It and the ICAA repealed and replaced the former *Arbitration Act*, R.S.B.C. 1979, c. 18. The two statutes divided between them the procedural law applicable to arbitrations, both internal and external. The CAA applies to cases not caught by the ICAA. The CAA replaced the power of the court under the former Act to set aside an award for error of law on the face of the award with review:

(a) for "arbitral error", a defined term that includes excess of jurisdiction[11], and

(b) of questions of law with leave of the court.[12]

121. The enactment of the CAA followed a 1982 *Report on Arbitration*, prepared by the Law Reform Commission, which has been referred to for assistance in interpreting the CAA.[13]

C. The ICAA

122. The ICAA implements in British Columbia, with some changes, the United Nations Commission on International Trade Law's ("UNCITRAL") *Model Law on International*

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[10] *Commercial Arbitration Act*, S.B.C. 1986, c.3.

[11] *Commercial Arbitration Act*, s. 1.

[12] See *Domtar Inc.* v. *Belkin Inc.* (1989), 39 B.C.L.R. (2d) 257 (B.C.C.A.) now overruled in part by *BCIT (Student Association)* v. *BCIT*, 2000 BCCA 496 [Mexico's Authorities, Tab 24].

[13] See *Domtar Inc* v. *Belkin Inc., supra*, at 262.

Commercial Arbitration (the "Model Law") [Mexico's Authorities, Tab 88]. The Model Law was developed to promote the efficient functioning of private international commercial arbitrations. The Model Law has been implemented federally and in most provinces and territories in Canada. It is a "collaborative effort among nations to facilitate the resolution of international commercial disputes through the arbitral process."

> *Corporacion Transnacional de Inversiones, S.A. de C.V. et al. and STET International, S.p.A. et al.* (1999), 45 O.R. (3d) 183 at 190 (Sup.Ct.), appeal dismissed (2000) 49 O.R. (3d) 414 (Ont. C.A.) [Mexico's Authorities, Tab 22]
>
> See also *Quintette Coal Ltd.* v. *Nippon Steel Corp.*, [1991] 1 W.W.R. 219, 50 B.C.L.R. (2d) 207 (C.A.), leave to appeal to S.C.C. refused (1990) 50 B.C.L.R. (2d) xxvii [Mexico's Authorities, Tab 55]

123. The grounds for setting aside an award under the Model Law are derived from Article V of the *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (the "*New York Convention*"). Interpretations of the parallel provisions of the *New York Convention*, to the extent they are consistent with the UNCITRAL working papers discussed below, may be considered when determining applications to set aside awards under the Model Law.

> *Corporacion Transnacional de Inversiones, S.A. de C.V. et al. and STET International, S.p.A. et al.*, *supra*, at 191

124. Authoritative guidance regarding the proper interpretation and application of the Model Law may be derived from the working papers that preceded its implementation. Section 6 of the ICAA specifically provides:

> 6. In construing a provision of this Act, a court or arbitral tribunal may refer to the documents of the United Nations Commission on International Trade Law and its working group respecting the preparation of the UNCITRAL Model Arbitration Law and must give those documents the weight that is appropriate in the circumstances.
>
> *International Commercial Arbitration Act*, *supra*, s. 6

125. Thus, the Report of the United Nations Commission on International Trade Law on the work of its eighteenth session (June 3-21, 1985), the Analytical Commentary contained in

the Report of the United Nations Commission on International Trade Law and the Papers of the Working Group have been referred to when interpreting the Model Law.

> *Report of the United Nations Commission on International Trade Law on the work of its eighteenth session* (Vienna, 3-21 June 1985) (A/40/17), Yearbook 1985, Volume XVI ("Report of the United Nations Commission 1985") [Mexico's Authorities, Tab 91]
>
> *Analytical Commentary on the Draft Text of a Model Law on International Commercial Arbitration, Eighteenth Session of the United Nations Commission on International Trade Law*, supplement *Canada Gazette*, Part I (Ottawa: Queens Printer, 1986) at 105 ("*Analytical Commentary*") [Mexico's Authorities, Tab 82]
>
> Holtzmann and Neuhaus, *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary* (Denver: Kluwer Law and Taxation Publishers, 1989)

D. The Question of Whether the ICAA or the CAA Governs This Petition

126. If the ICAA applies, then the CAA, by its terms, does not. Section 1 of the CAA defines "arbitration agreement" to exclude "an agreement to which the [ICAA] applies". Thus, it is necessary to consider first whether the ICAA applies.

127. The scope of the ICAA is set forth in s. 1. An arbitration falls within the scope of the ICAA if:

(a) the arbitration is "international" [s.1(1), s. 1(3)];

(b) the arbitration is "commercial" [s. 1(1), s. 1(6)]; and

(c) the place of arbitration is British Columbia [s.1(2)].

International Commercial Arbitration Act, *supra*, s. 1

128. All of the three criteria must be satisfied. It is submitted that (b) is not satisfied because this arbitration is not "commercial", as that term is defined by the ICAA.

E. The Meaning of "Commercial" Arbitration under the ICAA

129. By way of a footnote to the term "commercial" as used in the Model Law, UNCITRAL provided some guidance on its meaning:

> The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial

> nature. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business co-operation; carriage of goods or passengers by air, sea, rail or road.
>
> *Analytical Commentary, supra*, Chapter I, Part II, Art. 1 (fn.) at p. 102

In British Columbia, this footnote was, in part, elevated to a definition in s. 1(6) of the ICAA which includes as a "commercial" arbitration:

> (6) An arbitration is commercial <u>if it arises out of a relationship of a commercial nature</u> including, but not limited to, the following:
>
> (a) a trade transaction for the supply or exchange of goods or services;
>
> (b) a distribution agreement;
>
> (c) a commercial representation or agency;
>
> (d) an exploitation agreement or concession;
>
> (e) a joint venture or other related form of industrial or business cooperation;
>
> (f) the carriage of goods or passengers by air, sea, rail or road;
>
> (g) the construction of works;
>
> (h) insurance;
>
> (i) licensing;
>
> (j) factoring;
>
> (k) leasing;
>
> (l) consulting;
>
> (m) engineering;
>
> (n) financing;
>
> (o) banking;
>
> (p) investing. [Emphasis added.]
>
> *International Commercial Arbitration Act, supra*, s. 1(6)

130. The *Analytical Commentary* indicates that UNCITRAL intended that the meaning of "commercial" in the Model Law should be wide but not formally defined. According to the *Analytical Commentary*, it is not material that one of the parties to the commercial relationship is a sovereign state, "provided, of course, the relationship is of a commercial nature".

Analytical Commentary, *supra*, Chapter I, Part II, paragraph 21, p. 107

131. The relationship between investors and States under the NAFTA is not a "commercial" relationship. As was noted above, in *Pfizer Inc.* v. *Canada*, *supra*, international trade agreements, like the NAFTA:

> ... are matters of public law concerning public rights, rights affecting Canada as a sovereign state. They are not matters of private economic or commercial rights ... (at paragraph 55)

F. Dictionary Definitions of "Commercial"

132. In an Alberta case interpreting the Model Law – *Borowski* v. *Heinrich Fieldler Perforiertechnik GmbH*, [1994] 10 W.W.R. 623 (Alta. Q.B.) [Mexico's Authorities, Tab 14] – the court examined dictionary definitions of "commercial" to conclude that the term relates to the buying, selling and exchange of commodities for profit, as follows at 632:

> The following are some dictionary definitions of the terms "commerce", "commercial" and "trade". *The Shorter Oxford English Dictionary*, Third Edition, defines the word "commerce" as "Exchange between men of the products of nature and art; buying and selling together; exchange of merchandise, *esp.* on a large scale between different countries or districts." It defines the word "commercial" as "Engaged in commerce; trading. Of or relating to commerce or trade. Such as passes current in the transactions of commerce. Viewed as a matter of profit and loss." It defines the word "trade" as "Passage or resort for the purpose of commerce; hence, the buying and selling or exchange of commodities for profit; commerce, traffic, trading." *The Random House College Dictionary*, Revised Edition, defines the word "commerce" as "an interchange of goods or commodities, esp. on a large scale; trade; business." It defines the word "commercial" as "pertaining to, or characteristic of commerce, engaged in commerce, prepared, done, or acting with emphasis on saleability, profit or success." It defines the word "trade" as "act or process of buying, selling, or exchanging commodities, at either wholesale or

> retail prices, within a country or between countries; *domestic trade; foreign trade*; business, barter, dealing. TRADE is the general word: a *brisk trade between the nations*. COMMERCE applies to trade on a large scale and over an extensive area." *Webster's Third New International Dictionary* defines the word "commerce" as "the exchange or buying and selling of commodities esp. on a large scale and involving transportation from place to place." It defines the word "commercial" as "of, in or relating to commerce, as occupied with or engaged in commerce; related to or dealing with commerce." It defines the word "trade" as "the business of buying and selling or bartering commodities, exchange of goods for convenience or profit, commerce." The *Gage Canadian Dictionary* defines the word "commerce" as "buying and selling in large amounts between different places; business." It defines the word "commercial" as "of, for or having to do with commerce; made done or operating mainly for profit, especially at the expense of quality, artistic merit, etc." It defines the word "trade" as "the process of buying and selling; exchange of goods; commerce; an exchange; a bargain; business deal." There are other meanings for these words but these are some of the more appropriate in considering the issue in question.
>
> I agree with Hughes J.A. in the case of *New Brunswick (Minister of Municipal Affairs) v. Ashley Colter (1961) Ltd.* (1970), 10 D.L.R. (3d) 502 (N.B.C.A.), at p. 505, that given its ordinary and generally understood meaning, the term "commercial" relates to the buying, selling and exchange of commodities for profit.

133. The Court concluded in *Borowski* that a contract of employment was not a commercial arrangement.

G. The ICAA is Restricted to Contracts or Transactions

134. The restriction of the ICAA to what is generally understood as "commercial" – buying and selling and exchange transactions – is confirmed by s. 28(5) of the ICAA which provides:

> In all cases, the arbitral tribunal must decide in accordance with the terms of the contract and must take into account the usages of the trade applicable to the transaction. [Emphasis added.]

H. Article 1136(7)

135. Article 1136(7) deems Chapter Eleven arbitrations to be "commercial" for the purposes of the *New York Convention* and the *Inter-American Convention on International Commercial Arbitration*, the conventions that deal with enforcement of foreign arbitral awards. The ICAA (and the UNCITRAL Model Law) is not the *New York Convention*, nor is it the *Inter-American Convention*. NAFTA does not state therefore that an arbitration conducted pursuant to Chapter Eleven shall be deemed to be a "commercial arbitration" for purposes of an application to set aside an award (as opposed to enforcement which is quite different). Indeed, the express limitation in Article 1136(7) to the purposes of recognition and enforcement under of the *New York Convention* militates against that interpretation.

> *New York Convention* [Mexico's Authorities, Tab 89]
>
> *Inter-American Convention on International Commercial Arbitration,* Done at Panama, 30 January 1975; entered into force 16 June 1976; Organization of American States, Treaty Series, no. 42 [Mexico's Authorities, Tab 87]

136. It is important to understand what Article 1136(7) was meant to do. All three Parties, when implementing the *New York Convention*, enacted the "commercial" reservation permitted by Article I.[14] Therefore, in the context of the *New York Convention*, Article 1136 (7) was necessary to ensure awards were enforceable. Article 1136(7) was required in NAFTA because, without it, an award made by a Chapter Eleven tribunal would not otherwise fall within the meaning of "commercial" arbitration for the purposes of enforcing the award under the *New York Convention*.

137. The *New York Convention* is restricted to commercial matters, which do not include regulatory relationships.

> *Corcoran, Superintendent of Insurance of the State of New York* v. *Ardra Insurance Co. Ltd.* (1991), 16 Y.B. Comm. Arbn. 663 (N.Y.S.C. App. Div.) [Mexico's Authorities, Tab 21]

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[14] Article I allows a State, when implementing the *Convention*, to declare that it will apply the *Convention* only to differences arising out of legal relationships, whether contractual or not, which are considered commercial under the law of that State.

138. David P. Stewart also states in "National Enforcement of Arbitral Awards Under Treaties and Conventions" in *International Arbitration in the 21st Century: Towards "Judicialization" and Uniformity?* (Lillich and Brauer Editors) (Transnational 1993) [Mexico's Authorities, Tab 126] at p. 195:

> It is sometimes asserted that "mixed" arbitrations between private parties on the one hand and sovereign states, state entities, or parastatals on the other, are not (or ought not to be) subject to the New York Convention when they involve special governmental interests or issues of political dimension, even when arising in the context of otherwise clearly commercial transactions. Such situations might properly occur, it has been said, where breach of contractual terms is effected by political act of the legislature (e.g., through decrees of nationalization or expropriation), or where the dispute arises from state contracts involving permanent sovereignty over natural resources, or where jurisdiction over the respondent is precluded by the doctrines of sovereign immunity or Act of State.

139. The Convention does not affect the setting aside function in the country of the place of the arbitration. Setting aside an award is not dealt with directly in the *New York Convention*. This is left to the national laws of the State chosen as the seat of the arbitration. Acknowledgement of this is to be found in Articles V(i)(e) and VI of the *New York Convention* which make it a ground for not recognizing or enforcing an award which has been set aside by a competent authority of the country in which, or under the law of which, that award was made.

140. As noted by Albert Jan van den Berg *The New York Arbitration Convention of 1958: Towards a Uniform Judicial Interpretation* (Kluwer Law and Taxation: Deventer/Netherlands, 1981) [Mexico's Authorities, Tab 128] at pp. 19 and 20:

> The Convention is limited to the recognition and enforcement of a foreign award. It does not apply in the country in which, or under the law of which, that award was made (the "country of origin").
>
> ... the Convention is not applicable in the action for setting aside the award. This has been unanimously affirmed by the courts.

141. The difference between the grounds for refusal to enforce under the *New York Convention* and the grounds for setting aside an award was emphasized by the authors of *International Chamber of Commerce Arbitration, supra,* at p. 685:

> It is important to remember, however, that the New York Arbitration Convention establishes no criteria for proper or improper vacatur at the arbitral situs. Judicial review of an award at the place where made will be governed by the local arbitration law there in force, which may provide for award vacatur on any ground it sees fit, or for no vacatur at all. Footnote omitted.]
>
> [Mexico's Authorities, Tab 104]

142. This point was recognized by the U.S. Court of Appeals for the Second Circuit in *Yusuf Ahmed Alghanim & Sons, W.L.L.* v. *Toys "R" Us, Inc.; TRU (HK) Limited*, 126 F. 3d 15 (2nd Cir. 1997) [Mexico's Authorities, Tab 70] at 23:

> In sum, we conclude that the Convention mandates very different regimes for the review of arbitral awards (1) in the state in which, or under the law of which, the award was made, and (2) in other states where recognition and enforcement are sought. The Convention specifically contemplates that the state in which, or under the law of which, the award is made, will be free to set aside or modify an award in accordance with its domestic arbitral law and its full panoply of express and implied grounds for relief.

143. The law of the seat of the arbitration governs the procedure, both internal and external, relating to the arbitration. This includes the validity of the award itself. Once set aside, the award is null and void, and therefore not subject to recognition and enforcement in any jurisdiction subject to the *New York Convention*. The NAFTA, referring as it does only to the *New York Convention* and the *Inter-American Convention*, does not concern itself with the law applicable to the setting aside of an arbitral award as this is always left to the law of the place of arbitration.

I. The Federal Model Law

144. In this regard, the *Commercial Arbitration Act*, the federal statute that implements the Model Law for claims against Canada (and which is not restricted to international arbitrations), was amended to provide expressly that an arbitration conducted pursuant to Article 1116 or Article 1117 of Chapter Eleven shall be considered to be a "commercial arbitration". As noted, this provision would be unnecessary if Chapter Eleven arbitrations were already "commercial". The amendment to the federal statute did not extend to NAFTA claims in which

Mexico or the United States were respondents. British Columbia has not chosen to legislate in this manner. There is no equivalent provision in the ICAA that makes a NAFTA claim a "commercial arbitration" for the purposes of the ICAA.

> *Commercial Arbitration Act*, S.C. 1985, c. 17 (2nd Supp.), s. 5(4)

J. The Relationship Between Metalclad and Mexico Was Not Commercial

145. In the instant case, the relationship that Metalclad claimed existed between it and Mexico was not commercial, even by the widest definition of that term. Metalclad claimed relief by reason of allegedly untransparent laws and the Municipality's refusal of a permit to construct the landfill. This relationship between Metalclad and Mexico was the relationship between government and the governed, between legislator and the subject of legislation.

146. Likewise, the relationship between Metalclad and Mexico arising from the provisions of NAFTA Chapter Eleven is not a commercial arbitration agreement. The NAFTA is a treaty. The arbitration relationship arises in this case out of allegations of violation of Section A of Chapter Eleven which are restricted to legislative or administrative acts, the acts of the Municipality and the Federal Government's "tolerance" of those acts, taken in relation to issues of public health and environmental concerns, not in a commercial capacity.

147. In a recent NAFTA Chapter Eleven arbitration, the United States expressed strong doubt as to whether a claim for compensation for expropriation could be said to amount to a commercial arbitration dispute within the meaning of the Model Law, as implemented in Ontario by the *International Commercial Arbitration Act*, R.S.O. 1990, c. I-9. In its submission on the second procedural hearing in *Methanex Corporation* v. *United States of America*, the United States made the following comments with respect to the application of the Model Law to Chapter Eleven arbitrations:

> Section 2(2) of the Ontario International Commercial Arbitration Act applies the Model Law only "to international *commercial* arbitration agreements and awards." (Emphasis supplied) Chapter 11 of the NAFTA, however, is not a commercial arbitration agreement, and given the nature of this dispute – a challenge under

> international law to measures to protect public health and the environment – an award would not easily lend itself to being characterized as commercial.
>
> *Methanex Corporation* v. *United States of America*, Submissions of the United States of America, September 1, 2000, [Mexico's Authorities, Tab 37] at pp. 9-10

148. The United States made a further submission regarding NAFTA Article 1136(7), noted above, stating:

> It is unclear that this provision can be construed to deem Chapter 11 claims as commercial in contexts other than the two conventions specifically identified, and it is far from clear that the claims here could be considered "commercial" for other purposes.
>
> United States' Submission, *supra*, at p. 10, fn. 13

149. On December 31, 2000, the *Methanex* Tribunal gave its written reasons for designating Washington D.C. as the place of arbitration, stating at paragraph 16:

> Further, the Respondent queried (without so contending in this case) whether it was wholly correct to assume that the Canadian Courts would apply the UNCITRAL Model Law to a NAFTA arbitration held in Toronto. The Respondent noted that Section 2(2) of the Ontario International Commercial Arbitration Act applies the Model Law only to *"international commercial arbitration agreements and awards"*; and by itself Chapter 11 of NAFTA is not, of course, a commercial arbitration agreement between the investor-claimant and the respondent-party state. If this legal analysis were correct, which would be decided by the Canadian Courts and not the Tribunal, an award made in Canada could not be challenged or enforced under the UNCITRAL Model Law.

And at paragraph 27:

> Given that the Respondent did not eventually press its query relating to the application to this arbitration of the UNCITRAL Model Law as enacted in Ontario (see above), the Tribunal does not think it right for present purposes to second-guess the approach of the Canadian Courts. It is moreover an important and controversial issue better decided in a case which requires an actual decision by the appropriate tribunal, which is not the present situation in this arbitration. For these reasons, the Tribunal has

> placed no reliance on the query raised but apparently not invoked by the Respondent. No doubt it may be soon resolved in another NAFTA arbitration.
>
> *Methanex Corporation* v. *United States of America*, Decision of the Tribunal on the Place of Arbitration, dated September 7, 2000 [Mexico's Authorities, Tab-37]

150. On January 15, 2001, the *Methanex* Tribunal issued a decision in respect of an application by certain non-governmental organizations to intervene in the arbitration by filing *amicus curiae* briefs.

151. The *Methanex* Tribunal recorded the basis for the non-governmental organizations' petitions:

> 6. These submissions were expanded in the Institute Final Petition. It was argued that there was an increased urgency in the need for *amicus* participation in the light of the award dated 30th August 2000 in *Metalclad Corporation* v. *United Mexican States* and an alleged failure to consider environmental and sustainable development goals in that NAFTA arbitration.

152. In deciding to exercise its discretion under the applicable arbitral rules to permit the *amicus* submissions, the *Methanex* Tribunal held:

> 49. There is an undoubtedly public interest in this arbitration. The substantive issues extend far beyond those raised by the usual transnational arbitration between commercial parties. This is not merely because one of the Disputing Parties is a State: there are of course disputes involving States which are of no greater general public importance than a dispute between private persons. The public interest in this arbitration arises from its subject-matter, as powerfully suggested in the Petitions. There is also a broader argument, as suggested by the Respondent and Canada: the Chapter 11 arbitral process could benefit from being perceived as more open or transparent; or conversely be harmed if seen as unduly secretive. In this regard, the Tribunal's willingness to receive *amicus curiae* submissions might support the process in general and this arbitration in particular; whereas a blanket refusal could do positive harm.

Methanex Corporation v. *United States of America,* Decision of the Tribunal on Petitions From Third Persons to Intervene as "Amici Curiae", dated 15 January 2001 [Mexico's Authorities, Tab 37]

K. The CAA Applies to "Any Other Arbitration Agreement"

153. The application of the CAA is set out in s.2(1) as follows:

> 2. (1) This Act applies to the following:
>
> (a) an arbitration agreement in a commercial agreement;
>
> (b) an arbitration under an enactment that refers to this Act, except insofar as this Act is inconsistent with the enactment regulating the arbitration, or with any rules or procedure authorized or recognized by that enactment;
>
> (c) any other arbitration agreement.

154. "Commercial Agreement" is defined in s. 1 of the CAA but, since s. 2(1)(c) of the CAA makes it applicable as well to "any other arbitration agreement", it is not necessary to examine the definition of "commercial agreement" in any detail; it is enough for the CAA to apply to conclude that the ICAA is not applicable. If the arbitration is not covered by the ICAA, then it is covered by the CAA.

VI. GROUNDS OF REVIEW UNDER THE CAA

A. Extent of Judicial Intervention: Section 32 of the CAA

155. Section 32 of the CAA provides that an arbitral award "... must not be questioned, reviewed or restrained by a proceeding under the *Judicial Review Procedure Act* or otherwise except to the extent provided in this Act."

156. Section 30(3) provides that "except as provided in section 31, the court must not set aside or remit an award on the grounds of error of fact or law on the face of the award."

B. Section 30 of the CAA: Arbitral Error Includes Excess of Jurisdiction

157. Section 30 of the CAA provides that the court may set aside an award if an arbitrator has committed "arbitral error". Section 1 of the CAA defines "arbitral error" as:

> means an error that is made by an arbitrator in the course of an arbitration and that consists of one or more of the following:
> ...
> (c) exceeding the arbitrator's powers.

C. Section 31 of the CAA: Questions of Law with Leave

158. The provisions of s. 31 involve a two-step process. The first step requires the applicant to satisfy the provisions of s. 31(2) that:

(a) the importance of the result of the arbitration to the parties justifies the intervention of the court and the determination of the point of law may prevent a miscarriage of justice;

(b) the point of law is of importance to some class or body of persons of which the applicant is a member, or

(c) the point of law is of general or public importance.

159. If the first step is satisfied, then the second step involves consideration of whether the residual discretion of the court should be exercised by granting leave to appeal.

> *R. & P. West 8th Ave. Ltd.* v. *Mariposa Stores* (1990), 47 B.C.L.R. (2d) 354 (B.C.S.C.) [Mexico's Authorities, Tab 56]

160. An appeal under s. 31 of the CAA is limited to questions of law. The questions of law raised in this case include:

(a) misinterpretation or misapplication of the provisions of Chapter Eleven of the NAFTA;

(b) misapplication of principles of international law; or

(c) acting without any evidence or upon a view of the facts which could not reasonably be entertained.

> See *Marathon Realty Co.* v. *McIntosh Centre Ltd.*, [1993] B.C.J. No. 2540 [Mexico's Authorities, Tab 36] at paragraph 14, where Tysoe, J. considers what amounts to a question of law.

D. Leave to Appeal Should Be Granted in This Case on All Grounds

161. The applicant submits that the conditions of s. 31(2) are met in this case.

162. Paragraph (a) of s. 31(2) is met if the result of the arbitration is sufficiently important to the parties that the expense and time of court proceedings is justified and if the point of law, if decided differently, would have led the arbitrator to a different result.

163. The result is important to the parties to the arbitration. The interpretation of the provisions of Article 1105 and 1110 is important to each NAFTA Party, to their citizens, and to investors of the Parties.

> *Domtar Inc.* v. *Belkin Inc., supra* [Mexico's Authorities, Tab 24] 265, overruled in part *B.C.I.T. (Student Association)* v. *B.C.I.T.*, 2000 BCCA 496 [Mexico's Authorities, Tab 10]

164. The points of law raised do not involve "one of a kind" clauses and their general or public importance is manifest.

165. In *Kovacs* v. *Insurance Corp. of British Columbia* (1994), 23 Admin. L.R. (2d) 142 (B.C.S.C.) [Mexico's Authorities, Tab 32] Meiklem J. said at p.148:

> I am not persuaded to deny leave on discretionary grounds that the intention of the legislation will be thwarted by a proliferation of appeals or the arbitration process rendered less determinative. On the contrary, where arbitrators are called upon to reconcile or distinguish conflicting court decisions on similar issues, in order to determine a point of law of fundamental and wide-ranging general importance, it is desirable that the appeal process be available. Certainty, or at least reliance on binding authority, will strengthen the arbitration process.

166. As the first case to consider judicial review of a Chapter Eleven NAFTA arbitration, this Court should grant leave to Mexico to appeal on the questions of law detailed below and go on to consider the merits of the appeal.

VII. REVIEW UNDER THE ICAA

A. The Grounds of Review Available under the ICAA

167. The ICAA contains a provision similar to s. 32 of the CAA, as follows:

> 5. In matters governed by this Act,
>
> (a) a court must not intervene unless so provided in this Act; and
>
> (b) an arbitral proceeding of an arbitral tribunal or an order, ruling or arbitral award made by an arbitral tribunal must not be questioned, reviewed or restrained by a proceeding under the *Judicial Review Procedure Act* or otherwise except to the extent provided in this Act.

International Commercial Arbitration Act, supra, s. 5

168. Section 34 of the ICAA sets out the grounds on which an award may be set aside:

> 34 (1) Recourse to a court against an arbitral award may be made only by application for setting aside in accordance with subsections (2) and (3).
>
> (2) An arbitral award may be set aside by the Supreme Court only if
>
> (a) the party making the application furnishes proof that
>
> (i) a party to the arbitration agreement was under some incapacity,
>
> (ii) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication of that law, the law of British Columbia,
>
> (iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present the party's case,
>
> (iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the arbitral award which contains decisions on

matters not submitted to arbitration may be set aside, or

(v) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless that agreement was in conflict with a provision of this Act from which the parties cannot derogate, or, failing any agreement, was not in accordance with this Act, or

(b) the court finds that

(i) the subject matter of the dispute is not capable of settlement by arbitration under the law of British Columbia, or

(ii) the arbitral award is in conflict with the public policy in British Columbia.

(3) An application for setting aside may not be made after 3 months have elapsed from the date on which the party making that application had received the arbitral award or, if a request had been made under section 33, from the date on which that request had been disposed of by the arbitral tribunal.

(4) When asked to set aside an arbitral award the court may, if it is appropriate and it is requested by a party, adjourn the proceedings to set aside the arbitral award for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside the arbitral award.

169. By section 34(2)(a) the petitioner bears the burden of establishing that one or more of the grounds specified in s. 34(2)(a) of the ICAA are present. By s. 34(2)(b), the court may, on its own, conclude that the award is in conflict with public policy in British Columbia.

> *Corporacion Transnacional de Inversiones, S.A. de C.V. et al. and STET International, S.p.A. et al., supra*, 45 O.R. (3d) [Mexico's Authorities, Tab 22] at 191

170. Mexico relies on s. 34(2)(a)(iv) (excess of jurisdiction), s. 34(2)(a)(v) (arbitral procedure not in accord with agreement of the parties) and on s. 34(2)(b)(iii) (conflict with public policy).

B. The Application of the ICAA Review of Private International Commercial Arbitration Awards

171. The Court of Appeal's decision in *Quintette Coal Ltd.* v. *Nippon Steel Corp.*, is the leading case in British Columbia considering an application under the ICAA to set aside a private commercial arbitration award. In *Quintette*, the applicant claimed that the arbitral tribunal had decided matters beyond the scope of the question submitted for arbitration. Gibbs J.A. held that the tribunal was correct in its interpretation of the arbitral agreement.

> *Quintette Coal Ltd.* v. *Nippon Steel Corp,. supra* [Mexico's Authorities, Tab 55] at 230

172. In the course of his reasons, Gibbs J.A. noted the need to preserve the parties' autonomy to select the forum of their dispute, and to minimize judicial intervention in the review of private international commercial arbitral awards. Mere error of law or fact will not justify setting aside an award in a private international commercial arbitration.

> *Quintette Coal Ltd.* v. *Nippon Steel Corp., supra*
>
> See also K. Lysyk, "The Enforcement of International Commercial Arbitration Awards in Canada" in *Commercial Mediation and Arbitration in the NAFTA Countries* (Diaz and Oretskin, eds. (1999)) [Mexico's Authorities, Tab 113] where other Canadian cases are reviewed.

173. Gibbs J.A. left open the question of review on the basis of the domestic standard for patently unreasonable error. He said at 230:

> Even applying the domestic test (*Shalansky* v. *Regina Pasqua Hosp. Bd. of Gov.* (1983), ... 145 D.L.R. (3d) 413 ... (S.C.C.)), their interpretation is one which the words of the contract can reasonably bear. The conditions precedent to intervention by the court spelled out in s. 34(2)(a)(iv) of the Act have not been met. The language of the statute forecloses the court from intervention.

174. The case referred to, *Shalansky* [Mexico's Authorities, Tab 61], considered judicial review of a consensual arbitration board involving construction of a collective agreement and noted at p. 416 (D.L.R.):

> The decision of the arbitrator can be set aside only if it involves an interpretation which the words of the agreement could not reasonably bear.

175. The test of fundamental rationality has also been applied by U.S. courts allowing the court to vacate an award on the basis that the arbitrators have "exceeded their powers". Some of the authorities were reviewed by the U.S. Court of Appeals for the Third Circuit in *Swift Industries, Inc.* v. *Botany Industries, Inc.*, 466 F. 2d 1125 (1972 U.S. App.) [Mexico's Authorities, Tab 64] where the court, referring to an earlier decision in *Ludwig Honold Mfg. Co.* v. *Fletcher*, 405 F. 2d 1123 (3rd Circ. 1969) [Mexico's Authorities, Tab 35] stated at p. 1131:

> ... in holding that an arbitrator's award does not draw its essence from the agreement if the arbitrator's interpretation cannot be rationally derived therefrom, *Honold* has, in addition to limiting the arbitrator's authority to fashion relief, also established that an award may not stand if it does not meet the test of fundamental rationality. The New York Court of Appeals, whose opinions are the source of much instruction in this field, has held that an award of an arbitrator is not subject to judicial revision unless it is "completely irrational," Lentine v. Fundaro, 29 N.Y. 2d 382, 328 N.Y.S. 2d 418, 278 N.E. 2d 633 (1972). We consider this formulation to be a fair reading of *Honold*. In any event, it is an accurate statement of the law.

176. Earlier in the decision, similar principles are said to be consistent with the power of a court to vacate an award when the arbitrators have "exceeded their powers".

177. There is a presumption of enforcement of private commercial awards under the Model Law but that presumption is not unconditional. The purpose of the Model Law has been described as "to establish a climate where international commercial arbitration can be resorted to with confidence by parties from different countries on the basis that if the arbitration is conducted in accordance with the agreement of the parties, an award will be enforceable if no defences are successfully raised under arts. 35 and 36".

> See *Schreter* v. *Gasmac Inc.* (1992), 89 D.L.R. (4th) 365 at 375 (Gen. Div.), supplemental reasons at 89 D.L.R. (4th) 380 [Mexico's Authorities, Tab 59]

C. Different Factors Applicable to Investor-State Arbitrations of International Treaty Obligations

178. In *The Law and Practice of Commercial Arbitration in England*, Sir Michael J. Mustill and Stewart C. Boyd, 2nd ed. (Butterworths: London, 1989) [Mexico's Authorities, Tab

117], at p. 54, warn against reliance on generalized authorities to different types of arbitrations, stating:

> Furthermore, when considering a reported case it is necessary always to bear in mind the type of arbitration with which it was concerned. Decisions and statements of principle which were perfectly valid at the time, and remain good law today, may nevertheless yield completely false results if applied in a different context. A commodity arbitration on quality and a formal reference pursuant to statutory powers are both examples of arbitration, but they are barely recognizable as the same process, and attempts to transfer principles from one to the other will inevitably lead to error.[15]

179. As they applied to the case before the Court, Mexico takes no issue with the reasons of the Court of Appeal in *Quintette*, or the general approach taken to review of arbitrations between private parties under an arbitration clause in a commercial agreement. However, there are aspects of that approach and the policy considerations that underlie it, which do not govern this Petition, which arises from a mixed arbitration between an investor and a sovereign State regarding alleged breaches of a trilateral trade agreement. This is a dispute brought by a private party against a State that challenges sovereign acts under international law and implicates substantial public interests, including public health and environmental issues.

180. These factors have a bearing on the question of jurisdiction. *Quintette* emphasized that where a private commercial tribunal's jurisdiction is called into question, an applicant must overcome "a powerful presumption" that the tribunal acted within its powers.

> *Quintette Coal Ltd.* v. *Nippon Steel Corp., supra*, at p. 223.

181. *Quintette* did not involve an arbitration involving a sovereign State. The powerful presumption of jurisdiction referred to therein is inapplicable where a sovereign State is involved. As noted in *Southern Pacific Properties (Middle East) Limited* v. *Arab Republic of Egypt, supra*, in its award on jurisdiction, dated April 14, 1988, the Tribunal stated at p. 143:

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[15] Recently quoted in *Powell River (District)* v. *Ready*, [1993] B.C.J. No. 384 [Mexico's Authorities, Tab 53] at p. 6.

> Clearly, then, there is no presumption of jurisdiction – particularly where a sovereign State is involved – and the Tribunal must examine Egypt's objections to the jurisdiction of the Centre with meticulous care, bearing in mind that jurisdiction in the present case exists only insofar as consent thereto has been given by the Parties. [Emphasis added.]

182. Given the Parties' limited consent to arbitration in NAFTA Chapter Eleven, the need to confirm jurisdiction has been accepted by NAFTA Tribunals.

> *Waste Management, Inc.* v. *The United Mexican States, supra* [Mexico's Authorities, Tab 69] at § 16
>
> *Ethyl* v. *Canada*, 28 November 1997, Yearbook XXIV 211; 24 June 1998, Yearbook XXIV 219 [Mexico's Authorities, Tab 25] at 222-223

183. In any event, any presumption of jurisdiction is rebuttable. In William W. Park's article "Determining Arbitral Jurisdiction: Allocation of Tasks Between Courts and Arbitrators" (1997) 8 Am. Rev. Int'l. Arb. 133 [Mexico's Authorities, Tab 119] at 145 it is stated:

> In no event should a blanket presumption of arbitrability take the place of an inquiry into what exactly the litigants agreed to arbitrate as interpreted in the context of the relevant transaction. Shallow judicial examination of an arbitrator's jurisdiction can make little sense either in logic or in policy, and in the long run may result in the business community's loss of confidence in both arbitration and the judiciary that enforces the arbitral process.

And previously at p. 144:

> Judges reserve to themselves the job of delineating an arbitrator's power, for the simple reason that the parties' grant of arbitral jurisdiction on any given issue is the basic ingredient of valid waiver of a day in court. As long as one side calls upon government power to support the arbitral process, arbitrators (or alleged arbitrators) can never have the final word on their jurisdiction, since the extent of their authority is the very issue presented to courts asked to enforce arbitration agreements and awards.

184. There are other reasons to distinguish judicial review of the typical private commercial arbitration. One of the reasons for a narrow interpretation of the grounds for review of private commercial arbitration awards is that they do not have any public policy ramifications.

As simply the resolution of private disputes, where, often, even the existence of the dispute is not public and awards are not published, they do not create a body of law which could affect others.

185. This rationale is not applicable in the context of the interpretation of an international treaty such as the NAFTA where incorrect or unreasonable decisions will have significant public policy ramifications in all of the jurisdictions of the Parties. Such decisions will lead to an increase in claims against all three NAFTA Parties.

186. Within a month of its being rendered, this unprecedented Award was cited to four NAFTA Chapter Eleven tribunals, in claims against all three Parties.[16]

D. Excess of Jurisdiction: Award Based on Matters Beyond the Scope of Submission to Arbitration

187. As noted, s. 34(2)(a)(iv) of the ICAA provides that the Court may set aside the Award where it,

> deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, ...
>
> *International Commercial Arbitration Act, supra*, s. 34(2)(a)(iv)

188. The Court must review the provisions of NAFTA and the reasons underlying the Award to determine whether the Tribunal proceeded to consider an issue not properly before it.

> *Tiong Huat Rubber Factory (SDN) BHD* v. *Wah-Chang International Company Limited (China)*, reported in (1992) XVII Y.B. Comm. Arbn. 516 (Hong Kong Court of Appeal) [Mexico's Authorities, Tab 65]
>
> *Aamco Transmission Inc.* v. *Kunz,* [1991] S.J. No. 404 (C.A.) [Mexico's Authorities, Tab 2]
>
> *Parsons & Wittemore Overseas Co. Inc.* v. *Papier*, 508 F. 2d 969 (2nd Cir. 12/13/1974) [Mexico's Authorities, Tab 47]
>
> *Fertilizer Corporation of India et al.* v. *IDI Management, Inc.*, 517 F.Supp. 948 (S.D. Ohio 1981); rehearing denied, 530 F.Supp. 542 (S.D. Ohio 1982) [Mexico's Authorities, Tab 27]

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[16] *The Loewen Group Inc. and Raymond L. Loewen* v. *United States of America*, *Feldman* v. *United Mexican States*, *S.D. Myers Inc.* v. *Canada* and *Pope & Talbot, Inc.* v. *Canada.*

National Oil Corp. v. *Libyan Sun Oil Company*, 733 F. Supp. 800 (U.S. Dist. 1990) [Mexico's Authorities, Tab 43]

E. Agreement on Procedure: The Tribunal's Failure to Comply with Article 53 of the Additional Facility Rules

189. As noted, s. 34(2)(a)(v) of the ICAA provides that the Court may set aside the Award where:

> ... the arbitral procedure was not in accordance with the agreement of the parties ...

190. The arbitral procedure agreed upon included Article 53 of the Additional Facility Rules which imposed a mandatory requirement on the Tribunal to "deal with every question submitted to the Tribunal".[17]

F. Enforcement of an Award that Conflicts with Public Policy

191. Section 34(2)(b)(ii) of the ICAA provides that the Court may set aside the Award where it "is in conflict with the public policy in British Columbia".

International Commercial Arbitration Act, supra, s. 34(2)(b)(ii)

192. The *Report of the United Nations Commission 1985, supra*, describes what was intended by the addition of a ground for review based on the relationship between the Award and the public policy of the State in which the Award was sought to be set aside:

> 296. In discussing the term "public policy", it was understood that it was not equivalent to the political stance or international policies of the State but comprised the fundamental notions and principles of justice...
>
> 297. ... It was understood that the term "public policy" which was used in the 1958 *New York Convention* and many other treaties, covered fundamental principles of law and justice in substantive as well as procedural respects. Thus, instances such as corruption, bribery or fraud and similar serious cases would constitute a ground for setting aside. It was noted, in that connection, that the wording "the award is in conflict with the public policy of the State" was not to be interpreted

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[17] In the adequacy-of-reasons context, there is a decision that appears to distinguish the "award" from the "procedure" in interpreting Section 34(2)(a)(v): see *Food Services of America Inc.* v. *Pan Pacific Specialties Ltd.* (1997), 32 B.C.L.R. (3d) 225 (B.C.S.C.) [Mexico's Authorities, Tab 28].

> as excluding instances or events relating to the manner in which an award was arrived at.
>
> *Report of the United Nations Commission 1985, supra*, paragraphs 296-97

193. The "public policy" ground was therefore intended by UNCITRAL to allow reviewing courts to set aside awards where those awards violated the "fundamental principles of law and justice, both questions on the merits and procedural issues".

> *Report of the United Nations Commission 1985, supra*, paragraph 297

194. In *Corporacion Transnacional de Inversiones, S.A. de C.V.* v. *STET International, S.p.A., supra*, at 194:

> Under the Model Law, the concepts of fairness and natural justice enunciated in Article 18 significantly overlap the issues of inability to present one's case and conflict with public policy set out in Articles 34(2)(a)(ii) and (b)(ii). Since Article 34(2)(b)(ii) is to be interpreted to include procedural as well as substantive justice and is not to exclude the manner in which an award is arrived at, it seems to me that the grounds for challenging an award under Article 18 are the same as they are under Article 34(2)(b)(ii). Accordingly, in order to justify setting aside an award for a violation of Article 18, the conduct of the Tribunal must be sufficiently serious to offend our most basic notions of morality and justice.
>
> Instances of corruption, bribery or fraud referred to in the *Report of the United Nations* would not only offend the essential morality of Ontario, but would offend shared notions of justice that are common to legal systems throughout the world. No court would hesitate to set aside an award arrived at in this manner. In considering other kinds of conduct, it is important to bear in mind that the *Report of the United Nations* may be used as an interpretive aid to the Model Law and it refers to "similar serious cases". In my view, this contemplates that judicial intervention for alleged violations of the due process requirements of the Model Law will be warranted only when the Tribunal's conduct is so serious that it cannot be condoned under the law of the enforcing state.

195. The "public policy" ground for setting aside under the Model Law (and for resisting enforcement under the *New York Convention*) has been construed strictly. Courts have

adopted the principle that interference is only justified where enforcement would violate the "most basic notions of morality and justice" would offend "our local principles of justice and fairness in a fundamental way".

> *Parsons & Whittemore Overseas Co. Inc.* v. *Papier, supra*
>
> *Schreter* v. *Gasmac Inc., supra*
>
> *Corporacion Transnactional de Inversiones, S.A. de C.V. et al. and STET International, S.p.A. et* al., *supra*
>
> Booysen, "The Municipal Enforcement of Arbitration Awards Against States in Terms of Arbitration Conventions, with Special Reference to the *New York Convention*: Does International Law Provide for a Municipal Law Concept of an Arbitrable Act of State?" (1986), 12 *So.Afr.Yearbook Int'l L.* 73 at 98 [Mexico's Authorities, Tab 97]

196. Public policy review does not permit the court to reopen the merits of legal issues. In *Schreter* v. *Gasmac Inc., supra*, at 379:

> ... if this Court were to endorse the view that it should reopen the merits of an arbitral decision on legal issues decided in accordance with the law of a foreign jurisdiction and where there has been no misconduct, under the guise of ensuring conformity with the public policy of this province, the enforcement procedure of the Model Law could be brought into disrepute.

197. The primary justification for the narrow approach is that it would create an unworkable enforcement regime if domestic concepts of public policy were to be applied to awards made in another jurisdiction according to the standards of that jurisdiction.

> *Parsons & Whittemore Overseas Co. Inc.* v. *Papier, supra*

G. Canada's Basic Notions of Justice – Patently Unreasonable Error and Loss of Jurisdiction

198. In *Navigation Sonamar Inc.* v. *Algoma Steamships Ltd.*, Gonthier J. (sitting as a Justice of the Quebec Superior Court) in the first decision to consider the Model Law reviewed the *UNCITRAL Analytical Commentary* and Report and considered the meaning of "public policy". He held that the "fundamental principles of law and justice" inherent in the Model Law's use of the term "public policy" included the principle that a tribunal was not permitted to exceed its jurisdiction in the course of its inquiry. He also referred to the basic principle of

Canadian justice that it can be "jurisdictional" error to reach a result by a process of reasoning that is patently unreasonable.

> *Navigation Sonamar Inc.* v. *Algoma Steamships Ltd.*, [1987] R.J.Q. 1346; (1995), 1 M.A.L.Q.R. 1 (Que.S.C.) [Mexico's Authorities, Tab, 44]

199. Gonthier J. stated:

> Counsel for the applicant recognizes that a simple error of law cannot justify setting aside the award because that would mean examining the merits of the dispute. Rather, he relies on a patent absence of applicable law, claiming that the effect of the award is to disregard the law and the parties' agreement. He seems to be invoking the notion of a patently unreasonable error, which Mr. Justice Beetz, in *Blanchard* v. *Control Data Canada Ltd.*, [[1984] 2 S.C.R. 476 at 479] described as an abuse of authority amounting to fraud and of such a nature as to cause a flagrant injustice. The Court of Appeal, quoted by Mr. Justice Beetz at the same page, had described as follows the error which it saw in that case: "[the arbitrator] committed an excess of jurisdiction by giving the facts an unreasonable interpretation: his award was totally lacking in reality and contrary to public order. . . [it] constituted a flagrant denial of justice...". One may refer to the formulation of the Supreme Court in Canadian Union of Public Employees Local 963 v. New Brunswick Liquor Corporation [[1979] 2 S.C.R. 227]: "Put another way, was the Board's interpretation so patently unreasonable that its construction cannot be rationally supported by the relevant legislation and demands intervention by the court upon review?"
>
> *Navigation Sonamar Inc.* v. *Algoma Steamships Ltd.*, *supra*, at p. 19

200. As noted above, Gibbs J.A., in *Quintette*, *supra*, left open the question of review for patently unreasonable error. Gonthier J. referred in his reasons to the Canadian jurisprudence governing jurisdictional errors by administrative tribunals, consensual arbitrators, and statutory bodies protected by privative clauses. He concluded that a patently unreasonable error, amounting to an excess of jurisdiction such that the tribunal's findings of fact could not be rationally supported, would permit setting aside by the Court to preserve "public policy" (although he did not find such error in that case).

201. Review for patently unreasonable error can be seen as one variety of excess of jurisdiction, or can be seen as an independent ground for setting aside an award that conflicts

with public policy. Gonthier J. refers to both bases in *Navigation Sonomar Inc.* v. *Algoma Steamships Ltd.*, [1987] R.J.Q. 1346; (1995), 1 M.A.L.Q.R. 1 (Que. S.C.).

VIII. STANDARD OF REVIEW: THE PRAGMATIC AND FUNCTIONAL ANALYSIS

A. Introduction

202. To determine the proper standard of review applicable to decisions of bodies which otherwise had jurisdiction to proceed to an inquiry, the Supreme Court of Canada has adopted a "pragmatic and functional" approach. The over-arching question examines the constating documents to determine whether it was intended that the body should make the final decision, and the nature of the Court's role.

> *U.E.S., Local 298* v. *Bibeault*, [1988] 2 S.C.R. 1048 [Mexico's Authorities, Tab, Tab 68]
>
> *Pezim* v. *British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 [Mexico's Authorities, Tab 49]
>
> *Canada (Director of Investigations and Research)* v. *Southam Inc.*, [1997] 1 S.C.R. 748 [Mexico's Authorities, Tab 17]
>
> *Pushpanathan* v. *Canada (Minister of Citizenship and Immigration)*, [1998] 1 S.C.R. 982 [Mexico's Authorities, Tab 54]

203. Relevant factors to consider when undertaking the pragmatic and functional analysis, none of which is dispositive, include:

(a) the presence or absence of a privative clause (including the type of clause);

(b) the relative expertise of the tribunal, as compared to the Court;

(c) the nature of the decision being made, i.e. whether it is a question of law or a question of fact;

(d) whether the decision to be made is "polycentric", i.e. necessarily involves a consideration of often-conflicting and multi-facetted issues;

(e) the purpose of the provision and the constating documents more generally;

> *Baker* v. *Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817 [Mexico's Authorities, Tab 7] at 855
>
> *Pushpanathan* v. *Canada (Minister of Citizenship and Immigration)*, *supra*, at pp. 1005-12

204. The applicable standard of review is located on a spectrum, ranging from "correctness" at one end – where the tribunal must resolve the question before it correctly in order to stay within its jurisdiction – and "patent unreasonableness" at the other end – where the tribunal's decision will be upheld unless it is patently unreasonable. In the centre of the spectrum lies the standard of "*reasonableness simpliciter*". The standard of *reasonableness simpliciter* is closely akin to the "clearly wrong" test utilized by appellate courts in reviewing findings of fact by trial judges.

> *Baker* v. *Canada (Minister of Citizenship and Immigration), supra,* at 1005
>
> *Canada (Director of Investigation and Research)* v. *Southam Inc., supra,* at 776-7, 779

205. A decision of a tribunal that is subject to a "full" privative clause (one that declares that decisions of the tribunal are final and conclusive from which no appeal lies and all forms of judicial review are excluded) is still reviewable if the decision is patently unreasonable or if the tribunal has made an error in the interpretation of a provision limiting the tribunal's powers.

> *Pasiechnyk* v. *Saskatchewan (Workers' Compensation Board),* [1997] 2 S.C.R. 890 [Mexico's Authorities, Tab 48] at 904
>
> A patently unreasonable error requires review by the courts as it constitutes an excess of the tribunal's jurisdiction.
>
> *Pointe-Claire (City)* v. *(Quebec) Labour Court,* [1997] 1 S.C.R. 1015 [Mexico's Authorities, Tab 51] *per* L'Heureux-Dube J., at paragraph 68, dissenting in the result but not on this point.

206. To determine whether a decision is patently unreasonable it must be asked whether the decision was based on the evidence adduced and whether the interpretation was patently unreasonable. This can involve an examination of the reasons for the decision and the result of the decision: see *Pointe-Claire*, at paragraph 30, paragraphs 58-59.

B. The "Correctness" Standard

207. Where the standard of review is correctness, the tribunal is not entitled to any deference whatsoever. It must be correct, or its decision will be set aside. The Court is entitled to substitute its own views for those of the original decision-maker.

Nanaimo (City) v. *Rascal Trucking Ltd.*, [2000] 1 S.C.R. 342 [Mexico's Authorities, Tab 41] at p. 355

208. Where the question at issue concerns a constating provision that limits the tribunal's powers, the standard of review is that of correctness. The point was made by the Supreme Court of Canada in *U.E.S., Local 298* v. *Bibeault, supra,* at 1086:

> It is, I think, possible to summarize in two propositions the circumstances in which an administrative tribunal will exceed its jurisdiction because of error:
>
> 1. if the question of law at issue is within the tribunal's jurisdiction, it will only exceed its jurisdiction if it errs in a patently unreasonable manner; a tribunal which is competent to answer a question may make errors in so doing without being subject to judicial review;
>
> 2. if however the question at issue concerns a legislative provision limiting the tribunal's powers, a mere error will cause it to lose jurisdiction and subject the tribunal to judicial review.

209. In *Canadian Union of Public Employees Local 963* v. *New Brunswick Liquor Corporation*, [1979] 2 S.C.R. 227 [Mexico's Authorities, Tab 19], Dickson J., as he then was, stated at 237:

> It is contended ... that the Board, although possessing "jurisdiction in the narrow sense of authority to enter upon an inquiry", in the course of that inquiry did "something which takes the exercise of its powers outside the protection of the privative ... clause". In the *Nipawin* case [[1975] 1 S.C.R. 382], in a unanimous judgment of this Court, it was held that examples of such error would include, at p. 389:
>
> > "... acting in bad faith, basing the decision on extraneous matters, failing to take relevant factors into account, breaching the provisions of natural justice ..."

210. A failure on the part of an arbitrator to take relevant factors into account can cause the arbitrator to lose the jurisdiction which had been conferred by the parties by their arbitration agreement: see *C.P. Air Lines Ltd.* v. *Can. Air Line Pilots Assn.* (1987), 21 B.C.L.R. (2d) 340 [Mexico's Authorities, Tab 23] where Macdonald J. said at 344:

> I consider that to be a failure on the part of the board to take relevant factors into account, a determination of the question without addressing an essential issue. It was such a failure as to cause the board to lose the jurisdiction which had been conceded by both parties at the outset of the arbitration hearing.

C. The "Reasonableness *Simpliciter*" Standard

211. The "reasonableness *simpliciter*" standard is in the centre of the spectrum of possible standards of review. Iacobucci J. in *Canada (Director of Investigation and Research)* v. *Southam Inc., supra*, defined it as follows:

> This test is to be distinguished from the most deferential standard of review, which requires courts to consider whether a tribunal's decision is patently unreasonable. An unreasonable decision is one that, in the main, is not supported by any reasons that can stand up to a somewhat probing examination. Accordingly, a court reviewing a conclusion on the reasonableness standard must look to see whether any reasons support it. The defect, if there is one, could presumably be in the evidentiary foundation itself or in the logical process by which conclusions are sought to be drawn from it. An example of the former kind of defect would be an assumption that had no basis in the evidence, or that was contrary to the overwhelming weight of the evidence. An example of the latter kind of defect would be a contradiction in the premises or an invalid inference.
>
> *Canada (Director of Investigation and Research)* v. *Southam, supra,* at pp. 776-77

212. Iacobucci J. noted the distinction between the "reasonableness *simpliciter*" standard and the "patent unreasonableness" standard:

> The difference between "unreasonable" and "patently unreasonable" lies in the immediacy or obviousness of the defect. If the defect is apparent on the face of the tribunal's reasons, then the tribunal's decision is patently unreasonable. But if it takes some significant searching or testing to find the defect, then the decision is unreasonable but not patently unreasonable. As Cory J. observed in *Canada (Attorney General) v. Public Service Alliance of Canada*, [1993] 1 S.C.R. 941, at p. 963, "[i]n the Shorter Oxford English Dictionary 'patently', an adverb, is defined as 'openly, evidently, clearly'". This is not to say, of course, that judges reviewing a decision on the standard of patent unreasonableness

> may not examine the record. If the decision under review is sufficiently difficult, then perhaps a great deal of reading and thinking will be required before the judge will be able to grasp the dimensions of the problem. See *National Corn Growers Assn. v. Canada (Import Tribunal)*, [1990] 2 S.C.R. 1324, at p. 1370, *per* Gonthier J.; see also *Toronto (City) Board of Education v. O.S.S.T.F., District 15*, [1997] 1 S.C.R. 487, at para. 47, *per* Cory J. But once the lines of the problem have come into focus, if the decision is patently unreasonable, then the unreasonableness will be evident.
>
> *Canada (Director of Investigation and Research)* v. *Southam, supra*, at p. 777

D. The "Patently Unreasonable" Standard

213. The Supreme Court of Canada has repeatedly affirmed that the enforcement of a patently unreasonable decision would violate the most basic notions of justice. The "patently unreasonable" standard of review has been defined in various ways.

214. Recently, Bastarache J., dissenting in the result, but not on this point, said:

> There is no doubt that the patently unreasonable test sets a high standard of review: *Canada (Attorney General)* v. *Public Service Alliance of Canada*, [1993] 1 S.C.R. 941 at pp. 963-64, 101 D.L.R. (4th) 673. Nevertheless, a decision is patently unreasonable if it gives to the section of an Act a meaning which the words of a statute cannot reasonably bear: *Canadian Broadcasting Corp.* v. *Canada (Labour Relations Board)*, [1995] 1 S.C.R. 157, 121 D.L.R. (4th) 385, at para. 62.
>
> *Ajax (Town)* v. *C.A.W., Local 222* (2000), 185 D.L.R. (4th) 618 [Mexico's Authorities, Tab 3] at 623

215. In *Canadian Union of Public Employees Local 963* v. *New Brunswick Liquor Corporation*, as noted by Gonthier J. in *Navigation Sonomar Inc.* v. *Algoma Steamships* Ltd., Dickson J. (as he then was), framed it this way:

> Did the board. . . so misinterpret the provisions of the Act as to embark on an inquiry or answer a question not remitted to it? Put another way, was the Board's interpretation so patently unreasonable that its construction cannot be rationally supported by the relevant legislation and demands intervention by the court upon review?

Canadian Union of Public Employees Local 963 v. *New Brunswick Liquor Corporation, supra*, at p. 237

216. The task of the Court when assessing a decision for patent unreasonableness has also been described as follows:

> The Court must ... ask whether the administrative tribunal's decision was based on the evidence adduced and whether its interpretation of the legislative provisions was patently unreasonable.
>
> *Pointe-Claire (City)* v. *Quebec (Labour Court), supra*, [Mexico's Authorities, Tab 51] at p. 1037
>
> *Lester (W.W.) (1978) Ltd.* v. *United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry, Local 740*, [1990] 3 S.C.R. 644 [Mexico's Authorities, Tab 33] at 669

217. In some cases, "patent unreasonableness" has been construed to require an assessment of whether the tribunal's decision is "clearly irrational".

> *Ajax (Town)* v. *C.A.W., Local 222, supra*, at 621
>
> *Canada (Attorney General)* v. *Public Service Alliance of Canada*, [1993] 1 S.C.R. 941 [Mexico's Authorities, Tab 16] at 963-4

218. When determining whether a tribunal's decision is patently unreasonable, it is often necessary to examine closely the factual and legislative record. As Gonthier J. held in *National Corn Growers Assn.* v. *Canada (Import Tribunal)*,

> In some cases, the unreasonableness of a decision may be apparent without detailed examination of the record. In others, it may be no less unreasonable but this can only be understood upon an in-depth analysis. Such was the case in the *C.U.P.E.* decision where it was found that the Board's interpretation of the legislation at issue was reasonable even though it was not the only reasonable one. Similarly, understanding of the issues raised by the appellants herein as to the reasonableness of the Tribunal's decision requires some analysis of the relevant legislation and the way in which the Tribunal has interpreted and applied it to the facts.
>
> *National Corn Growers Assn.* v. *Canada (Import Tribunal)*, [1990] 2 S.C.R. 1324 [Mexico's Authorities, Tab 42] at 1370

Although the inquiry is whether the decision was patently unreasonable, it may be that "a great deal of reading and thinking will be required before the judge will be able to grasp the dimensions of the problem".

> *Canada (Director of Investigation and Research)* v. *Southam Inc.*, *supra*, at p. 777

219. In *Beazer East, Inc.* v. *British Columbia (Environmental Appeal Board)*, 2000 BCSC 1698 [Mexico's Authorities, Tab 11], Tysoe J. said at paragraph 41:

> The difference between "unreasonableness" and "patent unreasonableness" is demonstrated in *Kovach* v. *British Columbia (Workers' Compensation Board)*, [2000] 1 S.C.R. 55, a decision in which the Supreme Court of Canada allowed the appeal substantially for the dissenting reasons of Donald J.A. in the B.C. Court of Appeal (*Re Kovach* (1998), 52 B.C.L.R. (3d) 98). In contrast to the standard of reasonableness *simpliciter*, which involves a "somewhat probing examination", Donald J.A. stated that the review test for patent unreasonableness is whether the result is patently unreasonable, irrespective of whether there may be defects in the tribunal's reasoning (at p. 112).

E. Beyond Patent Unreasonableness – Absurdity

220. In discussing patent unreasonableness in the interpretation of statutes, L'Heureux-Dubé J., speaking for herself, also examined the concept of absurdity in the construction of statutes, as follows:

> The meaning of "absurdity" has been examined in P.-A. Côté, *The Interpretation of Legislation in Canada* (2nd ed. 1991), at pp. 378-380:
>
> > An interpretation is considered absurd if it leads to ridiculous or frivolous consequences.
> >
> > ...
> >
> > Another approach considers "absurd" to be synonymous with *extremely unreasonable* or inequitable: in other words, a result which cannot be imputed to a fair and reasonable legislator.

...

> "Absurd" can also be used to mean something illogical, incoherent or incompatible with other provisions or with the object of the legislative enactment. [Italics and underlining added.]

Thus, an absurd interpretation is synonymous with extreme unreasonableness which, in my view, is even greater unreasonableness than patent unreasonableness, let alone correctness. Accordingly, where an administrative tribunal contrives an absurd interpretation, it commits an error of law that warrants judicial intervention pursuant to any standard of review. [Emphasis in original.]

Pointe-Claire (City) v. *(Quebec) Labour Court, supra,* at paragraph 90

F. Summary

221. A patently unreasonable decision is one in which the tribunal has, *inter alia*:

(a) given an interpretation which the words cannot reasonably bear;

Canadian Broadcasting Corp. v. *Canada (Labour Relations Board),* [1995] 1 S.C.R. 157 [Mexico's Authorities, Tab 18A] at paragraph 62

(b) failed to have regard to relevant evidence;

Canadian Union of Public Employees Local 963 v. *New Brunswick Liquor Corporation, supra* [Mexico's Authorities, Tab 19]

Service Employees' International Union, Local No. 333 v. *Nipawin District Staff Nurses Assn.*, [1975] 1 S.C.R. 382 [Mexico's Authorities, Tab 60]

Canadian Broadcasting Corporation v. *Burkett, et al.* (1997), 155 D.L.R. (4th) 159 (Ont. C.A.) [Mexico's Authorities, Tab 18]

C.P. Air Lines Ltd. v. *Can. Air Line Pilots Assn., supra* [Mexico's Authorities, Tab 23] at 344 (S.C.)

(c) made a finding of fact for which there is no supporting evidence;

Blanchard v. *Control Data Canada Ltd.,* [1984] 2 S.C.R. 476 [Mexico's Authorities, Tab 13]

Toronto (City) Board of Education v. *O.S.S.T.F., District 15,* [1997] 1 S.C.R. 487 [Mexico's Authorities, Tab 66]

Morrell v. *New Brunswick,* [1999] N.B.J. No. 62 (C.A.) [Mexico's Authorities, Tab 40]

(d) made a finding of fact that is so contrary to the evidence that a reasonable person would not have made it; or

Morrell v. *New Brunswick, supra*

(e) breached the provisions of natural justice or important rules of procedure.

Canadian Union of Public Employees Local 963 v. *New Brunswick Liquor Corporation, supra*

Service Employees' International Union, Local No. 333 v. *Nipawin District Staff Nurses Assn., supra*

222. Patent unreasonableness has also been considered in the context of remedies. The Supreme Court of Canada has held that a remedial order will be considered patently unreasonable where, for example, there is no rational connection between the breach, its consequences and the remedy.

Royal Oak Mines Inc. v. *Canada (L.R.B.)*, [1996] 1 S.C.R. 369 [Mexico's Authorities, Tab 57]

G. Application of the Pragmatic and Functional Analysis to Determining the Standards of Review in this Case

223. As noted above, the following factors are to be taken into account when applying the pragmatic and functional approach to determining the standards of review:

(a) privative clauses;

(b) expertise;

(c) purpose of the provisions as a whole, and the purpose of the provisions in particular; and

(d) the nature of the problem.

In the search for privative clauses in the case of a consensual arbitration tribunal, it is necessary to examine:

(a) the arbitration agreement and applicable arbitral rules; and

(b) the legislation governing the arbitration.

The arbitration agreement replaces the constating legislation of an administrative tribunal in determining the scope of the powers conferred on the tribunal and informs the nature of the problem. The applicable arbitral rules may bear on expertise and the governing law may contain privative clauses and other relevant factors.

224. In this case, the arbitration agreement is formed by an investor's acceptance of the standing offer to arbitrate contained in Chapter Eleven of the NAFTA. This is done by filing a notice of claim that also stipulates the applicable arbitral rules.

225. Chapter Eleven does not contain a "full" privative clause (one that declares that decisions of the tribunal are final and conclusive from which no appeal lies and all forms of judicial review are excluded). Instead, it contemplates judicial review (in the case of ICSID Additional Facility and UNCITRAL arbitrations) in the courts of the place of arbitration, or ad hoc committee revision or annulment (in the case of ICSID arbitrations), with an automatic stay of enforcement pending review and further appeal.

226. Article 9 of the ICSID Arbitration (Additional Facility) Rules requires that arbitrators "shall be persons of high moral character and recognized competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment". There is no issue in this case that the Arbitrators possessed these requirements.

227. Expertise has been described as the most important of the factors the court must consider. This is a relative concept closely related to the nature of the problem. A decision which involves the application of a highly specialized technical expertise will militate in favour of a high degree of deference.

228. The questions raised before a Chapter Eleven tribunal involve questions of fact, questions of mixed law and fact and questions of international law. They can involve interpretation of the text of a new treaty and applicable rules of international law. Unlike WTO panels, ad hoc NAFTA tribunals have no professional secretariat to assist them in marshalling the evidence for the award (which was voluminous in this case) or analyzing the legal issues and assisting in drafting the award.

229. The purpose of Chapter Eleven as a whole is to provide arbitral adjudication of the substantive obligations of Section A of Chapter Eleven by a neutral tribunal, which itself is subject to review by a domestic court or by an ad hoc annulment ICSID committee, and to remove Chapter Eleven damages claims from the domestic courts of the State of the investment at the instance of the investor.

230. Another important point in determining the nature of the problem is whether the result is of any interest beyond the immediate parties to the arbitration. In this respect, a Chapter Eleven arbitration is completely unlike the case of an ad hoc private commercial arbitration where the result is not apt to be of much interest to others in the future. The work of NAFTA tribunals, and the work of the reviewing courts of the three Parties, is of intense and general interest to the Parties, their citizens and their investors given the generality of the application of the questions involved.

> *Methanex Corporation* v. *United States of America,* Decision of the Tribunal on Petitions From Third Persons to Intervene as "Amici Curiae", dated 15 January 2001 [Mexico's Authorities, Tab 37]

H. The Standard of Review in a Review Under Section 30 of the CAA

231. The courts have held that the correctness standard of review applies to interpretations of provisions limiting a tribunal's powers.

> *Pasiechynk* v. *Saskatchewan (Workers' Compensation Board), supra* at 904

I. The Standard of Review in an Appeal Under Section 31 of the CAA

232. The courts have held that, on an appeal, the correctness standard of review applies to pure questions of law.

> *B.C.I.T. (Student Association)* v. *B.C.I.T., supra*

233. In contrast, the reasonableness *simpliciter* standard applies to questions of law involving acting without any evidence or upon a view of the facts which could not reasonably be entertained.

> *Beazer East, Inc.* v. *British Columbia (Environmental Appeal Board), supra,* at paragraphs 38-41, per Tysoe J.

J. Standard of Review Under the ICAA

1. Excess of Jurisdiction

234. Under s. 34(2)(a)(iv), the Court must examine whether the Tribunal considered an issue not properly before it on a standard of correctness;

> See *Tiong Huat Rubber Factory (SDN) BHD* v. *Wah-Chang International Company Limited (China), supra*
>
> *Aamco Transmission Inc.* v. *Kunz, supra*

2. Loss of Jurisdiction

235. A patently unreasonable decision can give rise to a loss of jurisdiction under Article 34(2)(a)(iv).

3. Failure to Follow Agreement of Parties

236. The standard of review under Article 34(2)(a)(v) – failure to proceed in accordance with the agreement of the parties – is also reviewed on a standard of correctness.

> See, by analogy, *MINE* v. *Guinea, supra*

4. Contrary to Public Policy

237. Under s. 34(2)(b)(ii), if it is argued that the result is irrational then it is necessary to establish patently unreasonable error in order to permit setting aside to preserve "public policy". This is not required where "corruption and similar serious cases" are concerned.

IX. THE EXCESS OF JURISDICTION IN THE TREATMENT OF ARTICLE 1105

238. It is important to stress the distinction in public international law between "customary" international law and treaty or "conventional" international law. The former is found in the practice of States who by their conduct and statements show that they consider themselves to be bound by a rule of international law. The International Court of Justice and learned commentators speak of the need to determine the *opinio juris* of States. That is: through their practice do States show the necessary subjective element of considering themselves to be bound by an alleged customary rule of law.

> See Georg Schwarzenberger, *International Law as Applied by International Courts and Tribunals*, 3rd ed., (Stevens & Sons Limited: London, 1957) [Mexico's Authorities, Tab 123] at pp. 38-43
>
> Ian Brownlie, *Principles of Public International Law* (5th ed., 1998) [Mexico's Authorities, Tab 102] at pp. 7-11

239. An example of customary international law is the virtually universal practice of States to extend their "fishing zones" up to a twelve-mile limit, a practice which the International Court of Justice found to be "generally accepted" in 1974.

> *Fisheries Jurisdiction Case (United Kingdom* v. *Iceland)*, I.C.J. Reports (1974), 3 at 23-26

240. The more common form of international law applied by international courts and tribunals is treaty or conventional law. This is law negotiated and ratified by States. The majority of international legal obligations are treaty obligations; in the absence of a treaty there is no obligation unless the alleged rule has acquired the status of customary international law. The NAFTA itself is an example of treaty law.

241. NAFTA does, however, incorporate in treaty text international legal concepts that find their origins in customary international law. The "minimum standard of treatment"

obligation contained in Article 1105 is the leading example. As Canada noted in its NAFTA *Statement on Implementation*:[18]

> Article 1105, which provides for treatment in accordance with international law, is intended to assure a minimum standard of treatment of investments of NAFTA investors. ...this article provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law...
>
> *Canada Gazette*, Part I, January 1, 1994 at p. 149 [Mexico's Authorities, Tab 72]

242. In the instant case, in finding that Mexico "failed to ensure a transparent and predictable framework for Metalclad's business planning and investment", the Tribunal referred to the provisions of Chapter Eighteen, the NAFTA chapter that sets out the Parties' general treaty obligations in the area of transparency.[19] At paragraph 71, the Tribunal made it clear that its Article 1105 finding was based in part on Article 1802.1. In so doing, the Tribunal committed two acts in excess of jurisdiction: First, it used an alleged breach of NAFTA's transparency provisions – which are conventional not customary international law obligations – to find a breach of Article 1105. Second, it legislated transparency obligations not stated in the treaty. As an arbitral tribunal without law-making power, and charged only with applying the specific obligations that the NAFTA Parties consented to arbitrate with investors, this was not open to it.

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[18] This is an official description by Canada of the NAFTA published on January 1, 1994, the date of NAFTA's entry into force. The President of the United States published a similar description entitled: *The NAFTA Statement of Administrative Action* [Mexico's Authorities, Tab 80].

[19] Mexico is not alone in reading the Award in this way. Antonio R. Parra, the Deputy Secretary-General of ICSID, recently wrote of the Award:

> The award in the Metalclad case was the first to have applied the standard of "fair and equitable treatment." It linked that standard to the so-called "transparency" requirements of the NAFTA. The standard was also linked by the award to principles of due process.
>
> Antonio R. Para, "Applicable Substantive Law in ICSID Arbitrations Initiated under Investment Treaties", a paper delivered to the Seventeenth Joint Colloquium on Arbitration, Washington, D.C., November 10, 2000 at p. 6 [Mexico's Authorities, Tab 118].

A. Article 1105 Does Not Include Other Distinct NAFTA Obligations and the Tribunal Exceeded Its Jurisdiction by Relying on Transparency Obligations Found Elsewhere in the NAFTA

243. Article 1105 governs only where no other treaty provision is applicable. K. Scott Gudgeon, who was a principal drafter of the Model United States Bilateral Investment Treaty (upon which Chapter Eleven is modelled), has stated that:

> This standard of [fair and equitable] treatment is residuary in the sense that it governs only where no other treaty provisions are specifically on point.
>
> K. Scott Gudgeon, "United States Bilateral Investment Treaties: Comments on their Origin, Purposes, and General Treatment Standards", International Tax and Business Lawyer, 1986 Vol. 4 105 [Mexico's Authorities, Tab 107] at 125

244. Transparency is a conventional law concept which has been developed in international trade law, not in customary international law where the concept of the minimum standard of treatment expressed in Article 1105 has been developed. Transparency finds its origins in Article X of the 1947 General Agreement on Tariffs and Trade (GATT), the predecessor to the World Trade Organization (WTO). Article X, entitled Publication and Administration of Trade Regulations, set out certain basic requirements for the trade regimes of each GATT Contracting Party (as signatories of the GATT were known).

> *General Agreement on Tariffs and Trade*, open for signature October 30, 1947, 55 U.N.T.S. 194, T.I.A.S. No. 1700 [Mexico's Authorities, Tab 84]

245. Canada and the United States incorporated language derived from GATT Article X into their Free Trade Agreement (FTA). (See FTA Articles 1803 and 2102.) The NAFTA Parties then incorporated language from GATT Article X and the FTA into NAFTA Chapter Eighteen which is entitled, Publication, Notification and Administration of Laws.

> See the United States Statement of Administrative Action Accompanying the North American Free Trade Agreement, (re Chapter Eighteen) p. 642 [Mexico's Authorities, Tab 80] and the Canadian Statement of Implementation for the North American Free Trade Agreement, Canada Gazette, Part I, January 1, 1994 at pp. 196-198 [Mexico's Authorities, Tab 72]

246. The drafters of the NAFTA set out the general obligations of transparency in Chapter Eighteen, to apply to matters covered by the Agreement as a whole, and then, where they deemed it necessary, inserted chapter-specific transparency obligations.

> See Articles 718 (Notification, Publication and Provision of Information for Sanitary and Phytosanitary Measures), 803 (Administration of Emergency Action Proceedings), 909 (Notification, Publication and Provision of Information for Technical Barriers to Trade), 1019 (Provision of Information for Government Procurement), Annex 1210.5 (Processing of Applications for Licenses and Certifications) 1306 (Transparency for Telecommunications), 1411 (Transparency for Financial Services), and 1902 (Retention of Domestic Antidumping Law and Countervailing Duty Law).

247. A perusal of the Agreement shows that there is no chapter-specific transparency obligation in Section A over which a Chapter Eleven tribunal would have jurisdiction.

248. Thus, with respect to the first act in excess of jurisdiction, the Tribunal imported the content of conventional treaty obligations found outside of Section A into Article 1105. It could not properly do so within its limited jurisdiction. And, as there is no chapter-specific transparency obligation in Section A of Chapter Eleven it could not have used any other Section A obligation to find a breach of transparency obligations.

249. Mexico made the point in its Counter-memorial at paragraph 860 that there was no authority for interpreting fair and equitable treatment to extend to transparency and predictability requirements, noting in footnote 572 that these are addressed in Chapter Eighteen of the NAFTA.

> Counter-memorial, paragraph 860, footnote 572 [Record, Vol. 2, p. 1346]

250. Mexico has not consented to investor-State arbitration of transparency requirements or any NAFTA obligations other than those set out in Section A. As a Chapter Eleven tribunal, the Tribunal had no jurisdiction to go outside Section A to determine a "failure to ensure transparency" and to use such a failure to find a breach of Article 1105. A Chapter Twenty panel could make a determination of breach of Chapter Eighteen <u>if a NAFTA Party made such a complaint</u>. A Chapter Eleven tribunal has no jurisdiction to make such a determination even when such a complaint is made.

251. This point was made in the first NAFTA Award to be rendered, *Azinian et al.* v. *The United Mexican States*.[20] As it was the first dispute to consider the merits of a claim, the *Azinian* Tribunal (at paragraph 79) found it appropriate to consider "first principles":

> 82. Arbitral jurisdiction under Section B is limited not only as to the persons who may invoke it (they must be nationals of a State signatory to NAFTA), but also as to subject matter: claims may not be submitted to investor-State arbitration under Chapter Eleven unless they are founded upon the violation of an obligation established in Section A. [Emphasis added.]
>
> *Azinian et al.* v. *The United Mexican States*, ICSID (Additional Facility) Case No. ARB(AF)/97/2, 1 November 1999 [Mexico's Authorities, Tab 6]

252. The *Azinian* Tribunal continued:

> 83. To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, *and still not be in a position to state a claim under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may safely be assumed that many *Mexican* parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protections from this kind of disappointment, and nothing in its terms so provides. [Italics in original, underlining added.]
>
> 84. It therefore would not be sufficient for the Claimants to convince the present Arbitral Tribunal that the actions or motivations of the Naucalpan Ayuntamiento [Municipal Council] are to be disapproved, or that the reasons given by the Mexican courts in their three judgments are unpersuasive. Such considerations are unavailing unless the Claimants can point to a violation of an obligation established in Section A of Chapter Eleven attributable to the Government of Mexico.

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[20] Messrs. Jan Paulsson (President), Benjamin R. Civiletti and Claus von Wobeser comprised the Tribunal.

253. The *Azinian* Tribunal concluded that an alleged breach of a concession agreement by a municipal government did not involve an obligation established in Section A.

254. The *Azinian* Tribunal went on to delineate between acts that may cause an investor to be disgruntled with a NAFTA Party and those which may be elevated to the level of international responsibility:

> 87. The problem is that the Claimants' fundamental complaint is that they are victims of a breach of the Concession Contract. NAFTA does not, however, allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes. *The Claimants simply could not prevail merely by persuading the Arbitral Tribunal that the Ayuntamiento [the Municipal Council] of Naucalpan breached the Concession Contract.* [Emphasis in original.]

255. The same jurisdictional point was made by another NAFTA tribunal in its award on jurisdiction in *Ethyl* v. *Canada, supra,* at 223:

> The fundamental jurisdictional issue here, therefore, is whether Canada has consented to this arbitration. It has two aspects, as the jurisdictional proceedings have underscored. One aspect is that of scope: is Ethyl's claim within the types of claims that Canada has consented in Chapter 11 to arbitrate?

256. The *Ethyl* Tribunal went on to examine the notice of claim to determine whether it satisfied the requirements of Article 1116 and stated at 223:

> Claimant's Statement of Claim satisfies prima facie the requirements of Art. 1116 to established the jurisdiction of this Tribunal.

257. In a recent jurisdictional award in the case of *Feldman* v. *United Mexican States,* the Tribunal addressed this point. Although not binding upon other NAFTA tribunals, the *Feldman* Tribunal's approach to jurisdiction on this point shows a proper approach to the determination of a Chapter Eleven tribunal's limited jurisdiction.

258. In response to Mexico's objection to those aspects of the Claim which alleged breaches of Mexican domestic law and general international law prior to NAFTA's entry into force, the *Feldman* Tribunal held:

> 61. The Tribunal has taken due knowledge of the parties' respective allegations and observes that its jurisdiction under NAFTA Article 1117(1)(a), which is relied upon in this arbitration, is only limited to claims arising out of an alleged breach of an obligation under Section A of Chapter Eleven of the NAFTA. Thus, the Tribunal does not have, in principle, jurisdiction to decide upon claims arising because of an alleged violation of general international law or domestic Mexican law. Both the aforementioned legal systems (general international law and domestic Mexican law) might become relevant insofar as a pertinent provision to be found in Section A of Chapter Eleven explicitly refers to them, or in complying with the requirement of Article 1131(1) that "A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law." Other than that, the Tribunal is not authorized to investigate alleged violations of either general international law or domestic Mexican law. [Emphasis added.]
>
> *Feldman* v. *United Mexican States*, ICSID Case No. ARB(AF)/99/1, 6 December 2000, Interim Decision on Preliminary Jurisdictional Issues [Mexico's Authorities, Tab 26]

259. The *Feldman* Tribunal recognized that, beyond Section A of Chapter Eleven, its jurisdiction did not extend to alleged violations of general international law or domestic Mexican law.

> See also *Waste Management, Inc.* v. *The United Mexican States, supra, per* Arbitrator Highet, at §§ 8, 43-52, dissenting in the result on a point not addressed by the majority.

260. The *Feldman* Tribunal went on to find that insofar as Chapter Eleven was concerned, it also could not have jurisdiction over breaches of Chapter Eleven alleged to have occurred before it entered into force:

> 62. The reliance of the Tribunal on alleged violations of NAFTA Chapter Eleven Section A also implies that the Tribunal's jurisdiction *ratione materiae* becomes jurisdiction *ratione temporis* as well. Since NAFTA, and a particular part of NAFTA at that,

> delivers the only normative framework within which the Tribunal may exercise its jurisdictional authority, the scope of application of NAFTA in terms of time defines also the jurisdiction of the Tribunal *ratione temporis*. [Emphasis added.]

261. The Tribunal was not entitled to ignore the limitations on its jurisdiction. This point was emphasized in *Tiong Huat Rubber Factory (SDN) BHD* v. *Wah-Chang International Company Limited (China), supra,* where, in refusing to enforce a Convention award by reason of the tribunal going beyond the terms of the submission, it was said at p. 522:

> In my opinion the court is not entitled to ignore any of these words. No more is it entitled to write a fresh arbitration clause for the parties on the footing that so to do would render it more efficacious from a business point of view and enable all disputes arising under one or more of the agreements to be dealt with by the same tribunal. Any presumption that the parties so intended is rebutted by the express language which they have adopted. That parties are entitled to provide for restrictive reference confined, for example, to disputes as to condition or quality, was recognized by the House of Lords in *Falkingham* v. *Victorian Railways Commissioner*, [1900] A.C. 452.

262. In summary, by basing its decision on transparency objectives and requirements, the Tribunal based its Award on NAFTA provisions beyond those which it was permitted to take into consideration and apply, and on questions other than those contained in the submission to arbitration.

B. The Tribunal Also Went Outside the Scope of the Transparency Obligations Contained in Chapter Eighteen

263. In legislating a new transparency obligation, its second act in excess of jurisdiction, the Tribunal proceeded from an unfortunate rewriting of the NAFTA's text. The Tribunal said:

> 75. An underlying objective of NAFTA is to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives. (NAFTA Article 102(1) [Emphasis added.]

264. This was a revision of Article 102(1). Article 102 actually states:

> 1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:
> ...
> (c) increase substantially investment opportunities in the territories of the Parties;

265. Article 102 does not state the objective attributed to it by the Tribunal in the latter part of paragraph 75 of the Award. Nothing in its text speaks of "ensuring" the "successful implementation of investment initiatives". There is a fundamental difference between increasing investment opportunities and ensuring the successful implementation of investment initiatives. The NAFTA, as drafted by the States, is intended to create opportunities. The Tribunal took an "obligation of conduct" and transformed it into an "obligation of result".

266. This misunderstanding apparently resulted from the Tribunal's mixing of a statement from NAFTA's Preamble (see paragraph 71 of the Award) and its erroneous recording of Article 102's objectives. The resulting connotation of a strict liability of insurance was employed by the Tribunal when it legislated a new transparency duty for the NAFTA Parties as follows:

> 76. Prominent in the statement of principles and rules that introduces the Agreement is the reference to "transparency" (NAFTA Article 102(1)). The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party ... become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws. [Emphasis added.]

267. The Tribunal fashioned a duty to achieve a certain result in paragraph 76 in the same way as it created the notion of "ensuring the successful implementation of investment initiatives" in paragraph 75. Neither is found in the NAFTA's text.

268. The Tribunal concluded at paragraph 99:

> 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. [Emphasis added.]
>
> Award, paragraph 99

269. Leaving aside the plain error in transposing the language of Article 102, the Tribunal's fashioning of a legal duty out of the "statement of principles that introduces the Agreement" (paragraph 76 of the Award) was an improper act of legislation in excess of jurisdiction that resulted in the creation of a legal duty that goes beyond the transparency obligations actually negotiated and agreed by the NAFTA Parties.

270. Although NAFTA Article 1802 requires the Parties only to publish laws so that interested persons may "become acquainted with them", paragraph 76 of the Award goes much further to impose an obligation of result upon the "central government of any Party" to ensure that the "correct position [in the view of the Tribunal] is promptly determined and clearly stated".

271. Although NAFTA Article 1805 requires a Party to make judicial, quasi-judicial or administrative tribunals or procedures available for "the prompt review and, where warranted, correction of final administrative actions", paragraph 76 of the Award shifts the responsibility for determining whether a proposed investment complies with all applicable law from the investor who may invoke the Party's tribunals to the NAFTA Party, and on the facts of this case, imposes liability on the Party for the investor's failure to invoke the domestic judicial remedies properly.

272. It is well established in general international law and in international trade law that a dispute settlement body has no jurisdiction to legislate. International treaties are negotiated by sovereign States and they do not consent to arbitrators adding to the rights and obligations that have been established in lengthy and complex negotiations. The WTO's Dispute Settlement Understanding is typical in expressing this concern. Article 3, entitled General Provisions, states in this regard:

> 2. The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB [the Dispute Settlement Body] cannot add to or diminish the rights and obligations provided in the covered agreements. [Emphasis added.]
>
> WTO Understanding on Rules and Procedures Governing the Settlement of Disputes [Mexico's Authorities, Tab 95]

273. In summary, the Tribunal had no jurisdiction to add to the NAFTA's transparency obligations.

C. The Tribunal Ignored Domestic Legal Proceedings and Inserted Itself in the Place of a Mexican Court

274. The Tribunal's initial two excesses of jurisdiction were compounded by a further error. After the Municipality denied the construction permit, Metalclad requested reconsideration of the denial. Although not mentioned in the Award, when the denial was confirmed, Metalclad commenced domestic legal proceedings – an *amparo* challenge in the Federal Court. Under settled domestic law, it should have first proceeded to the State Administrative Tribunal for a review of the Municipality's action.

275. The *amparo* court determined under Mexico law that Metalclad had invoked the jurisdiction of the wrong court to initially pursue its remedy and rejected the complaint. In declining to hear the complaint due to the fact that it fell outside of its jurisdiction, the Federal Court acted consistently with established Mexican judicial practice and jurisprudence. It respected the limits on the jurisdiction vested in the federal *amparo* courts by the Mexican Constitution.

276. Metalclad filed an appeal to the Mexican Supreme Court but later abandoned the appeal in favour of negotiations with the Municipality. Thus, although the merits of Metalclad's

complaint were not reviewed by the Mexican courts, the courts did consider the complaint as presented to them and rejected it.

277. In its pleadings, Mexico pointed out that the failure to invoke the correct domestic judicial remedy properly was Metalclad's own act, and could not be attributable to Mexico.

> Mexico's Post-hearing Submission at paragraphs 14-22 [Record, Vol. 14, pp. 12,401-12,402]

278. On the facts presented to the Tribunal, therefore, as a matter of domestic law, the Municipality's denial of the permit was lawful.

279. A similar situation obtained in the *Azinian* arbitration, *supra*, where the Tribunal pointed out at paragraphs 96-97:

> How can it be said that Mexico breached NAFTA when the Ayuntamiento of Naucalpan purported to declare the invalidity of a Concession Contract which by its terms was subject to Mexican law, and to the jurisdiction of the Mexican courts, and the courts of Mexico then agreed with the Ayuntamiento's determination? Further, the Claimants have neither contended nor proved that the Mexican legal standards for the annulment of concessions violate Mexico's Chapter Eleven obligations; nor that the Mexican law governing such annulments is expropriatory.
>
> With the question thus framed, it becomes evident that for the Claimants to prevail it is not enough that the Arbitral Tribunal disagree with the decision of the Ayuntamiento. A governmental authority surely cannot be faulted for acting in a manner validated by its courts *unless the courts themselves are disavowed at the international level.* [Emphasis in original]

280. In the *Metalclad* Award, the Tribunal ignored the existence of the domestic legal proceedings and substituted itself for a Mexican court, disagreeing with the decisions of the Municipality and finding that in its view of Mexican law, the permit denial was improper. As shall be seen below, Mexico considers that the Tribunal made patently unreasonable errors in its treatment of the domestic law. But for present purposes, the Tribunal's approach raises more fundamental errors of jurisdiction.

281. Rather than accepting the juridical events as they existed, the Tribunal ignored them. This decision to ignore the domestic juridical events is a usurpation of the jurisdiction of the Party's domestic courts. In essence, the Tribunal held that the Mexican court's rejection of Metalclad's *amparo* should be disregarded and that it should assume the role of a court of appeal.

282. It should be noted in this regard that under Article 1131, the Tribunal had the jurisdiction to decide the issues in dispute in accordance with the NAFTA and applicable rules of international law. In this respect the Tribunal differed from an ICSID tribunal which, as discussed earlier, under Article 42 of the ICSID Convention, ordinarily is granted the jurisdiction to "apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable". ICSID tribunals, in effect, replace the domestic courts to decide domestic law issues.

Article 42(1) of the ICSID Convention [Mexico's Authorities, Tab 86]

283. An arbitral tribunal whose governing law does not include domestic law does not sit as an appellate court of review for the decisions of national courts or in the place of such national courts.

284. The *Azinian* Tribunal, *supra*, examined the basic approach taken in international law to the review of the domestic issues when those issues are the subject of the decisions of domestic courts. International law posits a strict test for finding that the acts of the domestic judiciary have attracted international responsibility to the State. The *Azinian* Tribunal observed in this regard that the possibility that international responsibility for the acts of the judiciary could be found "does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary appellate jurisdiction". It stated at paragraph 99:

> This is not true generally, and it is not true for the NAFTA. *What must be shown is that the court decision itself constitutes a violation of the treaty.* Even if the Claimants were to convince this Arbitral Tribunal that the Mexican courts were wrong with respect to the invalidity of the Concession Contract, this would not per se be conclusive as to a violation of NAFTA. More is required; the Claimants must show either a denial of justice, or a pretence of

form to achieve an internationally wrongful end. [Emphasis in the original.]

285. Judge Tanaka also addressed this principle in the International Court of Justice's decision in the *Barcelona Traction* case.[21]

> It is to be noted that the various complaints raised by the Belgian Government [the complainant] are mainly concerned with the interpretation of municipal [domestic] law, namely provisions of the Spanish commercial code and civil procedure code in the matter of bankruptcy, and provisions of Spanish private international law on the jurisdiction of Spanish Courts concerning bankruptcy. Questions relating to these matters are of an extremely complicated and technical nature: they are highly controversial and it is not easy to decide which solution is right and which wrong. Even if one correct solution could be reached, and if other contrary solutions could be decided to be wrong, we cannot assert that incorrect decisions constitute in themselves a denial of justice and involve international responsibility.
>
> In short, since these issues are of a technical nature, the possible error committed by judges in their decisions cannot involve the responsibility of a State. That the above-mentioned doctrine precludes such an error from being a constituent element in a denial of justice as an internationally wrongful act is not difficult to understand from other viewpoints also. The reason for this is that these issues are of a municipal law nature and therefore their interpretation does not belong to the realm of international law. If an international tribunal were to take up these issues and examine the regularity of the decisions of municipal courts, the international tribunal would turn out to be a "cour de cassation", the highest court in the municipal law system. An international tribunal, on the contrary, belongs to quite a different order; it is called upon to deal with international affairs, not municipal affairs. Now, as we have seen above, the actions and omissions complained of by the Belgian Government, so far as they are concerned with incorrectness of interpretation and application of municipal law, cannot constitute a denial of justice. This means that in itself the incorrectness of a judgment of a municipal court does not have an international character.

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[21] Separate opinion of Judge Tanaka, *Barcelona Traction, Light and Power Company, Limited*, 1970 I.C.J. Reports 4 [Mexico's Authorities, Tab 9] at 156-158.

286. This approach was reflected most recently in the *Feldman* Award on Jurisdiction which stated:

> ... the Tribunal does not have, in principle, jurisdiction to decide upon claims arising because of an alleged violation of ... domestic Mexican law.
>
> *Feldman* v. *United Mexican States*, *supra*, at paragraph 61

287. In any event, the Tribunal's finding of a disagreement with the Municipality's view of its jurisdiction alone does not establish a violation of Chapter Eleven. It follows from the Tribunal's view of Mexican law that the Municipality had no power to deny the permit and that a Mexican court, had it been presented with the merits of the complaint, would have arrived at the same conclusion and the Municipality's action would have been set aside. In effect, the Tribunal made Mexico liable for Metalclad's error in challenging the Municipality's permit denial. In so doing, the Tribunal ignored the legal question of "attributability" upon which the international law of State responsibility is founded. A State cannot be responsible for acts that are not attributable to it.

288. The relevant question the Tribunal ought to have asked and answered on the record evidence was whether a mechanism open to the foreign investor existed to resolve any domestic impropriety. As the *Azinian* case, *supra*, held, if the mechanism existed, Mexico could not be held internationally responsible unless that mechanism itself violated international law.

> Mexico's Post-hearing Submission at paragraphs 9-24 [Record, Vol. 14, pp. 12,400-12,402]

D. The Tribunal Did Not Examine Whether Domestic Remedies Existed to Resolve Legal Uncertainty

289. The Tribunal did not refer to the remedies actually exercised by Metalclad. Instead, the only reference to local remedies by the Tribunal was general and appeared in footnote 4 to paragraph 97 where the Tribunal stated:

> The question of turning to NAFTA before exhausting local remedies was examined by the parties. However, Mexico does not insist that local remedies must be exhausted. Mexico's position is correct in light of NAFTA Article 1121(2)(b) which provides that a

> disputing investor may submit a claim under NAFTA Article 1117 if both the investor and the enterprise waive their rights to initiate or continue before any administrative tribunal or court under the law of any Party any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in NAFTA Article 1117.

290. In this footnote, the Tribunal again misstated the text NAFTA, in this instance, of Article 1121(2)(b) and misunderstood Mexico's position.

291. Article 1121(2)(b) provides that a disputing investor may submit a claim for damages under the NAFTA if the investor and the enterprise waive their rights to initiate or continue damages claims before domestic tribunals. This Article applies to damages claims only. It expressly contemplates the investor initiating and continuing domestic "proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages".

292. None of the domestic remedies invoked by or open to Metalclad in this case following the Municipal stop-work orders and the denial of the municipal construction permit involved the payment of damages, and Article 1121 had no impact either on the exercise of those remedies or their juridical significance, once invoked.

293. Mexico referred to the leading international decision on point: the *Case Concerning Elettronica Sicula S.p.A. (United States* v. *Italy)*, [1989] I.C.J. Rep. 15 *("ELSI")* [Mexico's Authorities, Tab 20], a decision of the International Court of Justice, for the proposition, quoted below, that it would be "absurd" (to use the International Court's word) to conclude that the initial act of a local authority, one that had been challenged in the domestic courts unsuccessfully, could amount to a violation of international law.

> Mexico's Post-hearing Submission, paragraphs 303-330 [Record, Vol. 14, pp. 12,456-12,460]

294. Jurisdictional disputes over environmental matters in federations, especially those based on new laws and new technologies, often give rise to scope for misunderstanding or confusion as to the scope of relevant legal requirements. Uncertainty on such matters is commonplace. In all three NAFTA Parties, the constitutional jurisprudence on environmental matters is in its infancy and still developing.

295. In a federation, many legal questions, including constitutional questions, can arise respecting the validity and applicability of legislative and administrative responses posed by the need to protect the environment.

> See *Friends of the Oldman River Society* v. *Canada* (1992), 88 D.L.R. (4th) 1 (S.C.C.) [Mexico's Authorities, Tab 29] at 7, 18
>
> See also *114957 Canada Lteé (Spraytech, société d'arrosage* c. *Hudson (ville)*, [1993] Q.J. No. 1450 (Sup. Ct.); [1998] A.Q. No. 2546 (C.A.); leave to appeal to S.C.C. granted (appeal heard December 2000) [Mexico's Authorities, Tab 1]
>
> M. Conrod, "Environmental and Municipal Law" (2001) 25 Canadian Lawyer 46 [Mexico's Authorities, Tab 103]

296. In a constitutional challenge to the vagueness of environmental legislation, the Supreme Court of Canada emphasized at paragraph 43:

> What is clear from this brief review of Canadian pollution prohibitions is that our legislators have preferred to take a broad and general approach, and have avoided an exhaustive codification of every circumstance in which pollution is prohibited. Such an approach is hardly surprising in the field of environmental protection, given that the nature of the environment (its complexity, and the wide range of activities which might cause harm to it) is not conducive to precise codification. Environmental protection legislation has, as a result, been framed in a manner capable of responding to a wide variety of environmentally harmful scenarios, including ones which might not have been foreseen by the drafters of the legislation. This has left such legislation open to allegations of unconstitutional vagueness ... In none of these cases, however, has the s. 7 vagueness claim succeeded.

And further at paragraph 55:

> Societal values are highly relevant in assessing whether a general pollution prohibition, such as s. 13(1)(a) EPA, provides fair notice to citizens of prohibited conduct. It is clear that over the past two decades, citizens have become acutely aware of the importance of environmental protection, and of the fact that penal consequences may flow from conduct which harms the environment. Recent environmental disasters, such as the Love Canal, the Mississauga train derailment, the chemical spill at Bhopal, the Chernobyl nuclear accident, and the *Exxon Valdez* oil spill, have served as lightning rods for public attention and concern. Acid rain, ozone depletion, global warming and air quality have been highly publicized as more general environmental issues. Aside from high-

> profile environmental issues with a national or international scope, local environmental issues have been raised and debated widely in Canada. Everyone is aware that individually and collectively, we are responsible for preserving the natural environment.

And further in paragraph 84:

> Environmental protection is a legitimate concern of government, and as I have already observed, it is a very broad subject matter which does not lend itself to precise codification. Where the legislature is pursuing the objective of environmental protection, it is justified in choosing equally broad legislative language in order to provide for a necessary degree of flexibility.
>
> See *Ontario* v. *Canadian Pacific Ltd.*, [1995] 2 S.C.R. 1031 [Mexico's Authorities, Tab 46].

297. In the area of environmental regulation, the minimum standard of treatment at international law cannot require the "central government" of each NAFTA Party to eliminate all "doubt or uncertainty". Nor can it override appropriate local decision-making. As Principle 10 of the Rio Declaration on Environment and Development puts it (as adopted at the United Nations Conference on Environment and Development in June 1992):

> Environmental issues are best handled with the participation of all concerned citizens, at the relevant level. (Emphasis added.)
>
> *Rio Declaration on Environment and Development*, (1992) 31 ILM 876 [Mexico's Authorities, Tab 92]

The Tribunal's creation of a duty to eliminate all doubt and uncertainty and disenfranchise local decision-makers was absurd but it again involved asking itself the wrong question. The Tribunal failed to address the right question, properly within its jurisdiction, namely, whether there was a mechanism, open to investors and known to Metalclad, to resolve constitutional and legal uncertainty in respect of the Municipality's permitting jurisdiction. This mechanism included the whole judicial review process, and the writ of *amparo*.[22]

298. The leading international law decision, *ELSI, supra*, stated at p. 73:

> Yet it must be borne in mind that the fact that an act of public authority may have been unlawful in municipal law does not necessarily mean that that act was unlawful in international law, as a breach of treaty or otherwise. ... It would be absurd if measures later quashed by higher authority or a superior court could, for that reason, be said to have been arbitrary in the sense of international law. (Emphasis added)

299. In *ELSI*, unlike this case, there was a domestic court finding of illegality of the acts of a municipal official. Even then, the International Court of Justice found no breach of the investment protection treaty in issue. These are separate questions.

300. The reason that consideration of the availability of local remedies is essential for determination of responsibility under Article 1105 is that we are dealing with the responsibility of the State at international law. International law has developed minimum standards and procedures to protect the life, liberty and economic security of nationals of one State who visit, live or conduct business activities in another State. As Hackworth Green Haywood, *Digest of International Law* (1943) Vol. 5 [Mexico's Authorities, Tab 108], stated at 471:

> We are here concerned primarily with responsibility of the State. State responsibility may arise directly or indirectly. It does not arise merely because an alien has been injured or has suffered loss within the state's territory. If the alien has suffered an injury at the hands of a private person his remedy usually is against that person, and state responsibility does not arise in the absence of a dereliction of duty on the part of the state itself in connection with the injury, as for example by failure to afford a remedy, or to apply an existing remedy. When local remedies are available the alien is ordinarily not entitled to the interposition of his government until he has exhausted those remedies and has been denied justice. This presupposes the existence in the State of orderly judicial and administrative processes. In theory an unredressed injury to an alien constitutes an injury to his state, giving rise to international responsibility.

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[22] The writ of *amparo* was described by Carlos Loperena Ruiz "The Process of Amparo in Commercial Matters" (1998) 6 U.S. Mexico L.J. 43 [Mexico's Authorities, Tab 112].

301. Although Chapter Eleven allows an investor direct access against a State for damages claims, and does not require the interposition of his government in order to espouse a damages claim, an investor has no valid claim unless he can establish responsibility of the State. In the absence of dereliction of duty on the part of the State itself, for example, by failure to afford a remedy or by the removal of domestic remedies, there is no State responsibility merely because an investor has suffered an injury. The State has the right to expect that the investor will observe its laws, and take advantage of those local remedies available to redress the alleged wrong.

Azinian et al. v. *United Mexican States, supra*

302. By being permitted to take up its case for damages on its own behalf, the investor is still entering the domain of international law and it is asserting violation of certain international legal obligations. The investor is the claimant but in substance is asserting the right of its Party to obtain compliance by the other Party with obligations set out in Section A of Chapter Eleven. Unless those obligations have been violated, even when a claimant has been injured by domestic acts, there is no violation of the NAFTA.

X. THE EXCESS OF JURISDICTION IN THE TREATMENT OF ARTICLE 1110

A. The Tribunal's Analysis of Article 1110 Depended Upon its Jurisdictional Analysis of Article 1105

303. As a preliminary point, it is noted that the defects in the Tribunal's analysis of Article 1105 also infected its analysis of Article 1110. The same excess of jurisdiction in the treatment of Article 1105 informed the Tribunal's treatment of Article 1110 (see paragraphs 102-112 of the Award).

304. The Award identifies two different bases upon which to conclude that Mexico had taken "a measure tantamount to ... expropriation" in breach of Article 1110. The first basis, found in paragraph 104, indicated that:

> By permitting or tolerating the conduct of Guadalcazar in relation to Metalclad which the Tribunal has already held amounts to unfair and inequitable treatment breaching Article 1105 and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110(1). [Emphasis added]

305. It should be noted that the "measure" here identified by the Tribunal is not a positive act, but rather an alleged failure by Mexico to act. This indicates the Tribunal's assumption – never explained or justified – that the NAFTA imposes upon Mexico a positive obligation to take steps against the local municipality where, on the Tribunal's view of Mexican law (as opposed to the Federation's, state's and municipality's view of Mexican law), the Municipality had "improperly" denied Metalclad a construction permit for the landfill project. The Tribunal is: (1) using the rule against expropriation to impose upon the Federal Government the obligation to take steps to override the assertion of local jurisdictional competence, and (2) characterizing Mexico's "failure" to take such steps as an expropriation.

306. The second basis upon which the Tribunal identifies a violation of Article 1110 is by the "indirect expropriation" attributable to Mexico at paragraphs 106-107 of the Award:

> [In denying the permit] in part because of the Municipality's perception of the adverse environmental effects of the hazardous waste landfill and the geological unsuitability of the landfill site ...the Municipality acted outside of its authority... the Municipality's denial of the construction permit without any basis in the proposed physical construction or any defect in the site, and extended by its subsequent administrative and judicial actions regarding the *Convenio*, effectively and unlawfully prevented the Claimant's operation of the landfill.
>
> 107. These measures, taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation. [Emphasis added]

It is to be noted that "indirect expropriation" in the Tribunal's view comprises two distinct elements: the Municipality's unlawful denial of the construction permit (as a result of the Tribunal's finding of illegality under Mexican law) coupled with Mexico's representations and its failure to ensure that the Municipality's procedures for dealing with the construction permit operated "on a timely, orderly or substantive basis".

307. Article 1110(1) of NAFTA provides:

> No Party 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 ("expropriation"), except:
>
> (a) for a public purpose;
>
> (b) on a non-discriminatory basis;
>
> (c) in accordance with due process of law and Article 1105(1); and
>
> (d) on payment of compensation in accordance with paragraphs 2 through 6.

308. Having quoted part of Article 1110 at paragraph 102 of its Award, in the following paragraph 103 the Tribunal sets out the following:

> Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright

> seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in 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. [Emphasis added]

309. This single sentence constitutes the entirety of the Tribunal's reasoning on its jurisdiction over expropriation. The use of the word "thus" suggests that the conclusion set forth in paragraph 103 follows inexorably from the language of Article 1110.

310. In paragraph 103 the Tribunal's jurisdictional excess conflates two distinct legal concepts: *expropriation*, on the one hand, and *interference with property rights*, on the other hand. In general international law, which provides the background against which the NAFTA and its Article 1110 are to be applied, the latter concept falls short of an expropriation, which necessarily requires, in the words of the International Court of Justice, that "title to property itself ... is at stake".[23] In this regard it is to be noted that Article 1139 of the NAFTA, which defines exhaustively what types of interests can be considered to be an investment for the purposes of Chapter Eleven, extends the Chapter's protection to "real estate or other property ... acquired in the expectation or used for the purpose of economic benefit or other business purposes", but does not identify a "reasonably-to-be-expected economic benefit" of the property itself as a protected investment.

311. By conflating two distinct concepts the Tribunal has arrogated to itself a wider jurisdiction which is conferred by some bilateral investment treaties – but not the NAFTA – to compensate investors for mere impairment of economic benefit resulting from interference with property rights. On the Tribunal's view of its jurisdiction, any national or sub-national government regulation which limits a reasonably-to-be-expected economic benefit of private commercial property amounts to an expropriation.

312. The traditional and well-established distinction between jurisdiction over expropriation and jurisdiction over measures affecting property rights is reflected in international

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[23] See *ELSI*, *supra*, at 69 (paragraph 116).

practice. An example is the Algiers accord establishing the Iran-US Claims Tribunal. This provides in its Article II(1) that the Iran-US Claims Tribunal shall have jurisdiction over

> ... claims and counterclaims [which] are outstanding on the date of this agreement, whether or not filed with any court, and arise out of debts, contracts (including transactions which are the subject of letters of credit or bank guarantees), expropriations or other measures affecting property rights". [Emphasis added.]
>
> Referred to in Article 1128, Submission of the Government of Canada, July 28, 1999 [Record, Vol. 19, p. 1292]

313. Article 1110 of the NAFTA has no equivalent provision. The jurisdiction of any NAFTA Tribunal in this regard is limited to nationalizations or expropriations or a measure tantamount thereto. It does not extend to acts which would normally be included amongst "other measures affecting property rights".

314. The different types of investment protection treaties are summarized by Dolzer and Stevens in *Bilateral Investment Treaties* (Martinus Nijhoff Publishers: 1995) [Mexico's Authorities, Tab 106]. At p. 102 they refer in particular to the US model investment protection treaty, which only mentions "measures tantamount to expropriation or nationalization ('expropriation')". In contrast to the U.S. model treaty's restrictive definitional approach (which is similar to, but slightly more expansive than NAFTA Article 1110), Dolzer and Stevens refer to the U.S.-Zaire Bilateral Investment Treaty of 1984, which prohibits

> ... any other measure or series of measures, direct or indirect, tantamount to expropriation (including the levying of taxation, the compulsory sale of all or part of an investment, or the impairment or deprivation of its management, control or economic value)..."

315. According to Dolzer and Stevens, at p.102:

> The latter provision represents possibly the broadest scope in investment treaties with respect to indirect expropriation insofar as the inclusion of measures that cause the "impairment ... of [the] economic value" of an investment, equates expropriation with a host of measures which might not otherwise be considered as such under general international law, let alone under liberal systems of domestic law. [Footnotes omitted, emphasis added.]

316. Of particular note here is the authors' conclusion that measures which merely impair economic value would not be equated with expropriation under general international law. It is to be noted in this regard, that Article 1110 of the NAFTA is more restrictive than the U.S. model treaty (in that it reaches only a measure (in the singular) tantamount to expropriation rather than "measures or series of measures"), and it is patently on its face more restrictive than the US-Zaire Bilateral Investment Treaty.

317. Notwithstanding the NAFTA drafters' intentional narrowing of the "tantamount to" language of Article 1110, the Tribunal has assumed a jurisdiction beyond even the "possibly...broadest scope" of expropriation used in the U.S.-Zaire treaty. According to the Tribunal, it had jurisdiction to find an expropriation where there was:

> ... covert or incidental interference with the use of property which has the effect of depriving the owner...in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not ... to the obvious benefit of the host State. [Emphasis added.]

318. In arguing for a broad jurisdiction Metalclad relied upon a number of decisions of the Iran-U.S. Claims Tribunal in urging the Tribunal to find that its investment had been expropriated. Given the jurisdiction of the Iran-U.S. Claims Tribunal over any "measures affecting property rights", this was misguided. Canada intervened in the arbitration on this point, directing the Tribunal to the wider jurisdiction conferred by the Algiers Declaration, to consider "expropriation or other measures affecting property rights". Canada urged the Tribunal to take note of its narrower jurisdiction under NAFTA. But in its Award the Tribunal did not address Canada's argument.

319. For its part Mexico agreed with Canada's view that a NAFTA tribunal's jurisdiction is narrower than that of the Iran-U.S. Claims Tribunal. Mexico urged the Tribunal to exercise caution in applying that Tribunal's decisions to the instant case.[24] As with Canada, however, the Tribunal made no attempt to address Mexico's submissions on this point.

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[24] Post-hearing Submission at paragraphs 255-258 [Record, Vol. 14, pp. 12,447-12,448].

XI. THE TRIBUNAL'S FAILURE TO HAVE REGARD TO RELEVANT EVIDENCE

A. Introduction

320. Mexico submits that the Tribunal lost jurisdiction by reason of patently unreasonable findings made due to the failure to have regard to relevant evidence, specifically:

1. **The Prior Contamination of the Site Generated Reasonable Opposition to the Landfill**

(i) the site of the landfill had been contaminated by COTERIN in 1990 and 1991, which contamination had not been cleaned up and which led reasonably to the Municipality's legitimate opposition to the introduction of any new hazardous waste without the site being first remediated;

2. **Metalclad was Aware of the Municipality's Prior Assertion of Permitting Authority**

(ii) Metalclad was aware that COTERIN had applied for and had been denied a municipal permit in 1991;

(iii) the permits issued by the Federal Government were expressly without prejudice to the need for a municipal permit;

(iv) Metalclad received legal advice that a municipal permit was required;

(v) Metalclad amended the terms of its option to purchase COTERIN to defer payment of the full purchase price until a municipal permit was obtained or judicial approval was granted to proceed in its absence;

(vi) state and federal officials (the latter in writing) expressly told Metalclad that Municipal approval was required;

3. **The Existence and Exercise by Metalclad of Domestic Remedies**

(vii) clear, transparent and known mechanisms existed in domestic Mexican courts to determine whether a municipal permit was required and, if so, to challenge a permit denial. Metalclad initiated but later abandoned these domestic remedies;

4. **Metalclad Constructed Without Applying for a Permit**

(viii) Metalclad ignored two stop-work orders by the Municipality and completed construction of the landfill under the guise of performing what it called "maintenance" and "remediation" work at the contaminated site;

5. **The Municipality Had a Legitimate Basis to Challenge the *Convenio***

(ix) the Municipality had legitimate reasons for challenging the *Convenio* which was not a sufficient legal authorization to operate the landfill; *Convenio* [Record, Vol. 3, p. 2262]

6. **The Tribunal Overstated the Effect of a Public Demonstration and Ignored the Legal Effect of a Federal Administrative Order and an Injunction**

(x) a demonstration on March 10, 1995, asserted by Metalclad to have thereafter "effectively prevented" Metalclad from opening the landfill, dispersed after a single day;

(xi) at the same time a federal shut-down order dating back to September 26, 1991 was in place;

(xii) in addition, a federal court granted the Municipality's application for an injunction and Metalclad was enjoined from operating the landfill until the injunction was dissolved on May 18, 1999;

7. The Municipality was Prepared to Allow Operation of the Landfill as a Non-Hazardous Industrial Waste Landfill

(xiii) Metalclad has allowed the landfill to lie dormant, notwithstanding that the Municipality agreed it could operate as a non-hazardous industrial waste landfill.

321. In order to demonstrate the loss of jurisdiction by reason of the patently unreasonable aspects of the Award, it is necessary to consider in some detail the reasons of the Tribunal and portions of the record. This will be done to demonstrate that the result is patently unreasonable.

322. In this section, Mexico will set out, in italics, relevant portions of the Award, followed by references to the relevant evidence that the Tribunal failed to address.

B. The Municipality of Guadalcazar

323. The Court should be aware of the nature of the Municipality whose actions were impugned by the Tribunal. It is common ground between the parties that Guadalcazar, a relatively sparsely populated municipality, lies in an extremely impoverished region of the state of SLP. The climate is hot and arid and the flora and fauna are characteristic of a desert. The Municipality's inhabitants eke out a subsistence living. Ranching and very small agricultural production carried out by members of *ejidos* (a form of communal land-holding that was established after the Mexican Revolution of 1910) are the principal vocations. There is no substantial commercial activity in the Municipality.

324. Although the Municipality has electricity, there is no running water in much of it, nor are there other infrastructure services such as sewage lines. Telephone communications are few. The municipal government, for example, shares a telephone line with a public telephone booth. There is no public transportation system.

325. The Municipality is administered by an *Ayuntamiento*, or municipal council. Its members are elected by the residents, serving a three-year term. The Municipal President is elected by direct vote of the residents.

326. There is no well-established administrative infrastructure similar to the wealthier municipalities of Mexico or those of Canada and the United States. The Municipality has no taxing authority and relies almost entirely upon federal and state appropriations for its budget. There was a total of approximately 40 municipal employees during the relevant period. The Municipality had one station wagon, a jail and two peace officers.

327. The *Ayuntamiento*, which meets monthly, acts in a plenary fashion. It maintains written records of its meetings. The Municipal President is the repository of such records. There is little delegation of decision-making to officials because there are few such officials.

328. As part of its complaint, Metalclad argued that it had been denied national treatment under Article 1102 of the NAFTA because there was no evidence of a systematic construction permitting practice on the Municipality's part, yet a permitting requirement had been asserted against COTERIN. Mexico did not contest this factual allegation. Rather, it pointed out that the only significant economic activity in the Municipality was COTERIN's effort, starting in 1990, to establish its hazardous waste transfer station and planned landfill. There was no breach of the national treatment obligation because the Municipality also asserted its authority against COTERIN, while wholly Mexican-owned, in 1991, when the *Ayuntamiento* met in plenary session, and denied COTERIN's application for a construction permit. (The Tribunal did not address the national treatment complaint or defence in the Award.)

C. The Tribunal's Failure to Refer to the Prior Contamination of the Site

329. Although the site's contamination reasonably led to opposition and concern and motivated the Municipality, there is no mention of the impact of the illegal dumping that contaminated the site upon the subsequent events and actions of the Municipality.

> *28. In 1990 the federal government of Mexico authorized COTERIN to construct and operate a transfer station for hazardous waste in La Pedrera, a valley located in Guadalcazar in SLP. The site has an area of 814 hectares and lies 100 kilometers northeast of the capital city of SLP, separated from it by the Sierra Guadalcazar mountain range, 70 kilometers from the city of Guadalcazar. Approximately 800 people live within ten kilometers of the site.*

330. The Tribunal failed to have regard to the evidence that in 1990 COTERIN, when owned by Mexican investors, began to receive hazardous waste at the Transfer Station. The hazardous waste was not transferred as authorized, but rather illegally dumped onto the ground without separation or treatment. Later audits found that burying this hazardous waste without proper treatment or separation constituted a significant risk to health and the local environment.

> Chronology of the Dumping of Hazardous Waste 1990-1991 [Appendix A]

331. The illegal dumping of some 55,000 barrels (20,000 tonnes) of hazardous waste (an amount comparable to that contaminating the notorious Love Canal site) stimulated opposition by local residents, their elected leaders and those of surrounding municipalities, leaders of *ejidos*, a complaint to the National Human Rights Commission, an investigation by the UASLP Faculty of Medicine, and numerous federal inspections.

> Chronology of Selected References to Opposition Arising from Contamination of the Site and Proposal to Introduce New Waste to the Site [Appendix B]

332. After eleven months of continued illegal dumping, a federal order was issued on September 25, 1991 by the local federal sub-delegate ordering the complete shutdown of the Transfer Station. Federal closure seals were placed on the entrance to the site.

> Exhibit 2 to Witness Statement of Francisco Hernández [Record, Vol. 4, p. 2816]

333. From 1991 onwards, state and municipal authorities, non-governmental organizations and municipal residents sought remediation of this prior contamination and opposed any further introduction of new hazardous waste to the site prior to that remediation.

334. The prior contamination was not disputed by Metalclad. After acquiring COTERIN, Metalclad publicized its plans to construct the landfill. Metalclad claimed that, if it were permitted to construct the landfill, it would remediate the contamination created by COTERIN. To that end, Metalclad caused advertisements to be placed in local newspapers stating:

> [w]e recognize that a serious danger exists in the event that the facility, approved by the Federal Government, cannot be operated given the number of containers existing on the site may reach up to

120,000 in number representing close to 30,000 tonnes of dangerous and toxic waste deposited only in ditches which do not meet the construction standards and are only covered with dirt, without complying with the minimum safety conditions and standards and which may pose a great danger to the health of the inhabitants of the communities. Given this grave danger, METALCLAD CORPORATION is ready to treat and confine these wastes investing the amount of $5,000,000.00 to meet these ends thereby avoiding further damage that, at this moment, is already posed to the detriment of the environment. ...

Exhibit 1 to Counter-memorial [Record, Vol. 2, p. 1429]

D. The Tribunal's Failure to Have Regard to the Fact That the Express Terms of the Federal and State Permits Were Without Prejudice to the Need For Municipal Permits

335. The Award suggests that the federal and state permits obviated any permitting role for the Municipality. This ignored the record evidence.

> *29. On January 23, 1993, the National Ecological Institute (hereinafter "INE"), an independent sub-agency of the federal Secretariat of the Mexican Environment, National Resources and Fishing (hereinafter "SEMARNAP"), granted COTERIN a federal permit to construct a hazardous waste landfill in La Pedrera (hereinafter "the landfill").*

336. The Tribunal failed to have regard to the evidence that the federal permits were expressly without prejudice to the need to obtain a municipal permit.

337. Clause 10 of the first Federal Permit issued January 27, 1993, provided:

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

Witness Statement of René Altamirano, paragraph 29 [Record, Vol. 4, p. 2867]

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

> This Authorization is contained in the General Law of Ecological Equilibrium and the Protection of the Environment and in the Regulations derived from this Law, in the material on Toxic Waste, for which the company COTERIN S.A. DE C.V. must subject itself to all of the established dispositions in these legal instruments as well as to the applicable norms to those activities which are the motive of this Authorization.
>
> Exhibit 8 to Memorial, paragraph 36 [Record, Vol. 1, p. 390]

339. The former federal official who issued the permits, René Altamirano, gave the following written evidence before the Tribunal:

> 29. However, I was always careful in my position as General Director to ensure that the powers conferred on the federal authority to grant permits were fully exercised, but never invading the local government's sphere of jurisdiction ... [he noted that the law was new and pointed to the express language of the permit]...
>
> This meant that the authorization could not be considered as an authorization satisfying all legal requirements the company had to meet in order to establish a hazardous waste landfill. In other words, it meant that this authorization did not supersede other federal, state or municipal authorizations the applicant, in addition, needed to obtain to construct and operate the hazardous waste landfill.
>
> Witness Statement of René Altamirano [Record, Vol. 4, p. 2862]

340. Mr. Altamirano referred to the specific language of the federal permits in this regard.

> 32. I want to refer to the scope of the authorizations granted to COTERIN by the National Institute of Ecology (INE) in 1993 and to draw the Tribunal's attention to the text of such authorizations and to the legal basis for it being granted. Metalclad refers to those authorizations as final construction and operation permits. However, those permits are not legally construction nor operation permits, and are, instead, authorizations prior to the construction and operation of a controlled hazardous wastes landfill. That is why, for example, the federal permits necessary for the establishment of a hazardous waste landfill and the state permits

for land use, govern different regulatory jurisdictions and therefore are not in opposition; one does not prejudice the other.

...

36. The paragraphs cited from the Law, the Regulations and the authorization dated January 27, 1993, along with clause ten of this authorization, quoted above, clearly shows that a construction permit was never granted, but, instead, what was granted was an authorization in relation to the requirement regarding environmental impact as shown by the Mexican legislation.

Witness Statement of René Altamirano [Record, Vol. 4, p. 2862]

341. The May 11, 1993 state land use permit stated:

This License ... does not authorize works, constructions or the functioning of business or activities.

Exhibit 7 to Memorial [Record, Vol. 1, p. 381]

E. The Tribunal's Failure to Have Regard to the Mexican Legal Advice Given to Metalclad

342. The Tribunal failed to have regard to the evidence that Metalclad had been advised by its first set of local Mexican lawyers that a municipal permit may be required in order to construct and operate the landfill. In a letter dated September 16, 1993, Metalclad indicated the following:

Our law firm in San Luis Potosi believes that a municipal manifest may be needed for construction.

Letter from Lee A Deets to Reyes Luján dated September 16, 1993, Exhibit 5 to Reply Witness Statement of Lee A. Deets [Record, Vol. 7, p. 7079]

343. On August 17, 1994, Metalclad's second set of local counsel wrote to Javier Guerra (a new director of Metalclad) describing the steps required to apply for a municipal permit. García Leos advised that since:

... the fact that this was already mentioned some time ago to you [that is, before construction had commenced] with the additional information that the building license was applied for by COTERIN

> and denied [in 1991], and for such reason there is no certainty of the results if we proceed (to the courts) as mentioned.
>
> Letter from García Leos to Javier Guerra dated August 17, 1994, Rejoinder Witness Statement of García Leos, Exhibit 3 [Record, Vol. 12, pp. 10,864-10,865]

344. Fearing a negative response from the Municipality since Metalclad had already commenced construction, Metalclad's Chairman of the Board, Daniel Neveau, instructed local counsel to "ignore the problem rather than raise it to a level of awareness."

> Letter from Daniel Neveau to García Leos dated September 9, 1994, Rejoinder Witness Statement of García Leos, Exhibit 2 [Record, Vol. 12, pp. 10,860-10,861]

F. The Failure to Have Regard to COTERIN's Previous Municipal Permit Application

345. The Tribunal failed to have regard to the evidence that Metalclad admitted that it was aware, through the due diligence it conducted prior to acquiring COTERIN, that COTERIN had applied unsuccessfully for a municipal permit in 1991.

> August 15, 1991 Permit Application, Exhibit 37 to Counter-memorial [Record, Vol. 4, p. 3310.001]
>
> October 1, 1991 Permit Denial, Exhibit 43 to Counter-memorial [Record, Vol. 3, pp. 1685-1686]
>
> January 20, 1992 Municipal Confirmation of Denial, Exhibit 45 to Counter-memorial [Record, Vol. 3, pp. 1698-1699]
>
> Reply, paragraph 73 [Record, Vol. 7, p. 6290]

346. The evidence of a prior application and consideration of the permit disproved Metalclad's fundamental assertion in its Memorial that, "No construction permit from the Municipality of Guadalcazar was sought or required, nor has the lack of such a permit been timely raised by any government authority". The same due diligence that disclosed the 1991 application and its denial, also disclosed the Municipality's views as to the scope of its authority, and the applicable statutory provisions.

> Memorial, paragraph 17 [Record, Vol. 1, p. 57]

347. The October 1, 1991 denial by the *Ayuntamiento*, and the January 20, 1992 resolution by the new administration disclosed that the Municipality considered that it had the authority, when considering a construction permit application, to review the project's impact on the local environment, health and safety concerns, previous unauthorized conduct of the applicant, and the social interests of the Municipality as evidenced by local residents' opposition. It was clear that the Municipality did not consider it was obliged to issue the permit simply on the basis that federal approval had been given or that its role was purely administrative or that its role was narrow and restricted to matters relating to construction.

G. The Tribunal's Failure to Have Regard to Metalclad's Amendment to the Option Agreement to Deal with the Risks Associated with The Municipal Permit Requirement

348. The Award did not address the fact that, mindful of the permit issue it claimed in the arbitration not to be aware of, Metalclad expressly contracted for its resolution by amending the Option Agreement.

> Option Agreement, dated April 23, 1993 [Record, Vol. 4, p. 3651]
>
> Amended Option Agreement, dated September 9, 1993 [Record, Vol. 2, p. 1438]
>
> *30. Three months after the issuance of the federal construction permit, on April 23, 1993, Metalclad entered into a 6-month option agreement to purchase COTERIN together with its permits, in order to build the hazardous waste landfill.*

349. Metalclad admitted that its due diligence showed it was aware COTERIN had applied unsuccessfully for a municipal construction permit in 1991. The Tribunal failed to have regard to the evidence of Metalclad's September 5, 1993 amendments to the Option to Purchase COTERIN prior to its being exercised. These amendments specifically deferred payment of three-quarters of the purchase price until:

> ... the municipal permit for the building of the aforementioned confinement has been obtained by COTERIN, or as the case may be, definitive judgment in a writ of amparo that allows [the company] to legally proceed with the building of such confinement...
>
> Exhibit 3 to Counter-memorial, p. 7 [Record, Vol. 2, p. 1444]

350. The Amended Option Agreement indicates that prior to purchasing COTERIN Metalclad was aware of the assertion of the municipal permit requirement and the domestic legal means to resolve any uncertainty in that regard so as to be able to "legally proceed".

> Amended Option Agreement [Record, Vol. 2, p. 1438]

351. Metalclad's Chief Executive Officer admitted that Metalclad was aware of the municipal permit issue and that it posed a risk to the investment, stating:

> So [the amendment] explains – really, the reason for the amendment to the Aldrett contract was, to the extent there was any risk at all, we wanted him to share that risk. He [the vendor] was representing it – they [the Municipality] don't issue permits, and if they did, they would have to for the payment of a few pesos. So we said, fine, take that risk with us.
>
> Transcript, Vol. V, at p. 245 [Record, Vol. 15]

352. This evidence of Metalclad's own making undermined its claims of opacity and its expert's report's claim that "it was reasonable and even highly likely that METALCLAD, diligently acting in good faith, would have been unaware of this requirement".

> Report of Centro Jurici, Lack of Clarity in Mexican Environmental Legislation 1988 to 1996, [Record, Vol. 1, p. 296]

H. The Tribunal's Acceptance of the Claim of Representations by Federal Officials and its Failure to Have Regard to the Evidence Adduced by Metalclad and the Contemporaneous Documents

353. In finding that federal assurances were given, the Tribunal did not address the contemporaneous federal documents referring to municipal permits, and the corrupt relationship between Metalclad and the former federal official who testified that assurances were given.

> *33. Metalclad further asserts that it was told by the President of the INE [Sergio Reyes Lujan] and the General Director of the Mexican Secretariat of Urban Development and Ecology [Rene Altamirano] (hereinafter "SEDUE") (SEDUE is the predecessor organization to SEMARNAP) that all necessary permits for the landfill had been issued with the exception of the federal permit for operation of the landfill. A witness statement submitted by the President of the INE suggests that a hazardous waste landfill could*

be built if all permits required by the corresponding federal and state laws have been acquired.

...

80. When Metalclad inquired, prior to its purchase of COTERIN, as to the necessity for municipal permits, federal officials assured it that it had all that was needed to undertake the landfill project. Indeed, following Metalclad's acquisition of COTERIN, the federal government extended the federal construction permit for eighteen months.

...

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. In following the advice of these officials, and filing the municipal permit application on November 15, 1994, Metalclad was merely acting prudently and in the full expectation that the permit would be granted.

354. The Tribunal failed to have regard to the witness statement of Reyes Luján filed by Metalclad, which did not indicate what the Tribunal records as Metalclad's assertion, i.e., that Mr. Luján told Metalclad that all necessary permits had been issued with the exception of the federal permit for the operation of the landfill. Mr. Luján's full statement provided:

> I, am Fis. Sergio Reyes Luján and declare that during the period 1986-1992 I served in the federal government as Undersecretary of Ecology of the Secretariat of Urban Development and Ecology, the highest post in the federal government regarding the protection of environment at the time. Later on, during the period 1992-1993 I served the federal government as the Founder President of the National Institute of Ecology of the Secretariat of Social Development.
>
> In those capacities I met during the period 1991-1993 on several occasions with officials of Metalclad Corporation interested in the construction and operation of a hazardous waste landfill in the state of San Luis Potosi. The licenses and permits for the project were a responsibility of Arq. René Altamirano Pérez, the cognizant General Director at the National Institute of Ecology.
>
> As Undersecretary of Ecology, I participated actively in drafting the initiative of the General Law of Ecological Equilibrium and Protection of the Environment which was later passed by Congress. Such Law established the norms under which hazardous waste would be treated and disposed. It is my interpretation of such Law that anyone could build and operate a hazardous waste landfill, as

> long as, he/she has obtained all licenses, permits and authorizations required by the corresponding Federal and State laws.
>
> Witness Statement of Reyes Luján [Record, Vol. 18, p. C899]

355. The Tribunal failed to note that it is state laws that contain provisions for municipal permits, as in the case of provincial statutes providing for municipal laws in British Columbia.

356. Mr. Altamirano who was the actual permitting authority for the Federal Government, denied that he or Mr. Luján had made the alleged statements:

> 48. I have reviewed the Memorial and the witness statements mentioning my specific participation in the matter, and I have the following comments. Metalclad asserts that Mr. Reyes Luján and I gave them assurances that the federal authorizations took precedence over the local permits, and that we would take care of the State issues. I deny both allegations. I am very surprised that a company that represented itself as an experienced investor now makes these allegations. As I have already explained, we clearly noted in the authorizations issued that they did not relieve the applicant from the other requirements of federal, state and municipal law. I personally told them to pay attention to the state land use requirements. In addition, I thought I was dealing with an established company seeking to invest in a foreign country, and I assumed that such an investor would have retained Mexican legal counsel that would know this basic principle of our federal system. In establishing a business, especially a highly regulated facility such as a hazardous waste landfill facility, requires multiple authorizations from different authorities. [Emphasis added.]
>
> Witness Statement of René Altamirano [Record, Vol. 4, p. 2872]

357. The only former federal official (Humberto Rodarte Ramon) who testified (by way of two written statements) that such assurances were given was shown to have been improperly associated with both Metalclad and COTERIN's vendors, the Aldretts, long before the Option Agreement was entered into. (This is addressed below.)

I. The Failure to Have Regard to the Terms of COTERIN's Second Permit Application

358. On November 9, 1994, one of Metalclad's local lawyers forwarded to COTERIN copies of the applicable state laws which contained the requirement for the municipal permit application.

> Exhibit 4 to the Witness Statement of García Leos [Record, Vol. 12, pp. 10,868-10,870]

359. On November 14, 1994, he also advised that the time was expiring to mount a judicial challenge to the previous municipal closure order and that that order would become final if not challenged.

> Exhibit 6 to the Witness Statement of García Leos [Record, Vol. 12, pp. 10,880-10,881]

360. Although construction had already begun, on November 15, 1994, after the second shut-down order, COTERIN filed its second permit application with the Municipality. The terms of this application made clear that COTERIN was well aware of the applicable laws and in COTERIN's words, it was:

> ... necessary to request the municipal construction license ... where the constructions or works will generate a significant impact in the influenced area and environment, due to its dimensions and necessities of framework, services and transport, so as in the case of risks it may generate. [Emphasis added]
>
> Application of November 15, 1994 [Record, Vol. 4, p. 3023]

J. The Ongoing Construction of the Landfill and the Tribunal's Failure to Have Regard to Metalclad's Own Description of that Work as Remedial Only

361. The Tribunal accepted Metalclad's claim that it constructed openly without objection when the documentary evidence showed Metalclad itself described the work as "remedial" and "maintenance".

> *38. ... Consequently, in May 1994, after receiving an eighteen-month extension of the previously issued federal*

> *construction permit from the INE, Metalclad began construction of the landfill. ...*
>
> *39. Metalclad further maintains that construction continued openly and without interruption through October 1994. Federal officials and state representatives inspected the construction site during this period, and Metalclad provided federal and state officials with written status reports of its progress.*

362. The Tribunal recorded Metalclad's assertion that construction continued openly through October 1994 without having regard to the evidence that, when the initial stop-work order was issued by the Municipality in June 1994, Metalclad asked the Municipality and was permitted to continue performing what it described to all levels of government as "maintenance" and "remediation" work only. In its own documents, Metalclad described its work at the site as maintenance and remediation work relating to the environmental audit throughout this period. Metalclad never received municipal permission to continue construction of the landfill itself.

> Claimant's Admissions and Denials 424, 429, 456 [Record, Vol. 7, pp. 6590 and 6594]
>
> Exhibit 79 to Counter-memorial [Record, Vol. 3, p. 1965]
>
> Exhibit 18-3 to the Reply [Record, Vol. 8, pp. 7390-7391]

363. The Tribunal also failed to have regard to the evidence that, after the June 1994 municipal stop-work order, Metalclad wrote directly to the Municipality proposing a "host community" agreement as follows:

> Mr. Neveau concluded by requesting that Metalclad be given an opportunity to demonstrate that it was possible to professionally operate a hazardous waste landfill without risks to the health or the environment of the community and with benefits for the people. He offered to provide information showing how developed countries had done it and invited the Municipal official to jointly elaborate a working plan that would satisfy the community, and to leave distrust, miscommunication and other type of errors behind in order to promote regional development in compliance with Municipal, State and Federal laws.
>
> Letter from Neveau to Municipal President dated June 13, 1994, Exhibit 75 to the Counter-memorial [Record, Vol. 3, p. 1947]
>
> *40. On October 26, 1994, when the Municipality ordered the cessation of all building activities due to the absence of a*

municipal construction permit, construction was abruptly terminated.

364. The Tribunal failed to have regard to the evidence that, after this second shut-down order, representatives of the Federal Government again wrote to Metalclad telling it of the need to apply for a municipal permit.

> In relation to your letter (dated September 20, 1994) in which you mention the need to construct some works, for example, an evaporation lagoon, a solidification tank, a neutralization area, a temporary storehouse, a storehouse for solids, a laboratory as part of the conditions to conduct the environmental audit and the possible remediation of the site, as a result of the environmental audit, I wish to inform as follows:
>
> This State delegation under my responsibility does not oppose your company conducting construction of the works mentioned above, in the understanding that your company shall obtain the corresponding construction permits for the described works from the municipal and State authorities in accordance to their respective jurisdiction.
>
> Letter from Ramiro Zaragoza to Ariel Miranda, dated November 9, 1994, Exhibit 86 to the Counter-memorial [Record, Vol. 3, p. 2014]

And:

> I do not omit to mention that your represented company shall obtain the corresponding permits and authorizations from the competent State and Municipal authorities.
>
> Letter from Ramiro Zaragoza to Ariel Miranda, dated November 14, 1994, Exhibit 87 to the Counter-memorial [Record, Vol. 3, p. 2019]

K. The Finding that Metalclad was Prevented from Opening the Landfill by a Demonstration and the Tribunal's Failure to Have Regard to the Federal Shut-Down Order and the Dispersal of the Demonstration

365. In finding that a one-day demonstration "prevented" Metalclad from opening the landfill, the Tribunal ignored a federal closure order and a court injunction. It also completely misunderstood not only the evidence relating to the March 10th demonstration but Metalclad's own pleadings and averments of fact.

> *45. Metalclad completed construction of the landfill in March 1995. On March 10, 1995, Metalclad held an "open house," or*

> *"inauguration," of the landfill which was attended by a number of dignitaries from the United States and from Mexico's federal, state and local governments.*

366. This finding implied that with the *imprimatur* of the federal, state and local governments, the "inauguration" was held. Why else would "dignitaries from ...Mexico's federal, state and local governments" attend the inauguration?

367. In fact, in its Memorial Metalclad alleged that state officials, including the Governor, informed the company that he and his officials would not attend the opening ceremony "contrary to his earlier acceptance" and instructed municipal officials similarly not to attend (at paragraphs 87-88). Insofar as Metalclad alleged that federal officials attended the opening, Mexico canvassed all of the relevant officials and found that none of them had attended. Antonio Azuela, Federal Attorney General for Environmental Protection, testified that he turned down the invitation and had instructed other federal officials not to attend the opening.

> Counter-memorial Witness Statement of Antonio Azuela at paragraphs 12-13 [Record, Vol. 4, pp. 2579-2580]

368. Mexico also filed with its Counter-memorial a letter from the Mexican Embassy in Washington, D.C. to Mr. Kesler that stated that since the authorization to operate the landfill was "still pending of approval", "it would be premature to make the public announcement of the Metalclad opening before this matter is resolved by the Attorney General Office for the Protection of the Environment (PROFEPA)".

> Exhibit 95 to the Counter-memorial [Record, Vol. 3, p. 2055], cited at paragraph 487 (see also paragraphs 483-488) [Record, Vol. 2, pp. 1243-1246]

369. The Admissions and Denials section of Metalclad's Reply admitted that "Claimant erroneously included Secretary Carabias and Federal Attorney Azuela as attendees at the March 10, 1995 event."

> Reply at paragraph 494 of Claimant's Admissions and Denials [Record, Vol. 7, p. 6599]

370. Thus, the Tribunal made a finding of fact that was not alleged by Metalclad. The facts were that no Mexican dignitaries attended the "inauguration" because the potential opening

of the site was highly controversial. The undisputed evidence was that the federal environmental audit of the site was still to be completed and the Federal Government then went through an "audit of the audit" to try to generate public support for the project. It was only after the "audit of the audit" that the Federal Government agreed that the landfill could be operated and then, again, if the Municipality and State approved.

371. The Award did not address any of the contemporaneous documents or the witness statements on these points.

372. The Award then stated:

> *46. Demonstrators impeded the "inauguration," blocked the entry and exit of buses carrying guests and workers, and employed tactics of intimidation against Metalclad. Metalclad asserts that the demonstration was organized at least in part by the Mexican state and local governments, and that state troopers assisted in blocking traffic into and out of the site. Metalclad was thenceforth effectively prevented from opening the landfill.*

373. It is noted that, as in many other parts of its recounting of the "Facts and Allegations", the Tribunal recorded what Metalclad "asserts" without actually passing on whether Metalclad proved its assertion.

374. Paragraph 46 of the Award misstated the undisputed record evidence. It held that as a result of the demonstration, "Metalclad was thenceforth effectively prevented from opening the landfill."

375. This finding demonstrates the Tribunal's failure to have regard to the uncontested evidence that the site was shut down by federal order, an order imposed in 1991 which remained in effect until February 2, 1996. On March 10, 1995, the site was still being audited to determine the extent of the contamination caused by the illegal dumping in 1991-92. When the federal shut-down order was lifted in February 1996, the Municipality obtained an injunction against the receiving of new hazardous waste until the site was remediated. In other words, the site remained closed first by federal administrative order and then by court order until May 18, 1999.

It was patently unreasonable to find that the demonstration "thenceforth effectively prevented Metalclad from opening the landfill".

376. The Tribunal also failed to have regard to the Agreement of Understanding, discussed below, under which the Municipality agreed to allow the opening of the landfill as a non-hazardous industrial waste landfill.

L. Metalclad Started Construction Without First Resolving the Municipal Permit Issue

377. In describing the Municipality's acts, the Tribunal ignored the fact that COTERIN constructed without first resolving the permit issue.

> *50. On December 5, 1995, thirteen months after Metalclad's application for the municipal construction permit was filed, the application was denied. In doing this, the Municipality recalled its decision to deny a construction permit to COTERIN in October 1991 and January 1992 and noted the "impropriety" of Metalclad's construction of the landfill prior to receiving a municipal construction permit.*

378. As noted above, due diligence had disclosed that the local Municipality considered it had authority, when considering the grant or denial of construction permits for a hazardous waste landfill (when owned by Mexican interests) to consider health and safety concerns, previous illegal activity of the applicant and the social interests of the community. This was evidenced by the August 15, 1991 COTERIN application, the October 1, 1991 denial by the *Ayuntamiento*, and the January 20, 1992 resolution affirming the denial.

> COTERIN Application, Exhibit 37 to the Counter-memorial [Record, Vol. 4, pp. 3310.001]
>
> October 1, 1991 Denial, Exhibit 43 to the Counter-memorial [Record, Vol. 3, pp. 1685-1686]
>
> January 20, 1992 Resolution, Exhibit 45 to the Counter-memorial [Record, Vol. 3, pp. 1698-1699]

379. Metalclad conceded that the local Municipality could lawfully consider the impact of the project from the local population's perspective. Its January 13, 1994 press release recognized the autonomy of the Municipality stating:

> We agree with you that the consensus of the population of Guadalcazar is required in order to be able to construct and operate such a facility.
>
> Exhibit 2 to the Counter-memorial [Record, Vol. 2, p. 1435]

380. As noted above, the November 15, 1994 permit application made specific reference to the "impact in the influenced area and environment, ... [and] ... risks it may generate".

> Exhibit 88 to the Counter-memorial [Record, Vol. 3, p. 2028]

381. The legal advice given to Metalclad was that, according to Mexican law, by applying for the permit the company accepted the legitimacy of the permit requirement. This decision was taken with advice that an alternative remedy was to challenge the jurisdiction of the Municipality to issue the first closure order. The Claimant decided not to challenge the closure order and decided to apply for the permit.

> Witness Statement of García Leos, paragraph 51 [Record, Vol. 12, p. 10,852]

382. In considering the reasons given by the Municipality for the denial of the permit, it is noted that they can be supported whether or not municipal authority extended to considerations of environmental concerns in the case of hazardous waste. The minutes of the decision of December 1995 recorded four separate reasons for the denial:

(a) the previous denial (in the context of the illegal deposit of contamination and the construction in the face of that previous denial, recalling that no remediation has occurred);

(b) the construction had already been completed without a permit;

(c) the state land use permit did not authorize construction and appeared on its face to be null because of that prior construction; and

(d) the consensus of local opposition and the presence of a "great number of inhabitants of this Municipality" at the meeting expressing social opposition.

> Exhibit 31 to the Memorial [Record, Vol. 1, pp. 613-614]

No one disputed that the initial dumping of hazardous waste was illegal. Metalclad conceded that the dumping created a dangerous situation. COTERIN created this situation and Metalclad acquired it. Metalclad did not remediate it. It continued its ownership of the site in an unremediated state. The same corporate entity that deposited the waste illegally was now seeking a municipal construction permit.

383. In this regard, it should be noted that the Municipality of Guadalcazar acted in a plenary capacity. In its reasons denying the building permit, it was acting, not solely as the building permit inspector, but in a representational capacity, noting expressly the consensus of opposition to the landfill and the presence of a great number of inhabitants of the Municipality expressing social opposition to the proposed landfill. In effect, the Municipality was acting both in its administrative and bylaw-making capacity in rejecting the suitability of this investment. The courts have long recognized that such decisions may inevitably affect proprietary rights by the imposition of restrictions which fetter the ordinary use of land. Moreover, it must be remembered that the Municipality was prepared to allow use of the landfill as an industrial non-hazardous waste landfill.

384. Metalclad was advised that if COTERIN did not contest the October 26, 1994 closure order before November 16, 1994,

> ... the result will be that the closure will become final in which case there will be no appellate recourse. It is also true that the result of the amparo action is uncertain.
>
> November 14, 1994, García Leos to Humberto Rodarte,[25] Exhibit 6 to the Rejoinder Witness Statement to García Leos [Record, Vol. 12, p. 10,880]

385. Moreover, Metalclad was advised that if the Municipality denied the permit, a court petition could be brought for an order constraining the municipal council to grant the permit but, since "the fact that this was already mentioned some time ago to you [i.e., before construction commenced] with the additional information that the building license was applied

---

[25] At this time Mr. Rodarte was a disclosed employee of Metalclad.

for by COTERIN and denied, and for such reason there is no certainty of the results if we proceed as mentioned."

> August 17, 1994, García Leos to Javier Guerra, Exhibit 3 to the Rejoinder Witness Statement of García Leos [Record, Vol. 12, p. 10,864]

386. As will be noted below, COTERIN did ask the Federal Court to compel the issuance of the construction permit but its *amparo* was denied, initially by reason of the failure to proceed to the State Administrative Tribunal, and later by COTERIN's voluntary abandonment of those domestic remedies. The Tribunal ignored these undisputed juridical facts.

> Claimant's Admissions and Denials, paragraph 630 [Record, Vol. 7, p. 6617]

M. The Complaint About the Municipality's Alleged Inaction

387. The Tribunal's description of the Municipality's actions ignored record evidence of its discussion and consideration of the permit issue.

> *51. There is no indication that the Municipality gave any consideration to the construction of the landfill and the efforts at operation during the thirteen months during which the application was pending.*

388. With respect to the latter part of the sentence, the undisputed evidence is that due to the federal shut-down order, COTERIN could not operate even insofar as the Federal Government was concerned until February 1996, two months after the municipal permit was denied. As a result, there were no "efforts at operation" during the thirteen months while the application was pending.

389. Moreover, the Tribunal failed to have regard to record evidence that COTERIN's permit application was considered in December 1994 less than a month after it was filed by the then outgoing Municipal President who determined to wait for the "new City Council to decide".

> Exhibit 7 to the Rejoinder Witness Statement of García Leos [Record, Vol. 12, p. 10,884]

390. Leonel Ramos Torres, whose municipal administration began January 1, 1995, testified that prior to COTERIN's arrival, the Municipality had never confronted a construction

project of this significance and controversy. Nevertheless, the records of the *Ayuntamiento's* meeting show that the Council decided on February 13, 1995 that any discussion of the landfill must be held in open council, and an environmental committee was formed to replace the Ecology *Regidor* of the previous administration. The same council minute recorded continued local opposition to the introduction of more hazardous waste.

Exhibit 91 to the Counter-memorial [Record, Vol. 3, p. 2040]

391. As noted above, during this time, the site was shut down by federal order and it was not necessary for the Municipality to take any action in order to avoid the introduction of new hazardous waste. Immediately following the *Convenio*, noted below, when federal approval of the introduction of hazardous waste was forthcoming, the Municipality acted.

392. Another reason that the delay in the new Council's consideration of the permit application is of no legal consequence is because during the material period (January 1, 1995 to the end of February 1995) Metalclad simply ignored the permit requirement and completed construction. As of the beginning of March 1995, construction was complete.

Exhibit 93 to the Counter-memorial [Record, Vol. 3, pp. 2047-2048]

393. As noted, the fact of this unauthorized construction (commenced over five months before the permit application was made) was one of the reasons given by the Municipality for the subsequent denial of the permit application.

N. The Tribunal's Failure to Have Regard to the Prior Contamination and the Federal Shut-Down Orders when Considering the Municipality's Proceedings Against the *Convenio*

394. The Tribunal completely misunderstood the actions taken by the Municipality against the Federal Government's agreement with COTERIN.

> *94. Moreover, the Tribunal cannot disregard the fact that immediately after the Municipality's denial of the permit it filed an administrative complaint with SEMARNAP challenging the Convenio. The Tribunal infers from this that the Municipality lacked confidence in its right to deny permission for the landfill solely on the basis of the absence of a municipal construction permit.*

395. Having ignored the evidence of the prior contamination by COTERIN, the Tribunal also failed to have regard to the evidence of the Municipality's legitimate motives for challenging the *Convenio*. Its inference stems from a fundamental misapprehension of the documentary record.

396. The Municipality filed the administrative complaint against SEMARNAP and subsequently argued that the *Convenio* was unlawful on the basis that an August 30, 1994 PROFEPA resolution required Metalclad to remediate the site before introducing new hazardous waste to the site. The federal August 30, 1994 resolution had stated that:

> The introduction to the installation of any type of waste is strictly prohibited until the studies have been completed and the remediation works are carried out that could result from the audit mentioned in point 2 of the Technical Measures contemplated in clause III. [Emphasis added.]
>
> Exhibit 83 to the Counter-memorial [Record, Vol. 3, p.1999]

397. On October 7, 1994, Metalclad wrote to the Federal Government requesting clarification of the August 30, 1994 PROFEPA resolution. On November 14, 1994, representatives of the Federal Government responded as follows:

> Concerning your first request, I would like to clarify that the prohibition imposed as a technical measure in the above mentioned Administrative Resolution against the introduction of any type of waste into the confinement until the necessary studies to know the actual status of the site, including the environmental, ecological and public health aspects of the place, have been completed together with the necessary remediation activities, was the result of the unlawful activities in which the company that you represent incurred and that motivated the temporal shut down of the confinement for confining hazardous waste before having the necessary permits or authorizations granted by the then competent authorities (1991) ...

> Accordingly, it is ratified that COTERIN shall not introduce any type of waste into the Confinement until the prevailing situation of the site is known through the studies referred and the corrective measures established in such audit are performed. Neither shall COTERIN operate the hazardous waste landfill until the total remediation of the site. [Emphasis added.]
>
> Exhibit 87 to the Counter-memorial [Record, Vol. 3, pp. 2018-2019]

398. The Municipality considered that the *Convenio* violated this requirement and unsuccessfully petitioned SEMARNAP to review the *Convenio*. Then, on February 5, 1996, the Municipality filed an *amparo* in Federal Court against SEMARNAP, challenging SEMARNAP's rejection of its petition to review the *Convenio*. There was no evidence that these actions were taken by the Municipality because it lacked "confidence" in its position on the permit; rather, the evidence was that the Municipality was seeking to enforce the August 30, 1994 PROFEPA resolution in order to compel remediation of the contamination left by COTERIN, a separate issue from construction and operation of a new landfill.

> Exhibit 33 to the Memorial (Memorandum dated May 24, 1996 of Garcia Barragan) [Record, Vol. 1, pp. 622-624]

O. The Tribunal's Failure to Have Regard to the Domestic Legal Remedies Exercised by Metalclad

399. The Tribunal failed to have any regard whatsoever to the domestic legal remedies available to Metalclad, which Metalclad invoked but then abandoned.

400. On February 28, 1996, Metalclad petitioned the Municipal Council for reconsideration of the permit's denial. In April 1996, the Municipality refused reconsideration of the permit denial.

> Rejoinder Witness Statement of García Leos, at paragraph 56 [Record, Vol. 12, p. 10,853]
>
> Exhibit 33 to Memorial [Record, Vol. 1, pp. 622-624]

401. In May 1996, Metalclad filed *amparo* proceedings in the Federal Court challenging the Municipality's refusal to reconsider its decision. Metalclad failed first to challenge the denial at the State Administrative Tribunal level and in June 1996, its *amparo*

proceedings in Federal Court were denied on jurisdictional grounds. Metalclad appealed from this denial to the Mexican Supreme Court.

> Exhibit 33 to Memorial [Record, Vol. 1, pp. 622-624]
>
> Rejoinder Witness Statement of García Leos at paragraph 56 [Record, Vol. 12, p. 10,853]

402. On October 31, 1996, Metalclad abandoned that appeal in favour of direct negotiations with the Municipality. No complaint has been demonstrated with respect to any aspect of the Mexican judicial remedies open to or engaged in by Metalclad.

> Claimant's Admissions and Denials, paragraph 630 [Record, Vol. 7, p. 6617]

403. As noted above, according to the Mexican domestic courts, the Municipality's denial of the permit application stands as legally correct *qua* domestic law.

P. The Tribunal's Failure to Have Regard to the Agreement Allowing Operation of the Site as a Non-Hazardous Waste Landfill Site

404. The Tribunal also failed to address the agreement between Metalclad and the Municipality.

> *62. The landfill remains dormant. Metalclad has not sold or transferred any portion of it.*

405. The Tribunal failed to have regard to negotiations conducted in 1996 between Metalclad and the Municipality, and which led to the signing of the *Acuerdo de Entendimiento* (Agreement of Understanding) on January 8, 1997. This was an agreement to establish the framework for future negotiations on the site's possible operation as a hazardous waste landfill. The Municipality's consistent position was that Metalclad should comply with its legal obligation to remediate the landfill site, but that it could do so while receiving and depositing non-hazardous industrial waste. The Municipality did not rule out consideration of the possibility of hazardous waste operation if the local community supported that.

406. The fact that the landfill remains dormant was a commercial decision by Metalclad to insist on operation as a hazardous waste landfill only, rather than operate for the processing of non-hazardous industrial waste, while site remediation occurred.

Reply, paragraphs 75, 195 [Record, Vol. 7, pp. 6290-6291, 6349], Claimant's Admissions and Denials, paragraph 645 [Record, Vol. 7, p. 6618]

407. The Award left the impression that (at the end of the negotiations with Metalclad, negotiations which it omitted to refer to) the Municipality was arbitrarily opposed to any use of the site, an impression which is not supported by the contemporaneous evidence.

Q. Assuming the Tribunal Had the Jurisdiction to Interpret Mexican Law, its Failure to Have Regard to the Mexican Constitution

408. Mexico argued that the Tribunal should not act as a Mexican court in interpreting Mexican law, and its submissions on Mexican law were without prejudice to that position.

409. Having embarked on its interpretation of Mexican law, nowhere does the Tribunal examine the documentary evidence on constitutional principles of Mexican law, which failure led the Tribunal to conclude in paragraph 86 (after only five paragraphs of discussing the law) that the federal authorities' jurisdiction was controlling. The Tribunal failed to have regard to fundamental constitutional principles.

410. In paragraph 105 of the Award, the Tribunal said:

> *The Tribunal holds that the exclusive authority for siting and permitting a hazardous waste landfill resides with the Mexican federal government. This finding is consistent with the testimony of the Secretary of SEMARNAP and, as stated above, is consistent with the express language of the LGEEPA.*

411. As has been noted, this finding is completely inconsistent with the terms of the federal permits themselves, and the written advice from federal officials. It is also inconsistent with the testimony of the Secretary of SEMARNAP who testified:

> This is set forth in our constitution. Any project in our country requires municipal, state and federal approval.
>
> Transcript, Vol. 1, p. 134, ll. 2-4 [Record, Vol. 15]

412. The relevant principles are set out in Mexico's Post-hearing Submission, paragraphs 200-204. The Mexican Constitution is the supreme law of Mexico. It sets out the

basic structure of government. It is a fundamental principle of constitutional law that legislation must conform to the constitutional provisions. No federal or state law can modify constitutional provisions; rather, federal or state law must be construed in accordance with the Constitution (Article 133 of the Mexican Constitution).

> Mexico's Post-hearing Submission, paragraphs 200-204 [Record, Vol. 14, pp.12,437-12,438]

413. Thus, the provisions of the federal General Ecology Law of 1988 ("LGEEPA") stipulating the role of the Federal Government in the siting of hazardous waste landfills cannot, constitutionally, restrict or annul constitutional powers granted to municipalities to issue or deny construction permits and to control and supervise the use of land within municipal territories. Federal law cannot amend constitutional principles.

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

415. The Constitution directly confers a number of powers on municipalities in furtherance of their representative and autonomous nature as the political organ closest to the local community situated within their territorial boundaries. One such power is the power to issue construction permits. Another power is the power to control and supervise the use of land within their own territories (Article 115, V, of the Mexican Constitution).

416. The federal and municipal requirements are parallel, not primary and secondary. The error of the Tribunal in this regard is disclosed by its reference to the Federal Government as the "central government" (at paragraph 76). Metalclad itself published an advertisement recognizing the "autonomy" of the Municipality, a term of constitutional and political significance.

417. Municipalities do not have direct legislative powers and, therefore, states (the repository of all powers not otherwise expressly granted by the Constitution) are generally

empowered to enact laws applicable at the municipal level, in furtherance of their obligation to organize themselves into municipalities. Thus, the details of municipal construction permitting requirements (when required, how obtained and the sanctions for failure to obtain) are found in state legislation: the Ecological and Urban Code of the State of San Luis Potosi chiefly, but also the Municipal Organic Act of the State of San Luis Potosi, the Environmental Protection Act of the State of San Luis Potosi and the Treasury Act for the Municipalities of the State of San Luis Potosi.

R. The Failure to Refer to the Applicable Municipal Laws

418. The Tribunal failed to refer to the relevant provisions of the Ecological and Urban Code which provide when municipal construction permits are required, how they are applied for and the sanction for non-compliance, as follows:

> 5) Art. 1 – The provisions of this Code are of public order and of social interest and their objective is to regulate:
>
> IV. the use of … municipal constructions …
>
> 6) Art. 5 – The Executive of the State and the *Ayuntamientos* are empowered to establish restrictions to the use of land and to any kind of construction as required by urban development and ecological balance within the state territory.
>
> 7) Art. 13 – The *Ayuntamientos* in the State shall have, within the scope of their respective jurisdictions, the following powers:
>
> XII. to grant construction municipal licenses and to supervise the conduct of all works or construction performed within its jurisdictional territory.
>
> 8) Art. 31 – The following definitions are provided for the purpose of this title and Code:
>
> XIV. Uses that Produce Significant Impact.
>
> The uses that produce significant impact are constructions and facilities destined for industrial, commercial or residential uses that because of their dimensions, infrastructure, transportation needs or potential

contamination, may severely harm the life conditions of the inhabitants, the urban, ecological and landscape context, as well as the regular operation of the services.

9) Municipal Construction License

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

The municipal construction license shall be required to:

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

419. The Treasury Law for the Municipalities of the State of San Luis Potosi provides:

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

420. None of this transparent legislation, which was cited in both of COTERIN's unsuccessful permit applications, was referred to by the Tribunal when it concluded that there was no clear rule as to the requirement or not of a municipal construction permit.

421. The effect of the Tribunal's finding is to hold that:

(a) a legal power that was expressly vested in the Municipality by the Mexican Constitution,

(b) which was further elaborated by state law whose provisions related to the "public order and … social interest",

(c) which law further stated that municipalities were permitted to consider "uses that produce significant impact … because of their dimensions, infrastructure, transportation needs or potential contamination, may severely harm the life conditions of the inhabitants, the urban, ecological, and landscape context",

(d) that was admittedly not well developed administratively due to the impoverished state of the Municipality,

(e) but, nevertheless, had been asserted previously with respect to the same project, and

(f) which both COTERIN (by the content of its application) and the Municipality (by the content of its decision) considered allowed the Municipality to have regard to a broader range of factors than the Tribunal held was permissible under Mexican law,

amounted to an "improper" act at Mexican domestic law, even though the text of the domestic law supports the interpretation given to it by the Municipality (and supported by Mexico's expert reports on Mexican law – ignored by the Tribunal), in circumstances where the decision of the Municipality was not successfully challenged in the domestic courts.

S. The Failure to Have Regard to the Relative Expertise of the Experts

422. The Award stated:

> *81. As presented and confirmed by Metalclad's expert on Mexican law, the authority of the municipality extends only to the administration of the construction permit, "... to grant licenses and permits for constructions and to participate in the creation and administration of ecological reserve zones ...". (Mexican Const. Art. 115, Fraction V). However, Mexico's experts on constitutional law expressed a different view.*

423. In its implicit rejection of the "different view" of "Mexico's experts", nowhere did the Tribunal deal with the relative qualifications of the experts. The expert reports filed by Metalclad were authored by a 1994 graduate of the University of Arizona who was an LL.M. candidate at the Institute of Technological and of Higher Studies of Monterrey ("ITESM"), Mexico, and two of his colleagues at the ITESM. Mexico argued that, as such a recent graduate, this author would not qualify as an expert on U.S. law, let alone on Mexican law. Moreover, Mr. Eaton lacked the necessary credentials required to give an opinion on Mexican law.

> Transcript, Vol. 9, at p.147 [Record, Vol. 16]
>
> Mexico's Post-hearing Submission at paragraphs 212-220 [Record, Vol. 14, pp. 12,440-12,442]

424. Two legal opinions were filed by Mexico. One was prepared by the Institute of Legal Research of the Autonomous University of Mexico. Another was prepared by two former justices of the Mexican Supreme Court and a distinguished scholar.

425. Mexico challenged the credentials of Metalclad's expert after which the President commented that:

> No doubt, in their post-hearing briefs, the claimants will consider the question of these qualifications and quality of their experts.
>
> Transcript, Vol. 9 at p. 149 [Record, Vol. 16]

426. Mexico's Post-hearing Submission discussed this legal issue: arguing first, that the legal correctness of the Municipality's actions at domestic law was not the proper issue before the Tribunal at international law, and secondly, that even if it were, Metalclad's experts' reports should be rejected due to the lack of suitable qualifications of the proffered person and the defects of the two reports' reasoning, and thirdly, that the expert reports tendered by it were to be preferred on account of their superior weight and reasoning.

427. The Tribunal did not address the relative weight of the credentials of the two parties' experts and there was no discussion at all of Mexico's submissions on this point.

T. The Failure to Have Regard to the Terms of the Ecological Decree of September, 1997

428. In obiter comments, the Tribunal referred to the Ecological Decree of September 1997, as follows:

> *109. Although not strictly necessary for its conclusion, the Tribunal also identifies as a further ground for a finding of expropriation the Ecological Decree issued by the Governor of SLP on September 20, 1997. This Decree covers an area of 188,758 hectares within the "Real de Guadalcazar" that includes the landfill site, and created therein an ecological preserve. This Decree had the effect of barring forever the operation of the landfill.*
>
> *110. The Tribunal is not persuaded by Mexico's representation to the contrary. The Ninth Article, for instance, forbids any work*

> *inconsistent with the Ecological Decree's management program. The management program is defined by the Fifth Article as one of diagnosing the ecological problems of the cacti reserve and of ensuring its ecological preservation. In addition, the Fourteenth Article of the Decree forbids any conduct that might involve the discharge of polluting agents on the reserve soil, subsoil, running water or water deposits and prohibits the undertaking of any potentially polluting activities. The Fifteenth Article of the Ecological Decree also forbids any activity requiring permits or licenses unless such activity is related to the exploration, extraction or utilization of natural resources.*
>
> *111. The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal's finding of a violation of NAFTA Article 1110. However, the Tribunal considers that the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.*
>
> Ecological Decree of September 1997 [Record, Vol. 1, pp. 595-607]

429. The Tribunal's finding was that the Ecological Decree was not essential to its reasons, that is, these comments were obiter. It is not necessary for this Court to examine this issue further. It would appear that the Tribunal was not prepared, for jurisdictional reasons, to rest its decision upon the Ecological Decree since it was not in existence when this Tribunal was constituted and the Decree was not implemented.

430. However, consideration of what the Tribunal did say about the Decree also demonstrates failure to have regard to the uncontradicted evidence, that there were no cacti in need of preservation in the area immediately surrounding the landfill. The *Convenio* had already dealt with the issue of protection of cacti.

> *Convenio*, Clause Third [Record, Vol. 3, p. 2264]

The Federal Public Announcement of November 24, 1995 made this clear:

> 5TH PRESERVATION OF THE PLANT SPECIES OF THE ZONE
>
> In order to preserve the plant species present at the site, in particular the cactus, the installation of the landfill will occupy less

> than 5% of the total surface of the land and the company is obliged to carry out a rescue and conservation plan, the guidelines that are pointed out for the National Commission for the Knowledge and Use of the Biological Diversity (CONABIO).
>
> Exhibit 120 to Counter-Memorial [Record, Vol. 3, p. 2271]:

431. The Tribunal also failed to refer to the terms of the Decree which preserved permits and authorizations granted prior to its enactment or regularized within 90 days of the enactment date. The Decree expressly preserved any valid permits, licenses and authorizations previously granted (Article 4 of the Transitional Provisions).

432. The Decree also granted a 90-day term to bring into order any irregular permits, licenses or authorizations (Article 4 of the Transitions Provisions).

433. The Decree also permitted the establishment of new activities, provided that:

(a) sustainability of natural resources was ensured;

(b) an environmental impact authorization in accordance with the federal environmental legislation was obtained;

(c) the area management plan was complied with; and

(d) all other applicable laws and regulations were observed (Article 7).

434. The Decree covered 188,758 hectares (the total landfill site was 814 hectares of which only 5% was intended to be utilized). The Decree was the result of a process spanning several years, that began with detailed studies of the regional flora. Studies dated back to the mid-1950s but the more significant ones were performed since the 1990s. These studies concluded that the Guadalcazar region is the place with the highest concentration of cacti species in the world, including several endemic and threatened species.

435. The studies contributed to increase the community's awareness of and concerns regarding the protection of the environment. The Decree was issued in the exercise of the normal regulatory powers of the state, that is, in the exercise of its ordinary police powers, consistent with Mexico's rights under NAFTA Article 1114 which provides that:

> Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

436. The purpose of the Decree was to protect the Guadalcazar region, not by precluding the development of productive activities, but rather by exercising a more stringent control to ensure the sustainability of natural resources.

437. Of course, on the facts, Metalclad had already abandoned the project in favour of the NAFTA arbitration nine months before the Decree was promulgated.

XII. THE TRIBUNAL'S FAILURE TO ADDRESS THE EVIDENCE OF IMPROPER ACTS

A. Introduction

438. In its first pleading, Metalclad alleged corruption against a large number of Mexican officials and private citizens.[26] It supplied no proof of corruption other than claims made in witness statements, principally those of Metalclad's Chief Executive Officer, Grant Kesler, and Humberto Rodarte Ramon, a former senior federal environmental official in SLP and later Mexico City. In the course of defending itself, Mexico discovered that Mr. Rodarte, one of Metalclad's prime witnesses who, among other things, testified as to the giving of federal assurances on permitting matters, was improperly affiliated with Metalclad at all material times.

B. The Affiliation between Metalclad and One of its Principal Witnesses

439. When preparing its Counter-memorial, Mexico became aware that Mr. Rodarte had been appointed General Director of Metalclad's recently established Mexican consulting company, CATSA, in June of 1993, prior to leaving the Federal Government's employ in September. Clearly, this put Mr. Rodarte in a conflict of interest when he participated in a meeting between Metalclad representatives and the then-Governor of SLP and should have led to a finding on his lack of credibility.

Counter-memorial at paragraph 84 [Record, Vol. 2, pp. 1123-1124]

440. Mexico subsequently discovered that Mr. Rodarte was affiliated with Metalclad much earlier than had previously been understood to be the case. A review of Metalclad's SEC filings revealed that on August 14, 1991, two years before Metalclad acquired COTERIN, Mr. Rodarte's wife, Lucia Rátner Gonzalez, was made a shareholder of Metalclad's first Mexican venture, Eco-Administración, S.A. de C.V. ("ECO"), which was intended to construct a hazardous waste incinerator in SLP.

Rejoinder, Exhibit 18 [Record, Vol. 12, pp. 10,323-10,335]

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[26] Mexico dealt with every allegation made against each person concerned. A number of the witnesses accused Metalclad of improper acts including attempted bribery.

441. On February 24, 1993 Ms. Rátner entered into a Stock Exchange Agreement with Metalclad's Chief Executive Officer, Grant S. Kesler, whereby she agreed to exchange her shares in ECO for shares of Metalclad stock.

Rejoinder Exhibit 18 [Record, Vol. 12, pp. 10,323-10,335]

442. By that time her husband was the Special Advisor to the President of the federal environmental permitting authority in Mexico City. She received Metalclad stock worth about U.S. $150,000. Her agreement with Metalclad entitled her to further payments of cash and/or shares, triggered when further federal environmental permits were issued to Metalclad projects.

Rejoinder at paragraph 171 [Record, Vol. 11, pp. 9767-9768]

443. It was during this time, whilst in his official role as Special Advisor to the President of the INE, that Mr. Rodarte negotiated a commission arrangement with the Aldretts and then introduced them to Mr. Kesler and his colleagues. Obviously, he had a financial interest in seeing the COTERIN purchase occur and could be expected to minimize the permitting role of other jurisdictions.

444. Mexico also found that in response to a request for documents, Mr. Kesler enclosed a copy of a letter he sent to Metalclad's Mexico City legal counsel in which he instructed counsel to pay Ms. Rátner U.S. $10,000.

Rejoinder Exhibit 20 [Record, Vol. 12, p. 10,351]

445. Ms. Rátner received a second payment of U.S. $10,000 on September 9, 1993.

Translation of Tax Return – Balance Sheets (originals Dabbene Exhibits 24, 25) used in cross-examination of Anthony Dabbene [Record, Vol. 7, pp. 6828-6836; Vol. 20, pp. M44-M57]

446. After Mexico became aware of this evidence, Federal Environmental Secretary Julia Carabias reported Mr. and Mrs. Rodarte to the Attorney General's office.

Rejoinder Witness Statement of Julia Carabias [Record, Vol. 12, p. 11,071]

447. In addition to this documentary evidence, Mexico filed a witness statement from a former business associate of Mr. Kesler in Mexico, who testified that Mr. Kesler was "aware of

and approved" making Ms. Rátner a shareholder of ECO. Although Metalclad required the witness, Jorge Hermosillo, to attend in Washington for cross-examination, after he arrived, Metalclad excused him from cross-examination.

> Rejoinder Witness Statement of Jorge Hermosillo [Record, Vol. 13, p. 11,077]
>
> Transcript, Vol. 4 at p. 110 [Record, Vol. 15]

448. Mr. Hermosillo also testified in writing as to Mr. Kesler's agreement to issue shares of Metalclad stock and to make cash payments on the same basis as the Lucia Rátner agreement to one José de Jesús de la Torre. This agreement was significant because, according to Mr. Hermosillo, who established the closely held companies the shares of which Mr. de la Torre allegedly exchanged for Metalclad shares, Mr. de la Torre (of whom he had never heard) was never a shareholder and therefore could not have been in a position to exchange shares that he did not own for shares of Metalclad stock.

> Rejoinder at paragraphs 153-158 [Record, Vol. 11, pp. 9759-9761]
>
> Rejoinder Witness Statement of Jorge Hermosillo at paragraphs 15-18 [Record, Vol. 13, p. 11,078]

449. Prior to the hearing, the parties were required to identify which of the opposing party's witnesses they required to attend the hearing for cross-examination. Mexico identified Mr. Rodarte as one such witness. During the hearing Metalclad filed a letter from Mr. Rodarte's legal counsel informing the Tribunal that since Mr. Rodarte was under criminal investigation in Mexico he was advised not to attend the hearing for cross-examination. Mr. Rodarte accordingly did not attend the hearing.

> Transcript, Vol. 3 at pp. 85-86 [Record, Vol. 15]
>
> Transcript, Vol. 4 at p. 111 [Record, Vol. 15]
>
> Letter dated August 31, 1999, from Roberto Ismael Vélez Rodríguez to Clyde C. Pearce [Record, Vol. 20, p. M61]

450. Metalclad had earlier submitted documentary evidence of ledger entries aimed at supporting its claim that it had spent significant sums on the landfill project (a point that Mexico disputed). As noted, the hand-written ledgers contained records of payments to Lucia Rátner described as "Legal Expenses". Thus, payments for bribes were included in the claimed expenditures for which Metalclad sought compensation from Mexico.

451. Mexico reproduced the hand-written ledgers in typed format for the purposes of cross-examination. Metalclad's Chief Financial Officer was cross-examined on these and other irregular payments, such as to company insiders, that had been included in Metalclad's claimed expenditures for which it sought compensation from Mexico.

> Translation of Tax Return – Balance Sheets (originals Dabbene Exhibits 24, 25) used in cross-examination of Anthony Dabbene [Record, Vol. 7, pp. 6828-6836; Vol. 20, pp. M44-M57]
>
> Transcript, Vol. 6 at pp. 119-132 [Record, Vol. 16]

C. Rodarte's Commission for the Sale of COTERIN

452. Over and above the payments made to Lucia Rátner in its subsequent employment contract with Mr. Rodarte, Metalclad agreed to protect and cover a "commission" which Mr. Rodarte negotiated, whilst a federal official, for his role in arranging the sale of COTERIN from its previous owners, the Aldretts, to Metalclad.

453. According to the oral testimony of Mr. Kesler during the Hearing, this understanding to secure the commission dated back to the outset of the relationship between Mr. Rodarte and Metalclad:

> Q. That's right. And, in fact, Metalclad agreed to protect that commission when Mr. Rodarte went to work for Metalclad subsequently; correct?
>
> A. Yeah, he asked us, Will you support and protect my right? And we said, If you have an agreement, we'll support and protect that, because we have a relationship with Aldrett where we can use influence to protect your position. Yes, we will.
>
> Transcript for September 3, 1999, Vol. 5 at p. 112 [Record, Vol. 15]

454. This agreement was evidenced in writing during the course of Mr. Rodarte's employment by Metalclad in a memorandum from Mr. Kesler to Metalclad's Chairman, Mr. Neveau, of June 27, 1994, where, in summarizing a meeting with Mr. Rodarte and commenting

on the terms of his relationship with Metalclad, Mr. Kesler stated "and in light of our agreement to be sure that the Aldretts compensated Humberto as agreed ...".

> Metalclad Memorandum from Grant Kesler to Dan Neveau on the subject of Humberto Rodarte, Claimant's Production of Documents, June 27, 1994 [Record, Vol. 19, pp. C1042-C1043]

455. Finally, under the terms of the release agreement between Mr. Rodarte and Metalclad of March, 1996, under clause "SIXTH. PAYMENT OF COMMISSION", Metalclad agreed to pay a pro-rated portion of any money it might owe in the future to the "sellers of the shares", the Aldretts, of COTERIN up to U.S. $100,000 to Mr. Rodarte.

> Exhibit 21 to the Rejoinder [Record, Vol. 12, p. 10,355]

456. Mexico's Rejoinder reviewed this evidence in detail. Its Post-hearing Submission also devoted ten pages to the issue because it went directly to the credibility of Metalclad's claim that it relied "in good faith" upon the assurances that it claimed federal officials gave to it prior to its exercise of the option to purchase COTERIN, to Metalclad's bad faith, and to the admissibility of the claim. Mr. Rodarte was the only former Mexican official who testified that assurances were given by federal officials. His refusal to attend the hearing deprived Mexico of the opportunity to challenge his testimony.

D. The Relevance of the Rodarte Evidence to Metalclad's Claim of "Detrimental Good Faith Reliance" on Federal Assurances

457. The significance of Mr. Rodarte's "commission" and his connection to Metalclad through his wife's shareholding in ECO and then Metalclad itself, was demonstrated by a passage from Mr. Altamirano's witness statement, filed with the Counter-memorial before Mexico became aware of the true nature of Mr. Rodarte's relationship with Metalclad:

> 26. ...I remember that, to my great surprise, in September 1993, Mr. Humberto Rodarte Ramon quit at SEDUE and became a corporate representative for Metalclad. I do not recall his official title, but my impression was that he was in charge of facilitating and accelerating the granting of permits for the La Pedrera project. Once he joined Metalclad, he facilitated the communications and translation during our discussions.

> 27. I direct the Tribunal's attention to the matters concerning the language in which we communicated because I am absolutely certain that I discussed the issues regarding federal jurisdiction with the Metalclad representatives. I remember that I specifically said that the authorization granted only referred to the approval of the conditions of the site and of the technology planned to be used there. This authorization did not mean that the Federal Government could approve land usage, because that was an issue concerning the State and the Municipality. I have no doubt that I made this very clear in my discussion with the Metalclad's representatives.
>
> 28. I also remember that Mr. Rodarte Ramón gave the impression that he believed that they would prevail over the state and municipal concerns. He thought the influence of the Federal Government could tilt the decision in favor of the project.
>
> 29. However, I was always careful in my position as General Director to ensure that the powers conferred on the federal authority to grant permits were fully exercised, but never invading the local government's sphere of jurisdiction...
>
> Witness Statement of René Altamirano [Record, Vol. 4, pp. 2866-2867]

458. This testimony (not challenged by Metalclad and not referred to by the Tribunal in the Award) explained that Mr. Rodarte, as a federal official, gave assurances of federal primacy. Metalclad's own documents demonstrated that when he was a federal official giving such assurances, he was also simultaneously improperly in the vendor's employ to sell COTERIN and, through his wife, improperly associated with Metalclad.

459. Yet the Award accepted Metalclad's claim that it relied in good faith upon federal assurances and repeatedly made reference to such assurances (at paragraphs 80, 85, 87, 88) before it found that:

> 99. ...The totality of these circumstances demonstrates a lack of orderly process and timely disposition <u>in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly</u> in accordance with the NAFTA. [Emphasis added.]

and

> 107. These measures [the denial of the municipal permit and the Municipality's court action], <u>taken together with the</u>

> representations of the Mexican federal government, on which Metalclad relied ... amount to an indirect expropriation. [Emphasis added.]

460. In Mexico's respectful submission, there was no "good faith" reliance by Metalclad. The evidence was to the contrary. In Mexico's submission, Metalclad was aware that Mr. Rodarte was acting improperly by having his wife become as a shareholder of ECO, then Metalclad, and by acting as an "agent" to arrange the sale of COTERIN to Metalclad whilst a federal official.

461. In *Transport de Cargaison (Cargo Carriers) (Kasc-Co) Ltd.* v. *Industrial Bulk Carriers*, [1990] R.D.J. 418 (Que. C.A.) [Mexico's Authorities, Tab 67], application for leave to appeal to S.C.C. dismissed April 4, 1991, the respondent objected to the enforcement of an arbitral award on the basis that it was contrary to the public policy of Quebec for two reasons. The second reason was that the award provided for reimbursement of a bribe paid by the applicant.

462. The Court of Appeal held that if the arbitrators had ruled that an actual bribe had to be repaid by the respondent, it would not hesitate to find the award contrary to public policy. On the facts, the Court of Appeal found that the applicant had not actually paid a bribe, but rather a ransom in the form of increased dockage fees in order to keep the ship from being detained in port. In those circumstances, enforcement of the award was held not contrary to public policy. In the instant case, Metalclad's own evidence of the expenses claimed included corrupt payments to the wife of the former federal official, Mr. Rodarte.

463. At the hearing, after counsel for Mexico cross-examined Metalclad's Chief Executive Officer on a variety of improprieties and the company's relationship with Mr. Rodarte through his wife's shareholding in ECO and then Metalclad, the President of the Tribunal expressed the view that this evidence and line of questioning seemed irrelevant to him:

> I see you're raising questions about the propriety of Mr. Kesler's behavior in other contexts, but I don't quite see its relevance to the issues presented in this case, which is a case about the application of Chapter 11 of NAFTA.
>
> Transcript, Vol. 5 at p. 162 [Record, Vol. 15]

464. He expressed this view again, later in the hearing.

> Transcript, Vol. 7 at pp. 66-71 [Record, Vol. 16]

Metalclad's nominated Tribunal member also commented:

> ... I'm well aware that the credibility of witnesses whose testimony is directly relevant and material to the issues in the case is of utmost importance in these proceedings or other similar type proceedings. But where the issues, as one might see them, are dependent on independent facts or, for example, perhaps in this case the actions of the federal government, the state government, and the municipal government of Mexico and the reasons, justifications, process for their decision-making, and Mr. Kesler's particular credibility is not directly material to those issues, then establishing or spending a great deal of time establishing missteps or imprecision or inaccuracies, or worse, seems to me to be, one might say, overkill.
>
> Transcript, Vol. 5 at p. 163 [Record, Vol. 15]

465. It is respectfully submitted that these remarks, made when the Tribunal should have already been aware of the extensive documentary evidence of the Metalclad-Rátner-Rodarte relationship, based on Metalclad's own documents, showed that it was not willing to address the issues of improper acts and relationships even though they were clearly relevant to the admissibility of the NAFTA claim, to Metalclad's claimed "detrimental good faith reliance" upon federal assurances, and to the fact that Metalclad was claiming as part of its alleged expenditures compensation for the payments it made to a Mexican official's wife.

> See Grant Kesler's admission at Transcript, Vol. 5 at 167-168 [Record, Vol. 15]

466. The Award did not address any of the evidence or Mexico's submissions on the point.

467. It is respectfully submitted that the Tribunal failed to pursue the necessary inquiry and make the appropriate findings of fact on the propriety of Metalclad's acts under the mistaken belief that the evidence and cross-examination directed to that issue was simply as to credit. The Claimant was seeking damages for the failure of an investment that was promoted by improper acts. The Claimant included in its expenditures for which it claimed damages, irregular payments labelled as "Legal Expenses" in its accounts.

468. If the application is governed by the ICAA, s. 34(2)(b)(ii) expressly provides that the Court may set aside the Award where it "is in conflict with the public policy in British Columbia". Section 6 of the Act permits the Court to refer to the documents of the United Nations Commission on International Trade Law and its working group respecting the preparation of the UNCITRAL Model Arbitration Law.

469. According to the Report of the United Nations Commission 1985, *supra*, the term "public policy" includes corruption as a ground for setting aside an award:

> 297. ...It was understood that the term "public policy" which was used in the 1958 *New York Convention* and many other treaties, covered fundamental principles of law and justice in substantive as well as procedural respects. Thus, instances such as corruption, bribery or fraud and similar serious cases would constitute a ground for setting aside. It was noted, in that connection, that the wording "the award is in conflict with the public policy of the State" was not to be interpreted as excluding instances or events relating to the manner in which an award was arrived at. [Emphasis added.]

470. The Report of the United Nations Commission 1985 goes on to state:

> 303. It was understood that an award might be set aside on any of the grounds listed in paragraph (2) irrespective of whether such ground had materially affected the award.

471. In Mexico's submission, the documented evidence of improper acts ought to have led the Tribunal to refuse to entertain the claim and should have led to a finding that it was

inadmissible.[27] As the Tribunal did not do so, this Court has a duty to exercise its corrective jurisdiction.

[27] See Mexico's Post-hearing Submission at paragraphs 471-475 [Record, Vol. 14, p. 12,493].

XIII. THE TRIBUNAL'S FAILURE TO ADDRESS ALL QUESTIONS WHICH, HAD THEY BEEN ADDRESSED, COULD HAVE CHANGED THE DECISION'S OUTCOME

A. Introduction

472. Article 53 of the ICSID Arbitration (Additional Facility) Rules imposes the following mandatory requirement on the Tribunal:

> The award shall be made in writing, shall deal with every question submitted to the Tribunal and shall state the reasons upon which it is based.

473. Article 53 of the Arbitration (Additional Facility) Rules is derived from similar language in the ICSID Convention's Article 48(3), as follows:

> The award shall deal with every question submitted to the Tribunal, and shall state the reasons upon which it is based.

474. A commentary on ICSID Article 48 by Professor Christoph Schreuer, "Commentary on the ICSID Convention: Article 48", ICSID Review – Foreign Investment Law Journal, Vol. 13, No. 1, Spring 1998 [Mexico's Authorities, Tab 122], at p. 265, states:

> The requirement that the award must deal exhaustively with the dispute, as submitted by the parties, is one of the general principles underlying arbitration. A tribunal may not hand down a partial award leaving questions submitted to it undecided. This principle is mandated by the parties' will underlying the arbitration as well as by requirements of procedural economy. An award that is not comprehensive and exhaustive of the parties' questions is the obverse of an excess of powers committed through a decision on questions that have not been submitted to the tribunal.

475. A "question" is a material legal or factual issue that is raised by either party, the resolution of which could have affected the result.

476. As noted above, ICSID Convention awards are reviewed, not by domestic courts, but rather by ad hoc review committees in annulment proceedings. Successive ad hoc committees reviewing ICSID awards have held that a violation of the obligation to deal with every question may expose the award to annulment: see *Klöckner v. Cameroon*, Decision on

Annulment, 3 May 1985, 2 ICSID Reports 95 [Mexico's Authorities, Tab 31]; *Amco* v. *Indonesia*, Decision on Annulment, 16 May 1986, 1 ICSID Reports 508 [Mexico's Authorities, Tab 4]; *MINE* v. *Guinea*, Decision on Annulment, 22 December 1989, *supra* [Mexico's Authorities, Tab 38].

477. Professor Schreuer summarizes some of the criteria that have been developed by the ad hoc review committees as follows:

> The reasons need not deal with all arguments that the parties presented to the tribunal. The reasons are complete if they address all arguments of the parties that were accepted as necessary or relevant for the decision. They must also address all arguments made by the parties that were rejected and which, had they been accepted, would have changed the decision's outcome. [Emphasis added.]
>
> Professor Schreuer, *supra*, at p. 274

478. In Broches "On the Finality of Awards: A Reply to Michael Reisman" (1993) 8 ICSID Review – Foreign Investment Law Journal 92 [Mexico's Authorities, Tab 100] at 96:

> Moreover, the explicit requirement to deal with such questions constitutes a fundamental procedural protection of the parties against arbitrary decisions. Failure of a tribunal to observe it is a serious departure from that fundamental rule of procedure which is a ground for annulment under Article 52(1)(d).

479. Broches commented in another article further that the suggestion that a tribunal may decline to answer questions submitted to it was "formalistic" and incorrect:

> This formalistic approach leads to the absurd result that a tribunal may pick and choose among the questions submitted to it by a party and deal only with those on which it will base a reasoned award, *acting as if the other questions had not been raised.* [Emphasis in original.]
>
> Broches, "Observations on the Finality of ICSID Awards", (1991) 6 ICSID Review – Foreign Investment Law Journal, 321 [Mexico's Authorities, Tab 99] at 367

This is precisely what the Tribunal did in the instant case.

480. It has been demonstrated above that the Tribunal manifestly failed to address substantive Mexican defences which, had they been accepted, would have changed the decision's outcome. Without repeating all of the points made above, the following material questions at a minimum ought to have been addressed:

(1) the fact of prior contamination of the site and how that prior contamination:

(a) created health concerns in the small communities near the site (for example, Mexico adduced testimony of a local resident living near the landfill site whose infant daughter was born essentially without a brain and who testified that three other children in the area had been born with the same condition after the contamination and other evidence relating to the health risks of this contamination);

See Rejoinder Witness Statement of Juan Romo [Record, Vol. 12, p. 11,041]

(b) motivated the Municipality to deny the construction permit application;

(c) motivated the Municipality to initiate legal proceedings in the Mexican courts to challenge the *Convenio*;

(d) motivated the March 1995 demonstration, which demonstration was by private citizens and non-governmental organizations whose acts are not attributable to the Mexican State, and the issue of non-attributability itself;

(e) motivated the Municipality to seek remediation of the site;

(2) the existence and relevance at international law of the domestic legal remedies available to Metalclad, invoked by Metalclad and abandoned by it in favour of negotiations with the Municipality, including the significance of the Municipality's willingness to agree to the use of the site as an industrial non-hazardous waste landfill.

481. Another separate failure – the failure to deal with the issue of the lack of good faith on the part of Metalclad – is discussed next.

B. The Failure to Consider the Issue of Good Faith

482. International law and State practice is settled on the duty of a State to act in good faith when bringing an international claim. In the absence of investor-State arbitration, claims for alleged breaches of international law that result in loss to an investor can be espoused only by the State of whom the investor was a national. In deciding whether to espouse a claim, a State would examine the events giving rise to the claim and the investor's conduct in relation to the claim to determine whether it would espouse the claim.

483. States would refuse to act once evidence of fraud or deception arose in a claim which they were espousing came to light:

> Nations can not afford to have the intercourse which the interests of their citizens require to be kept open, subjected to the annoyances and risks which would result from the admission of fraud or duplicity into such intercourse. It has therefore become a usage, having the authority of a principle, in the correspondence between enlightened governments, in relation to the claims of citizens or subjects, that any deception practised by a claimant upon his own government in regard to a controversy with a foreign government, for the purpose of enhancing his claim, or influencing the proceedings of his government, forfeits all title of the party attempting such deception to the protection and aid of his government in the controversy in question, because an honourable government cannot consent to complicate itself in a matter in which it has itself been made or attempted to be made the victim of a fraud, for the benefit of the dishonest party.[28] [Emphasis added]

484. During the arbitration, Mexico made submissions on the applicability of this body of international law and State practice to investor-State arbitration. It argued that, as a matter of international law, the duty of good faith that is imposed upon claimant States must perforce be imposed upon private claimants who are given the extraordinary right to prosecute an international claim.

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[28] Mr. Seward, Sec. of State, to Lord Lyons, British min., May 30, 1862, MS. Notes to Gr. Brit. IX. 187 [Mexico's Authorities, Tab 124]. See also the comments of Commissioner Hassaurek of the Ecuadorian-United States Claims Commission (1862) 3 Moore Int. Arb. 2739. Hassaurek's opinion was cited and the same principle was applied in the U.S.-Venezuela Mixed Claims Commission (1903): Jarvis Case, Vol. IX R.I.A.A., United Nations at p. 208 [Mexico's Authorities, Tab 30].

Mexico's Post-hearing Submission at pp. 84-95 [Record, Vol. 14, p. 12,415]

485. Mexico advanced the good faith argument because it repeatedly encountered bad faith in the prosecution of the *Metalclad* claim. In addition to acts of bad faith and illegality in the events giving rise to the claim, the problem started in the arbitration with the filing of a false and misleading Memorial and experts' reports and continued through to the completion of the hearing.

C. The Two Principal Material Deceptions in the Pleadings

486. Metalclad sought to perpetrate two material deceptions on the Respondent and the Tribunal. The first concerned Metalclad's claim that it was not until two years after it acquired COTERIN that "any government authority" asserted that a municipal construction permit was necessary. According to the Memorial:

> 17. ...No construction permit from the Municipality of Guadalcazar was sought or required, nor has the lack of such a permit been timely raised by any government authority. As late as May, 1994, remedial construction work on the transfer station – directed, authorized and supervised by PROFEPA [the Federal Attorney General for the Environment] – was performed without a municipal construction permit. Not until December, 1995, did any state or local official allege that such a permit was or is needed... [Emphasis added.]
>
> Memorial at paragraph 17 [Record, Vol. 1, p. 57]

487. This was patently false. Metalclad was forced to admit in its Reply that it "was a matter of corporate record" that COTERIN applied for and was denied a municipal construction permit for the same site in 1991-92. Mexico also filed documents showing that on June 6, 1994, the Municipality issued a stop-work order to the company thus precipitating a June 13, 1994 letter from Metalclad's Chairman Daniel Neveau to Municipal President Juan Carrera proposing a "Host-Community" agreement, and the second stop-work order issued on October 26, 1994.

> Counter-memorial at paragraph 411 [Record, Vol. 2, p. 1224]
>
> Exhibit 75 to the Counter-memorial [Record, Vol. 3, pp. 1946-1947]

488. In furtherance of its Memorial's claim that the Mexican legal system was untransparent and therefore it could not have known of the municipal permit issue, Metalclad filed an expert's report asserting that the company was unaware of the municipal permit issue at the time that it entered into the option to purchase COTERIN:

> It is not clear that a local construction permit was required for the La Pedrera landf00ill. But given these facts, we opine that, if it was required, it was reasonable and even highly likely that METALCLAD, diligently acting in good faith, would have been unaware of this requirement. [Emphasis added.]
>
> Report of Centro Jurici, Lack of Clarity in Mexican Environmental Legislation 1988 to 1996, at p. 8 [Record, Vol. 1, p. 296]

489. Metalclad's pleading and the central factual premise of the expert's report was false. Mexico conducted a search of the company's SEC filings and found that it had filed the Amended Option Agreement by which COTERIN was acquired. As noted above, the Option Agreement was amended to make payment of three-quarters of the purchase price expressly contingent upon the resolution of the municipal permit issue.

> Exhibit 3 to the Counter-memorial [Record, Vol. 2, pp. 1438-1454]

490. The second material deception Metalclad sought to perpetrate concerned its entry into Mexico. The Memorial presented the story that it was specifically invited to make the acquisition of COTERIN by senior officials and implied that it had not previously invested in Mexico.

491. The Memorial stated in this regard:

> 13. Metalclad officers first met Mexican federal officials at a conference in New York City in October of 1992. Dr. Sergio Reyes Luján, at the time Deputy Secretary of the Environment, Mexico's highest ranking environmental official, and Dr. Santiago Oñate Laborde, the first Environmental Attorney General, publicly invited U.S. investment to their country, especially to help Mexico deal with its acute hazardous waste problem. Metalclad officers had studied the hazardous waste needs in Mexico with a view toward entering the market under appropriate conditions. [Emphasis added.]
>
> Memorial at paragraph 13 [Record, Vol. 1, p. 55]

492. Metalclad's CEO, Grant S. Kesler, testified in his first written statement that prior to investing in COTERIN in 1993, in late 1991-1992 the company:

> ...worked on a project with some executives at Ford, Bacon and Davis...who wanted to build a hazardous waste incinerator in San Luis Potosi, Mexico.
>
> Memorial Witness Statement of Grant Kesler (30 September, 1977) p. 1 [Record, Vol. 1, p. 181]

493. In fact, Metalclad's involvement with the first of numerous unexecuted hazardous waste projects dated back to August of 1991. The evidence showed that the project, which Mr. Kesler described as belonging to "some executives at Ford, Bacon and Davis", was his company's own project (the company in question was ECO), Metalclad's subsidiary incorporated in August 1991) and by the time that Metalclad acquired COTERIN, it had announced a total of three other hazardous waste projects in Mexico, none of which were ever constructed, let alone completed.

494. In Mexico's submission, Metalclad's actions were calculated to deceive for three reasons:

(a) First, obscuring its prior investment activity in Mexico was necessary to enable Metalclad to plead that it did not know about a municipal permit issue that was "sprung" upon it two years after it acquired COTERIN. Metalclad's own documents contradicted its claim. The evidence which emerged, moreover, showed that for its first hazardous waste incinerator project in the same state of SLP, for which two sites were considered, in both instances, its subsidiary, ECO, obtained municipal authorizations.

> Exhibit 24 to Rejoinder Witness Statement of Jorge Hermosillo [Record, Vol. 13, p. 11,447]
>
> Exhibit 25 to Rejoinder Witness Statement of Jorge Hermosillo [Record, Vol. 13, p. 11,450]

(b) Second, without informing Mexico or the Tribunal, and refusing throughout the proceeding despite numerous requests to provide an itemized list of expenditures that could be reviewed by Mexico's experts, Metalclad lumped all of its alleged

U.S. $20.5 million expenditures on the other failed or abandoned projects in its claim which its damages expert expressly described as the "direct" cost of acquiring the land and constructing the COTERIN landfill. Its expert falsely described the expenditures as follows:

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

First Expert Report by American Appraisal Associates at p. 74 [Record, Vol. 1, p. 877]

Second Expert Report by Kevin Dages of Chicago Partners, April 19, 1999 [Record, Vol. 13, pp. 11,499-11,540]

(c) Third, by omitting to inform the Tribunal of its previous investment activities, Metalclad obscured the corrupt relationship with Humberto Rodarte that dated back to its first Mexican investment in August 14, 1991. Mr. Rodarte became a prime witness for Metalclad in the arbitration, filing two written statements before refusing to attend for cross-examination.

495. In order to divert attention from Metalclad's actual state of knowledge and experience in Mexico, the Memorial made many scandalous and unsubstantiated allegations against Mexican officials and private citizens. This necessitated the filing of a much longer Counter-memorial than would otherwise have been required because of the need to rebut each allegation.

496. Each of the persons against whom allegations were made denied them and in fact in some cases, responded that it was Metalclad, not they, that proposed the payment of bribes.

497. Metalclad alleged repeatedly that a would-be competitor, RIMSA, was the cause of its difficulties in SLP. RIMSA figured prominently throughout the Memorial. By the time of the hearing, after Mexico had filed extensive evidence in reply, RIMSA was not even mentioned in the Claimant's case on liability. RIMSA was mentioned during the hearing only in respect of

its permits and landfill capacity. No allegations concerning RIMSA were pursued in cross-examination or in closing argument.

498. The misconduct in both the events giving rise to the claim and at the hearing led counsel for Mexico to present a series of questions to the Tribunal for its consideration. Since Article 53 of the governing rules required the Tribunal to "deal with every question submitted to" it, Mexico's counsel posed a series of questions to the Tribunal that dealt with the way in which the claim had been presented and asked that the Tribunal consider the questions in the course of making its award.

> Transcript, Vol. 9 at pp. 157-162 [Record, Vol. 16]

499. The Award did not address any of the questions raised by Mexico either at the hearing or in its Post-hearing Submission.

D. When Undertaking its Damages Analysis, the Tribunal Failed to Address Evidence of Metalclad's Own Making When Determining the Fair Market Value of the Investment

500. In its Memorial, Metalclad claimed that it had spent U.S. $20.5 million on acquiring the site and constructing the landfill. It filed with the Memorial an expert's report by American Appraisal Associates (AAA) which relied upon a one page summary of the company's alleged expenses on the landfill. (The summary was prepared by Metalclad's Chief Financial Officer.)

501. The AAA Report was very specific in stating that the $20.5 million claimed expenditure directly related to the acquisition of the site and construction of the landfill:

> The $1,151,500 was the purchase price for COTERIN. The balance of $19,323,028 represents Metalclad's expenditures for the analysis of the site and construction of the La Pedrera facility as it exists today. Total cost to Metalclad was almost $20,500,000.
>
> AAA Report at p. 74 [Record, Vol. 1, p. 877]. This was reviewed with Anthony Dabbene; see Transcript, Vol. 6, at p. 77 [Record, Vol. 16]

The AAA report went on to describe the expenditures as relating to the "bricks and mortar" of the landfill.

502. After reviewing the Memorial, Mexico repeatedly requested Metalclad to prepare both an itemized list of its claimed expenditure of U.S. $20.5 million on the landfill so that it could be vouched by Mexico's expert, and further that it provide its Mexican subsidiaries' tax returns so that Mexico's expert could differentiate between the many Mexican enterprises that Metalclad announced to its investors and identify which expenditures were made on the COTERIN landfill and which were made on Metalclad's (at least) seven other Mexican ventures.

503. Metalclad repeatedly refused to provide an itemized list of expenditures and therefore Mexico's expert was never able to vouch the claimed expenditures.

504. However, he did examine the company's SEC filings and expressed his opinion that the expenditures claimed to be related to the La Pedrera project were far less than U.S. $20.5 million and probably less than the U.S. $3.7 million that Metalclad's auditors permitted the company to capitalize for U.S. income tax purposes.

> First Expert Report of Kevin Dages at paragraphs 10.5 to 10.18 [Record, Vol. 5, pp. 4735-4740]

505. When Metalclad filed its Reply, it recast the claimed expenditures as being related to "Mexican project development" rather than being directly related to the "bricks and mortar" of the landfill's acquisition and construction.

> Second Expert Report of Kevin Dages at pp. 8-12 [Record, Vol. 13, pp. 11,499-11,503]

506. In preparation for its Rejoinder, Mexico again requested more detailed evidence of the expenditures. Metalclad refused. Mexico then requested production of the tax returns of Metalclad's many Mexican ventures so that its expert could review which expenditures related to which investment. Metalclad refused to provide the tax returns.

507. It was only after Mexico requested and received a Tribunal order that Metalclad disclose the Mexican subsidiaries' tax returns that a few such returns were provided to Mexico. Two of the tax returns were of assistance. COTERIN's return and ECOPSA's return for the fiscal year ending 1996 were provided to Mexico. (COTERIN owned the landfill; ECOPSA was the former ECO and owned land at another site in SLP where Metalclad had planned but

abandoned construction of a hazardous waste incinerator. ECOPSA was to be the operating entity of the landfill.)

508. Going into the hearing, Mexico's expert reiterated his view that the best evidence of the expenditures was what Metalclad's U.S. auditors permitted it to allocate to its "landfill expenses" in its consolidated U.S. tax returns.

> Second Expert Report of Kevin Dages at pp. 15-46 [Record, Vol. 13, pp. 11,506-11,537]

509. At the hearing, Metalclad's Chief Financial Officer, Mr. Dabbene, admitted under cross-examination that although his Reply witness statement sought to justify the U.S. $20.5 million figure, nowhere in his sworn statement did he testify that Metalclad had actually spent U.S. $20.5 million on the landfill. His evidence was, in Mexico's view, an evasive and misleading attempt to re-cast the claimed expenditures.

> Transcript, Vol. 6, at pp. 90-91 [Record, Vol. 16]

510. Metalclad's lack of good faith was illustrated vividly by this issue. In obscuring its previous ventures in Mexico and proffering an expert's report that did no independent analysis of the claimed expenditures but still asserted that the costs were the direct costs of acquiring the land and constructing the landfill, Metalclad seriously misled the Tribunal as to what went into the claimed U.S. $20.5 million figure. It was only under cross-examination, for example, that Mr. Kesler admitted that the figure included costs that were allegedly incurred in connection with its other Mexican ventures such as ECO, Descontaminadora, and Eliminación.

> Transcript, Vol. 5, at pp. 166-168 [Record, Vol. 15]

511. As noted above, during the hearing the President of the Tribunal and one other arbitrator expressed their view that the cross-examination of Metalclad's CEO as to the company's other activities in Mexico was irrelevant. However, after their comments were made, Mr. Kesler admitted that he had included the company's expenditures on those other projects in the U.S. $20.5 million sum that the company and its expert had represented was the "direct cost" of acquiring the land and building the landfill. The Award's damages calculation showed that the Tribunal must have realized after the fact that Metalclad's inclusion of expenditures relating

to its Mexican projects prior to its acquisition of COTERIN was not proper because it reduced the claimed expenditures by excluding costs related to 1991-1992.

Award, paragraph 125

512. Mexico also led evidence and cross-examined Metalclad witnesses on the company's numerous other projects that were purportedly being pursued while the COTERIN landfill was being constructed. The Tribunal apparently agreed with the general thrust of this evidence because it purported to reduce the claimed expenditures further.

Award, paragraph 126

513. However, the Award did not disclose how the Tribunal excluded expenditures relating to those other projects for the years 1993 to 1996, nor did it make transparent the amount deducted for the costs of remediation.

514. There was no indication on the face of the Award how these sums were calculated. This is of particular importance because very late in the written phase of the proceeding, Metalclad finally provided to Mexico the tax return that it had filed for COTERIN for the year ending December 31, 1996 (the year in which the Tribunal found the landfill was expropriated).

515. According to COTERIN's 1996 tax return, Metalclad declared to Mexican tax authorities that COTERIN's total asset value i.e., the fully constructed landfill, amounted to only U.S. $136,339.

Transcript, Vol. 9 at pp. 168-173 [Record, Vol. 16]

Mexico's Post-hearing Submission at pp. 69-70 [Record, Vol. 14, pp. 12,467-12,468]

516. Metalclad also provided a tax return for ECOPSA (ECOPSA was formerly known as ECO; it was to operate the landfill).

517. According to ECOPSA's tax return for 1996, Metalclad declared that ECOPSA's total asset value was U.S. $3.4 million. Mexico pointed out at the hearing and in its Post-hearing Submission that the ECOPSA tax return included a line item of almost $2 million described as

"other fixed assets and deferred charges". Mexico pointed out that ECOPSA's existence dated back to August 11, 1991 and another proposed project at Santa Maria del Rio, SLP, and therefore Mexico was not prepared to accept that the $2 million line item was in any way related to the landfill.

Transcript, Vol. 9 at pp. 169-173 [Record, Vol. 16]

518. After Mexico directed the Tribunal to this documentary evidence, Arbitrator Civiletti stated:

> ARBITRATOR CIVILETTI: So, depending on how you calculate this and how you calculate the remediation liability, it [the value of the landfill] might be a negative figure.
>
> MR. THOMAS: It is quite possible, sir.
>
> Transcript, Vol. 9 at p. 172 [Record, Vol. 16]

519. Notwithstanding this exchange, the Award was silent on this aspect of the landfill's fair market valuation.

520. The Tribunal's failure to address the "declared tax value" criterion in Article 1110:2 was both patently unreasonable and a breach of the governing arbitration rules. There was undisputed record evidence of Metalclad's own making that was highly relevant to Mexico's defence that Metalclad had not proved that it spent anywhere near the U.S. $20.5 million that it claimed had been spent as the "direct cost of acquiring the land and constructing the landfill".

521. The difference between the declared tax value of the asset at U.S. $136,339 and the U.S. $20.5 million expenditure figure the Tribunal used as the point of departure for its subtraction exercise at paragraphs 123-127 of the Award was not addressed by the Tribunal.

522. The Tribunal's failure to address this question is precisely the same arbitral error as that committed by the ICSID tribunal in the *MINE* v. *Guinea* case, *supra*. In what is widely considered to be the leading ICSID annulment case, the ad hoc committee reviewing the award found that the tribunal had failed to address the questions raised by Guinea in its damages defence and thus, its damages award had to be annulled.

XIV. ERRORS OF LAW IN INTERPRETATION OF ARTICLES 1105 AND 1110

523. If the Court concludes that this proceeding is governed by the CAA, then Mexico respectfully requests that it grant leave to appeal with respect to the following relating to the interpretation of Articles 1105 and 1110 and set aside the Award as containing errors of law, as set out below.

A. Article 1105: The Tribunal erred in law in its interpretation and application of Article 1105 by finding that the international minimum standard of treatment imposes a duty on the authorities of the central government to remove all doubt and uncertainty in the legal requirements applicable to investors

524. There are general principles that inform the content of Article 1105.

525. First, NAFTA expressly provides that the fair and equitable standard is "explicitly subsumed under the minimum standard of customary international law". The international minimum standard of treatment is an established concept of customary international law.

> R. Dolzer, M. Stevens, *Bilateral Investment Treaties, supra*, p. 60 [Mexico's Authorities, Tab 106]

526. Second, the principle is fact driven. Professor Muchlinski, *Multinational Enterprises and the Law* (Blackwell Publishers Inc.: Oxford, 1995) [Mexico's Authorities, Tab 116], states at p. 625:

> The concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests. It is, therefore, a concept that depends on the interpretation of specific facts for its content. At most it can be said that the concept connotes the principle of non-discrimination and proportionality in treatment of foreign investors.

1. Customary International Law

527. At customary international law the standard is the minimum standard that States have demanded for treatment of their nationals operating abroad, and has been employed as a safety net in cases where the treatment extended by certain States to their nationals has fallen below the international minimum.

528. A State's conduct has been held to fall below this standard where its treatment of non-nationals amounts to an outrage, to wilful neglect of duty or to an insufficiency of governmental action that every reasonable and impartial person would recognize as insufficient. A State's conduct will also fall below the minimum standard when it is determined that there has been a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process or a failure to provide guarantees which are generally considered indispensable to the proper administration of justice.

529. The *Canadian Statement of Implementation* for NAFTA confirms that Article 1105 incorporated that particular body of customary international law concerning the treatment of foreign investments. It states:

> Article 1105, which provides for treatment in accordance with international law, is intended to assure a minimum standard of treatment of investments of NAFTA investors. National treatment provides a relative standard of treatment, while this article provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law.[29]

530. Publicists have confirmed the high threshold for application of the international minimum standard.[30] *Oppenheim's International Law* describes the standard as having "a fairly high threshold". Likewise, P. Malanczuk writes in *Akehurst's Modern Introduction to*

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[29] *Canadian Statement of Implementation for NAFTA*, Canada Gazette, Part I, January 1, 1994 at 149 [Mexico's Authorities, Tab 72]. The American equivalent simply says that "[a]rticle 1105 provides that each country must also accord NAFTA investors treatment in accordance with international law": *Statement of Administrative Action Accompanying the North American Free Trade Agreement*, H.R. 3450, H.R. Doc. No. 159, Vol. 1, 103d Cong., 1st Sess., 140 [Mexico's Authorities, Tab 80] at 141.

[30] According to the Statute of the International Court of Justice, among the "subsidiary means for the determination of rules of law" are "the teachings of the most highly qualified publicists." [Mexico's Authorities, Tab 93]

International Law that the threshold for the breach of the international standard is the very high one cited in the 1926 *Neer* claim: an outrage, bad faith, wilful neglect of duty or insufficiency of

governmental action so far short of international standards that every reasonable and impartial person would recognise its insufficiency.

> R. Jennings & A. Watts eds., *Oppenheim's International Law*, Vol. 1, 9th ed. (United Kingdom: Longham Group, 1996) [Mexico's Authorities, Tab 111] at 570
>
> P. Malanczuk, *Akehurst's Modern Introduction to International Law*, 7th ed. (London: Routlege, 1997) [Mexico's Authorities, Tab 114] at 261
>
> *Neer (U.S.A.)* v. *United Mexican States* (1926), 4 R.I.A.A. 60 (Mexico-U.S. General Claims Commission) [Mexico's Authorities, Tab 45]

531. The failure to comply with the international law standard will occur only in circumstances where conduct is egregious. Brierly states that "misconduct must be extremely gross."

> J. Brierly, *The Law of Nations*, 6th ed. (Oxford: Clarendon Press, 1963) at 276-287 [Mexico's Authorities, Tab 98]

2. The Importance of All Relevant Facts

532. Decisions of international tribunals dealing with various alleged breaches of the minimum standard of treatment also consistently affirm that the threshold for a violation of the minimum standard is extremely high. There must be outrageous or egregious conduct to breach the international minimum standard.

533. The cases decided by the United States-Mexico Claims Commission have been described as "the backbone of our evidence in support of the international standard". These arise from the United States-Mexico Claims Commission in the 1920's, which concerned events occurring during a series of revolutions in Mexico.

> A.H. Roth, *Minimum Standard of International Law Applied to Aliens* (1949) (Geneva: University of Geneva Thesis) [Mexico's Authorities, Tab 121] at 95

534. In the *Neer* case, *supra*, Paul Neer, an American citizen and superintendent of a mine in Mexico was murdered by a group of armed men on the way home from the mine. His wife filed a claim charging that the Mexican authorities had shown an unwarranted lack of diligence.

535. The Commission found there was no denial of justice because Mexican authorities had acted with sufficient diligence. The Commission noted that "[I]t is not for an international tribunal ... to decide, whether another course of procedure taken by the local authorities ... might have been more effective."

Neer (U.S.A.) v. *United Mexican States, supra*, paragraph 5

536. Commenting on the conduct of Mexican authorities, the Commission said:

> ... the propriety of governmental acts should be put to the test of international standards, and (second) that the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency. (Emphasis added.)
>
> *Neer (U.S.A.)* v. *United Mexican States, supra*, paragraph 4

537. The test in *Neer* was applied consistently by the United States-Mexico Claim Commission in claims brought before it.

538. In *ELSI, supra* [Mexico's Authorities, Tab 20] the Mayor of Palermo, Italy had requisitioned an American plant and allowed the employees to occupy it after the owners announced their intention to close the plant. After the requisition period, the plant was allowed to go into bankruptcy. Despite this, and a 16-month delay in ruling on an administrative appeal of the Mayor's action, the International Court of Justice found that there was no breach of the international minimum standard.

539. In rejecting the U.S. claim in *ELSI*, the Court took the view that the requirement that "the most constant protection and security" (similar to language of NAFTA Article 1105) be provided did not mean that "property shall never in any circumstances be occupied or disturbed". Equally, it concluded that the Italian court's 16-month delay in ruling on the illegality of the Mayor's action did not constitute any denial of procedural justice, nor did the Mayor's action, found to be unlawful at Italian law, give rise to a breach of international law by Italy.

540. Among the factors considered relevant by the International Court of Justice in determining whether there had been arbitrary conduct on which to found a breach of the

minimum standard was the fact that the claimant had not availed itself of a domestic administrative decision process which was available to address the issues. There will not be a breach of the international minimum standard unless the remedial process is woefully inadequate.

ELSI, supra, paragraphs 109-112

541. As the International Court noted:

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

ELSI, supra, paragraph 128

542. The "duty of transparency" legislated by the Tribunal found its origin in the misstated NAFTA Article 102(1) and not in Chapter Eleven. As already argued, such a duty, which does not exist in NAFTA's text, cannot be sanctioned by arbitrators whose mandate is limited to evaluating compliance with Chapter Eleven. The question then arises whether the Tribunal had the authority to interpret the "fair and equitable" standard so as to include the duty of "transparency".

543. The notion that "transparency" includes "the idea" that "central governments" have the duty to dispel any possible "misunderstanding or confusion" as to laws or regulations at all levels of government which may affect investments, or else face sanctions for having implicitly violated the "fair and equitable" standard of Article 1105, is entirely novel. It suggests that a NAFTA Party may have to mobilize a legal team to face an international tribunal every time a litigious foreign investor alleges that it was confused. The concept is unprecedented in international law.

544. The transparency duty appeared for the first time as a pure *ipse dixit* in the Award in this case. It is a significant intrusion into the sovereignty of a NAFTA Party, and it can not be presumed that the Parties intended to relinquish sovereignty to that extent.

B. Article 1110: The Tribunal erred in its interpretation and application of Article 1110 by finding that incidental deprivation, in significant part, of the "reasonably-to-be-expected economic benefit of property" amounts to expropriation of that property

545. The Municipality was always prepared to allow operation of the landfill as a non-hazardous industrial waste landfill. The refusal to allow another, higher economic beneficial use does not amount to expropriation.

1. The Text of Article 1110 and the Tribunal's Interpretation

546. The Tribunal erred in law in interpreting and applying Article 1110. The Tribunal defined expropriation in a manner which was wholly unsupported by the language and plain meaning of Article 1110, or by the object and purpose of Article 1110, or by any authority or rule of customary international law. The Tribunal's approach is premised on the following definition of expropriation:

> ... expropriation under NAFTA includes ... covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in 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. [Emphasis added.]
>
> Award, paragraph 103

547. The definition of expropriation upon which the Tribunal's Award is premised is novel, unsupported by practice or precedent or the language and context of Article 1110, and is at odds with the intent of the NAFTA's drafters.

548. In *Amco* v. *Indonesia*, an ICSID tribunal stated the essential ingredients of an expropriation at international law as follows:

Even if there are many different opinions as to the concept of expropriation in international law … it emerges, however, as a *conditio sine qua non* that there shall exist a taking of private

> property and that such taking shall have been executed or instigated by a government, on behalf of a government or by an act which otherwise is attributable to a government.
>
> Award on the Merits, November 20, 1984, 1 ICSID Reports 413 [Mexico's Authorities, Tab 4] at paragraph 158 (The Award was annulled on other grounds.)

549. Expropriation does not occur through the incidental effect of the exercise of governmental power.

> *S.D. Myers Inc.* v. *Canada* (Partial Award of 13 November 2000) [Mexico's Authorities, Tab 58]
>
> B.A. Wortley, *Expropriation in Public International Law* (Cambridge: University Press: 1959) [Mexico's Authorities, Tab 130]

550. Expropriation is not established by interference with the economically optimal use of a property.

> Dolzer, "Indirect Expropriation of Alien Property" (1986) 1 ICSID Rev. 41 at 60 [Mexico's Authorities, Tab 105]

551. It will be recalled that classical international law distinguishes between acts of expropriation (whether direct or indirect) and other governmental acts which may interfere with the enjoyment of property rights but which do not amount to expropriation. NAFTA Article 1110 prohibits the former but does not as such prohibit the latter. The mere interference with property rights falling short of expropriation, whether direct or indirect, will not violate Article 1110.

(a) Mexico did not directly or indirectly expropriate Metalclad's investment

552. The term "expropriation" is not defined in Article 1110 of the NAFTA or elsewhere in the Agreement. It falls to be interpreted by reference to Article 31(1) of the 1969 Vienna Convention on the Law of Treaties. This provides that:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

553. The three Parties to the NAFTA – Canada, Mexico and the United States of America – intended Article 1110 to do no more than adopt the prohibition on expropriation as reflected in customary international law. The concept of "expropriation" should be given its ordinary meaning. The Parties did not intend to add new categories to the traditional category of acts which were ordinarily covered by the term "expropriation". If they had intended otherwise they would have done so in clear terms. The Tribunal referred to no evidence to support the proposition that the NAFTA Parties intended to redefine the term "expropriation" to include acts which might traditionally be characterized as interference with property rights but could in no case amount to an expropriation. There is no such evidence.

554. In the absence of any agreed definition of "expropriation" by the Parties to NAFTA, the term falls to be interpreted by reference to its accepted and ordinary meaning in international law. In international law it is accepted that it is usual to distinguish between two types of expropriation:

> A direct expropriation, which constitutes "a compulsory transfer of property rights" or "the deprivation of a former property owner of his property" by direct act of the State, such as legislation.
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> *Amoco International Finance Corporation* v. *The Government of the Islamic Republic of Iran and others* (1987) 15 Iran-U.S. C.T.R. 189, at 220 (paragraph 108) [Mexico's Authorities, Tab 5]
>
> *Oppenheim's International Law, supra* at p. 916 [Mexico's Authorities, Tab 111]

> An indirect expropriation, by contrast, may occur where a State interferes with property rights "to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and legal title to property formally remains with the owner".
>
> *Starrett Housing Corporation, Starrett Systems, Inc., Starrett Housing International Inc.* v. *the Government of the Islamic Republic of Iran, Bank Marzaki, Bank Omran, Bank Mellat*, Iran-US Claims Tribunal, (1983) 85 I.L.R. 349 [Mexico's Authorities, Tab 63] at 390

555. There are two common threads linking direct and indirect expropriation: the act (or acts) must affect title to the property, and it must have a permanent and irreversible character.

556. This traditional approach to expropriation, requiring a "taking", has been confirmed in relation to Article 1110 of the NAFTA by another NAFTA tribunal, in the case of *S.D. Myers Inc.* v. *Canada, supra,* at paragraph 280:

> The term "expropriation" in Article 1110 must be interpreted in light of the whole body of state practice, treaties and judicial interpretations of that term in international law cases. In general, the term "expropriation" carries with it the connotation of a "taking" by a governmental-type authority of a person's "property" with a view to transferring ownership of that property to another person, usually the authority that exercised its *de jure* or *de facto* power to do the "taking"

557. The *Myers* Award followed the approach taken by the tribunal in *Pope & Talbot Inc. and The Government of Canada*, Interim Award by Arbitral Tribunal, 26 June 2000 [Mexico's Authorities, Tab 52], at paragraphs 100-105.

558. The concept of expropriation under Article 1110 does not diverge from the customary principles of international law. As one commentator has noted with respect to Article 1110:

> This provision states the traditional view of customary international law respecting nationalization or expropriation.
>
> Jon Johnson, *The North American Free Trade Agreement: A Comprehensive Guide* (Ontario: Canada Law Book Inc., 1994), p. 289

559. This and other writings and arbitral decisions confirm that there are at least three fundamental elements that are required for a finding of "expropriation" in general international law, namely:

(a) the action at issue results in substantial interference with or deprivation of the claimant's property or property rights;[31]

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[31] W. Mapp, *The Iran-United States Claim Tribunal, The First Ten Years 1981-1991*, (Manchester University Press, Manchester and New York, 1993) [Mexico's Authorities, Tab 115] at pages 152 and 155. See also J.A. Westberg, "Applicable Law, Expropriatory Takings and Compensation in Cases of Expropriation; ICSID and Iran-United States Claims Tribunal Case Law Compared", (1993) 8 ICSID Review-Foreign Investment Law Journal 1 [Mexico's Authorities, Tab 129], at page 13, and R. Higgins, "The Taking of Property by the State:

(b) such interference or deprivation is permanent or irreversible;[32]

(c) the expropriatory effect is attributable to the State.

Amco v. *Indonesia, supra* [Mexico's Authorities, Tab 4]

560. It follows that mere interference with the investment's use or enjoyment of benefits associated with property is not the standard for expropriation at international law. The question is not whether the measure adopted by a State interferes with some benefit of property held by the investor, but whether the measures expropriate the investment. The denial of "some benefit" associated with property is not sufficient for a finding of expropriation. As Professor Rosalyn Higgins (now a Judge at the International Court of Justice) has stated:

> the tendency is for a diminution in value to remain uncompensated, so long as rights of use, exclusion and alienation remain.
>
> R. Higgins, "The Taking of Property by the State: Recent Developments in International Law", *supra,* at p. 271

561. It is against this consistent pattern of treaty, judicial and arbitral practice, as well as commentary that the Tribunal's approach to the interpretation and application of "expropriation" in *Metalclad* falls to be assessed. The Tribunal's definition of expropriation marks a radical departure from classical international law.

C. The *Biloune* Case is Distinguishable

562. The expansive approach of the Tribunal to the interpretation of a "measure tantamount to ... expropriation" and "indirect expropriation" is unsupported by international case law. Indeed, the Tribunal invoked no authority, save one: the only decision on expropriation to which the Tribunal referred is *Biloune et al.* v. *Ghana Investments Centre.* According to the

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Recent Developments in International Law" (1982) 176 *Hague Recueil* 262 [Mexico's Authorities, Tab 110], at page 351.

[32] For example, when the period of interference with property or property rights is unreasonable and when the taking is not, or ceases to be, temporary (Louis B. Sohn and R.R. Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens", 55 *The American Journal of International Law* 545 (1961) [Mexico's Authorities, Tab 125], at page 559.

Tribunal the *Metalclad* case "resembles in a number of pertinent respects that of *Biloune*" and it cited it for its "persuasive authority".

> Award, paragraph 108
>
> *Biloune et al.* v. *Ghana Investments Centre*, (1990) 95 ILR 183 [Mexico's Authorities, Tab 12]

563. The only similarity between the two cases is that they both involved construction permits, although in very different contexts. *Biloune* and *Metalclad* are easily distinguishable. In *Biloune* the investor and his company had obtained a right to construct a tourist facility. The site concerned had been leased by the Government of Ghana to the Ghana Tourist Development Company (GTDC, a corporation owned by the Ghanaian Government) for a period of 50 years. Mr. Biloune's company entered into a lease with GTDC to renovate, expand and operate a restaurant resort at the site. His company obtained financial and other benefits from the Ghana Investment Centre (another Government corporation), which contractually undertook not to expropriate the investment. The company commenced work on the project before a building permit was applied for. In fact, the earlier construction on the site had taken place without a permit on the personal instructions of the former dictator of Ghana, President Nkrumah "whose instructions were not subject to examination". One year after construction commenced, a demand for the production of the building permit was made of the investor. When it could not be produced, a stop work order was issued and five days later the project was partially demolished.

> *Biloune* at pp. 197, 195

564. In *Biloune*, the circumstances included

> ... the conjunction of the stop work order, the demolition [of the construction works], the summons [of Mr. Biloune], the arrest [of Mr. Biloune late at night by plain-clothes para-military police when, by Ghanian law, arrest should take place by day-light], the detention [of Mr. Biloune for 13 days without charge], the requirement of filing assets declaration forms [imposed upon Mr. Biloune and others by Ghana's "National Investigations Committee"], and the deportation of Mr. Biloune without possibility of re-entry had the effect of causing the irreparable cessation of work on the project. Given the central role of Mr. Biloune in promoting, financing and managing MDCL, his expulsion from the country effectively prevented MDCL from

> further pursuing the project. In the view of the Tribunal, such prevention of MDCL from pursuing its approved project would constitute constructive expropriation of MDCL's contractual rights in the project...
>
> *Biloune*, at p. 209

565. It was these acts cumulatively which had the effect of causing "the irreparable cessation of work on the project". The expropriation in *Biloune* was premised on a finding of the "irreparable cessation" of the project. In *Biloune*, it was not in dispute that earlier construction on the site had not benefited from a construction permit, from which the Tribunal drew the conclusion that "a permit was not indispensable" even if it was required by the letter of the law (at p. 208). By contrast, in *Metalclad*, the municipality had been consistent in asserting its permitting authority. Metalclad knew of the refusal when it acquired COTERIN. Metalclad was sufficiently aware of the contingency to condition the payment of three-quarters of the purchase price upon the resolution of the permit issue. Moreover, in *Metalclad* there was no question of the investors being arrested, held without bail, searched for their assets, and then being summarily deported from Mexico, a combination of facts which evidently weighed heavily for the Tribunal in *Biloune* and were indispensable to its finding of a "constructive expropriation".

566. The sole authority relied upon by the Tribunal is thus completely distinguishable on its facts: the underlying thrust of the decision in *Biloune* is that for an expropriation to occur there must be an "irreparable cessation" in the work, and such cessation must be due to government measures going beyond the mere refusal of a construction permit to include the arrest and expulsion of the project's proponent. Applying the *Biloune* standard, there was plainly no expropriation in *Metalclad*.

D. There Was No Transfer of Property Rights

567. Plainly the acts attributed to Mexico cannot be qualified as a "direct expropriation": there was no "compulsory transfer of property rights".

E. The Tribunal's Finding of Indirect Expropriation is Unsupportable

568. At paragraphs 106 and 107 of its Award the Tribunal identifies the two elements which amount to an "indirect expropriation". These are:

(1) the Municipality's "improper" denial of the construction permit, and

(2) Mexico's representations to the investor and its failure to provide for the Municipality's procedures for dealing with the construction permit "on a timely, orderly or substantive basis".

569. As to (1), the investor knew when it made its investment that the construction permit was required by law, had previously been applied for and denied and that the Municipal President was opposed to the construction of the landfill. It had available to it domestic legal remedies in Mexico to challenge the acts of the Municipality. It failed to take advantage of these remedies. In these circumstances, how can it be said that the denial of the permit was "improper"? As to (2), to Mexico's knowledge, the Tribunal's approach represents the first occasion that one or more statements by a State have been found to amount to, or contribute to, an act of expropriation. Both elements, which form the core of the Tribunal's approach to expropriation, are without judicial or arbitral precedent.

570. It is commonplace for municipal decisions to affect property rights. For example, in *Monarch Holdings Ltd.* v. *The Corporation of the District of Oak Bay et al.* (1977), 4 B.C.L.R. 67 (B.C.C.A.) [Mexico's Authorities, Tab 39], a property owner had made an application to the municipality for a building permit. After it had received the application, the municipality passed a bylaw that restricted building rights in the area where the property was located.

571. The owner applied to the court for an order of *mandamus* compelling the municipality to issue a building permit and for an order quashing the bylaw. The owner's application was dismissed by the Supreme Court and the decision was upheld by the Court of Appeal.

572. McIntyre J.A. said at p. 86:

> The weight of authority supports the view that the prima facie right of a landowner to do what he will with his land can be defeated by a by-law passed in good faith by a municipal council. The courts have long recognized that inherent in the power to zone and rezone properties is the power to affect rights adversely and to make differing regulations in differing districts or areas within a municipality. It is inevitable that proprietary rights will suffer from time to time and that restrictions will be imposed which fetter the ordinary use of land.

573. Imagine the situation of the property owner if this Tribunal's Award were to be upheld. At the time of making the application for a building permit, the property owner could have no knowledge of the terms of the subsequently enacted bylaw. By definition, that requirement would not be transparent giving rise, in the Tribunal's view, to the right to bring an international claim in respect of Article 1105.

574. Moreover, consider the position of the property owner after the original refusal by the B.C. Supreme Court to make an order of *mandamus*. Instead of appealing to the Court of Appeal, the property owner could, on the Tribunal's approach, immediately bring a NAFTA claim against Canada and argue that the building permit denial was "improper" and amounted to an indirect expropriation.

575. Canada will have potentially become liable in damages for the correctness or incorrectness of lower court decision-makers and the lack of clarity in the domestic law.

F. Mexico took no "measure tantamount to expropriation"

576. If Mexico did not directly or indirectly expropriate the investment it cannot have taken a "measure tantamount to expropriation". Nevertheless, the Tribunal found that:

> By permitting or tolerating the conduct of [the local municipality] ... and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation ...

577. The Tribunal's approach does not withstand scrutiny. First, acts which are not expropriatory in character cannot be "tantamount to expropriation". And second, the acts attributed to Mexico, namely its failure to take certain positive steps, do not constitute or otherwise amount to "a measure" within the meaning of Article 1110.

578. Like "expropriation", the term "tantamount" is not defined by the NAFTA. In Mexico's view "tantamount" means no more than "equivalent to". This is consistent with the French and Spanish texts (which are equally authoritative as the English text of the NAFTA) and which respectively use the words "équivalent" and "equivalente" in place of tantamount.

579. This means that for an act to be qualified as "tantamount to expropriation" it must be "equivalent to an expropriation". A measure "tantamount to expropriation" must logically have the same essential features as a direct or indirect expropriation. A measure which does not have the same features as an expropriation – for example "other measures affecting property rights" within the meaning of Article II(1) of the Algiers Accord – will not be caught by Article 1110 and will not fall within a NAFTA tribunal's jurisdiction (unless, of course, some Section A provision other than Article 1110 catches it).

580. This submission was put to the Tribunal by Mexico but, once again, ignored by the Tribunal. It was also put to the Tribunal by the United States, which had exercised its rights as a NAFTA Party to intervene and share with the Tribunal its views on the meaning and effect of Article 1110. The United States analyzed the negotiating history and concluded that the inclusion of the words "tantamount to expropriation" did not expand the meaning of expropriation at customary international law. According to the United States' submission, Article 1110 covered only two types of expropriation, namely direct and indirect:

> ... it is the position of the United States that the phrase "take a measure tantamount to ... expropriation" explains what the phrase "indirectly ... expropriate" means; it does not assert or imply the existence of an additional type of action that may give rise to liability beyond those types encompassed in the customary international law categories of "direct" and "indirect" nationalization or expropriation.

Submission of the Government of the United States of America in *Metalclad Corporation* v. *The United Mexican States*, ICSID Case No. ARB(AF)/97/1 at paragraph 9 [Record, Vol. 20, p. 1658]

581. The United States went on to say:

> 10. The United States Government believes that it was the intent of the Parties that Article 1110(1) reflect customary international law as to the categories of expropriation. The United States Government reflected that position in its Statement of Administrative Action, transmitted to the Senate during the process of concluding the NAFTA. ... Neither of the other Parties has ever expressed a view contrary to this United States public statement of intent. The customary international law of expropriation recognizes only two categories of expropriation: direct expropriation, such as the compelled transfer of title to the property in question; and indirect expropriation, i.e., expropriation that occurs through a measure or series of measures even where there is no formal transfer of title or outright seizure. To conform to these rules of customary international law, Article 1110(1) must be read to provide that expropriation may only be either direct, on one hand, or indirect through "a measure tantamount to nationalization or expropriation of such an investment," on the other.
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> 11. The context in which the phrase "tantamount to expropriation" is found confirms that it was not intended to create a new category of expropriation. If Article 1110 had been meant to create a wholly new, third category of expropriation, thereby departing radically from customary international law, the Parties would surely have included language providing guidance on what circumstances, other than either direct or indirect expropriation, were meant to be covered. Instead, there are no standards for determining when such a new category would be applicable. It is extremely unlikely that the Parties would have exposed themselves to potentially significant liability for an entirely new category of expropriation without such guidance. As they did not provide the necessary standards, the only reasonable conclusion is that the Parties did not intend an expansion of the two categories of expropriation currently recognized under customary international law.

Submission of the Government of the United States of America in *Metalclad Corporation* v. *The United Mexican States*, ICSID Case No. ARB(AF)/97/1 [Record, Vol. 20, p. 1658]

582. The Tribunal did not directly address the United States' submission but its separate findings of "indirect expropriation" and measures "tantamount to" expropriation show that it did not comprehend the central point of the United States' intervention.

583. The approach argued by Mexico and taken by the other NAFTA Parties has been endorsed by the other NAFTA Tribunals which have been called upon to interpret and apply this part of Article 1110, with the exception of the *Metalclad* Tribunal. In *Pope & Talbot, supra*, the Tribunal said (at paragraph 104) that it was:

> ... unable to accept the Investor's reading of Article 1110. "Tantamount" means nothing more than equivalent. ... Something that is equivalent to something else cannot logically encompass more. No authority cited by the Investor supports a contrary conclusion. References to the decision of the Iran-U.S. Claims Tribunal ignore the fact that that tribunal's mandate expressly extends beyond expropriation to include "other measures affecting property rights".[33]

584. More recently, in its award of 13 November 2000 in *S.D. Myers Inc.* v. *Canada, supra*, another NAFTA Tribunal confirmed the approach of *Pope & Talbot, supra* (at paragraph 286):

> The Tribunal agrees with the conclusion in the Interim Award of the *Pope & Talbot* Arbitral Tribunal that something that is "equivalent" to something else cannot logically encompass more. In common with the *Pope & Talbot* Tribunal, this Tribunal considers that the drafters of the NAFTA intended the word "tantamount" to embrace the concept of so-called "creeping expropriation", rather than to expand the internationally accepted scope of the term expropriation.

585. The Tribunal in *Metalclad* has adopted a wholly different approach to the words "tantamount to expropriation". It construed the words to include deprivation "of the use or reasonably-to-be-expected economic benefit" of property.

> Award, paragraph 103

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[33] *Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran,* Jan. 19, 1981, Article II.

586. The Tribunal's unreasoned expansion of the scope of Article 1110 is not based upon the text of Article 1110, or upon the intent of the NAFTA Parties, or upon the customary international law standard as to the meaning of expropriation. The Award is inconsistent with the decisions of other NAFTA Tribunals.

587. For Mexico to have violated Article 1110 the investor must show that it took a "measure" which is "tantamount to expropriation". As set out above, the only measure which the Tribunal identifies as giving rise to the violation of Article 1110 is "permitting or tolerating" the local Municipality's refusal to grant a construction permit. This amounts to a finding of expropriation by inaction. Mexico knows of no authority for the proposition that a State can expropriate by inaction, or take a measure "tantamount to expropriation" by inaction.

588. Moreover, the finding runs into the face of the undisputed record evidence showing that the Mexican Federal Government disagreed with the state and the Municipality on the question of the site's suitability for use as a hazardous waste landfill. Moreover, the Federal Government entered into an agreement with Metalclad that dealt with matters subject to its jurisdiction (although careful to state publicly and contemporaneously that it was not purporting to invade the jurisdiction of the other levels of government), denied the Municipality's administrative appeal to the Secretary of SEMARNAP after the *Convenio* was agreed with COTERIN, and ultimately successfully defended the Municipality's court challenge against the *Convenio* and had the injunction against the operation of the site vacated. It cannot be said that the Federal Government in any way authorized or ratified any decisions of the Municipality or the state.

G. The Municipality's Conduct

589. In ignoring the court decisions in Mexico, the Tribunal found that the denial of a construction permit was outside the Municipality's authority under Mexican law. The Tribunal then linked the permit denial to the Municipality's "subsequent administrative and judicial actions regarding the *Convenio*", concluding that these acts together "effectively and unlawfully" prevented the Claimant's operation of the landfill. The Tribunal ruled that these actions by the Municipality, together with representations of the Federal Government, and the

absence of a timely, orderly or substantive basis for the permit denial, amounted to an indirect expropriation within the meaning of Article 1110.

Award, paragraph 106

590. Assuming that the Tribunal's findings are correct (they are not in Mexico's view), then on the Tribunal's approach an indirect expropriation may occur where a local municipality asserts a non-existent jurisdiction which it cannot enforce.

591. The Tribunal's finding that resort to domestic legal remedies and submission to the jurisdiction of the domestic courts is "unlawful" and can contribute to an expropriation, or a measure tantamount to an expropriation, is unprecedented. The Tribunal has established the proposition that mere recourse to the local courts to resolve issues of domestic law by a challenge to the decision of another level of government can amount to, or contribute to an expropriation. This unduly expansive approach to the concept of expropriation will limit the ability of different levels of government within a federal system to resort to the courts to challenge the acts of another level of government.

XV. NATURE OF ORDER REQUESTED

592. Mexico respectfully requests:

(a) an Order setting aside the Award;

(b) costs; and

(c) such further and other Orders as this Court may deem just.

All of which is respectfully submitted.

Dated: February 5, 2001

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