

**International Centre for Settlement of Investment Disputes**

**TECNICAS MEDIOAMBIENTALES TECMED S.A.**

**v.**

**THE UNITED MEXICAN STATES**

**CASE No. ARB (AF)/00/2**

**AWARD**

**President: Dr. Horacio A. GRIGERA NAON**

**Co-arbitrators: Prof. José Carlos FERNANDEZ ROZAS  
Mr. Carlos BERNAL VERA**

**Secretary to the Tribunal: Ms. Gabriela ALVAREZ AVILA**

**Date of dispatch to the parties: May 29, 2003**

## TABLE OF CONTENTS

	Para.
A. <b><u>Introduction</u></b> .....	1-3
B. <b><u>Procedural History</u></b> .....	4-34
C. <b><u>Summary of Facts and Allegations</u></b> .....	35-51
D. <b><u>Preliminary Matters</u></b> .....	52-92
I.    Jurisdiction of the Arbitral Tribunal.....	53-71
II.   Timely submission by Claimant of its claims against Respondent.....	72-74
III.  Scope of the Purchase Transaction.....	75-92
E. <b><u>The Merits of the Dispute</u></b> .....	93-201
I.    Expropriation.....	95-151
II.   Fair and Equitable Treatment.....	152-174
III.  Full Protection and Security and other Guarantees under the Agreement.....	175-181
F. <b><u>Compensation. Restitution in Kind</u></b> .....	182-200
G. <b><u>Decision</u></b> .....	201

## THE TRIBUNAL

Constituted as indicated above,

Having conducted its deliberations,

Issues the following award:

### **A. Introduction**

1. The Claimant, Técnicas Medioambientales, TECMED S.A., is a commercial company organized under Spanish law, domiciled in Madrid, Spain. It is represented in this arbitration proceeding by:

Mr. Juan Carlos Calvo Corbella  
Técnicas Medioambientales TECMED S.A.  
Albasanz 16 – 1a planta  
28037 Madrid, Spain

Ms. Mercedes Fernández  
Mr. Juan Ignacio Tena García  
Jones, Day, Reavis & Pogue abogados  
Velázquez 51 – 4a planta  
28001 Madrid, Spain

2. The Respondent is the Government of the United Mexican States, represented in this arbitration proceeding by:

Mr. Hugo Perezcano Díaz  
Consultor Jurídico  
Dirección General de Consultoría Jurídica  
de Negociaciones Comerciales  
Subsecretaría de Negociaciones Comerciales Internacionales  
Secretaría de Economía  
Alfonso Reyes No. 30, piso 17  
Colonia Condesa  
Mexico, D.F., C.P. 06179, Mexico

3. This Award decides on the merits of the dispute between the parties in accordance with Article 53 of the Arbitration Additional Facility Rules (Arbitration Rules) of the International Centre for Settlement of Investment Disputes.

## **B. Procedural History**

4. On July 28, 2000, the Claimant filed with the Secretariat of the International Centre for Settlement of Investment Disputes (“ICSID”) an application for approval of access to the Additional Facility and a request for arbitration against the Respondent in accordance with the Additional Facility Rules for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes (hereinafter referred to as the “Rules”) and under the provisions of the Agreement on the Reciprocal Promotion and Protection of Investments signed by the Kingdom of Spain and the United Mexican States (hereinafter referred to as the “Agreement”). The Agreement entered into force for both countries on December 18, 1996. The Claimant is the parent company in Spain of TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. de C.V. (“Tecmed”), a company incorporated under Mexican law, and holds over 99% of the shares of such company. Additionally, Tecmed holds over 99% of the shares of CYTRAR, S.A. DE C.V. (“Cytrar”), a company incorporated under Mexican law through which the investment giving rise to the disputes leading to these arbitration proceedings was made.

5. On August 28, 2000, the Acting Secretary-General of ICSID, pursuant to Article 4 of the Rules, notified the Claimant that access to the Additional Facility Rules had been approved with respect to this case and that the notice of institution of arbitration proceedings had been registered; he then sent the certificate of registration to the parties and forwarded copies of the notice of institution of arbitration proceedings to the Respondent.

6. On October 2, 2000, the Claimant notified the Centre of the appointment of Professor José Carlos Fernández Rosas as arbitrator and of its consent for the Parties to appoint as arbitrator a person of the same nationality of the Party making the proposal.

7. On November 7, 2000, the Respondent notified the Centre of the appointment of Mr. Guillermo Aguilar Alvarez as arbitrator and nominated Mr. Albert Jan van den Berg as President of the Arbitral Tribunal.

8. On November 29, 2000, the Claimant objected to the nomination of Mr. van den Berg and proposed instead that the Parties request their designated arbitrators to appoint the President of the Arbitral Tribunal, which was accepted by the Respondent.

9. On January 30, 2001, the ICSID Secretariat informed that Mr. Fernández Rosas and Mr. Aguilar Alvarez had appointed Dr. Horacio A. Grigera Naón as President of the Arbitral Tribunal. On February 2, 2001, the Claimant confirmed its agreement to this appointment and, in its communication dated February 22, 2001, the Respondent notified the Centre of its agreement to the President’s appointment.

10. On March 13, 2001, the Centre’s Acting Secretary-General informed the parties that, as from that date, the Arbitral Tribunal was deemed to have been constituted and the proceedings to have begun.

11. The first session of the Arbitral Tribunal with the parties was held in Paris, France on May 7, 2001. During the course of the session, procedural rules applicable to these

proceedings were established and the schedule for the submission of memorials by the Parties was fixed, among other things.

12. On September 4, 2001, the Claimant filed its memorial.

13. On November 16, 2001, the Respondent made certain observations regarding opinions alleged to have been given by Mr. Aguilar Alvarez in another arbitration proceeding which, in the Respondent's view, also involved legal matters to be debated in this arbitration proceeding.

14. On November 16, 2001, Lic. Aguilar Alvarez submitted his resignation as arbitrator in these proceedings, upon which, in a letter of the same date, the ICSID Secretariat served notice of the suspension of the proceedings until the vacancy created by Mr. Aguilar Alvarez's resignation was filled.

15. On November 20, 2001, the Arbitral Tribunal accepted the resignation of Mr. Aguilar Alvarez.

16. On December 14, 2001, the Respondent served notice of the appointment of Mr. Carlos Bernal Vereá in replacement of Mr. Guillermo Aguilar Alvarez.

17. On December 17, 2001, the ICSID Secretariat informed that Mr. Carlos Bernal Vereá had accepted his appointment by the Respondent to serve as arbitrator in these proceedings and as from such date deemed the Arbitral Tribunal to have been reconstituted and the arbitration proceedings to have resumed.

18. On January 22, 2002, the Arbitral Tribunal issued a procedural order deciding certain procedural matters raised by the Parties and extended the deadline for the submission of the Respondent's counter-memorial until February 4, 2002.

19. Following a new request by the Respondent in its written communication of January 31, 2002, on February 1, 2002, the Arbitral Tribunal extended the deadline for the submission of the Respondent's counter-memorial until February 11, 2002.

20. The Respondent's counter-memorial was received on February 11, 2002. On February 19, 2002, the Respondent enclosed a list of the facts alleged in the memorial that were recognized by the Respondent in its counter-memorial and those that were not.

21. On March 7, 2002, the Arbitral Tribunal issued Procedural Order No. 1, fixing the week of May 20, 2002 for the Evidentiary Hearing to be held in Washington, D.C., USA, dispensing with the submission of a reply and rejoinder by the Parties, establishing guidelines for holding the hearing and setting June 28, 2002 as the deadline for the Parties to submit their closing statements after the hearing.

22. Following new requests and exchanges between the Parties in the notes of the Respondent and Claimant dated March 13 and 21, 2002, respectively, the Arbitral Tribunal issued its Procedural Order No. 2, which—in addition to specifying certain additional

matters in relation to the hearing scheduled for the week of May 20 – provided that, at the end of the hearing on May 24, 2003, the Parties could address the Arbitral Tribunal orally, and extended the deadline for the submission of closing statements until July 15, 2002.

23. On April 29, 2002, the Secretariat of ICSID notified the Parties of the agenda issued by the Arbitral Tribunal for the conduct of the hearing.

24. The hearing was held in Washington, D.C., at the seat of ICSID. It began in the morning of May 20, 2002, and ended on May 24, 2002, after the Parties addressed the Arbitral Tribunal orally.

25. A stenographic transcript of the hearing was made, which lists the following persons as having been present at the hearing:

**Members of the Arbitral Tribunal**

1. Dr. Horacio A. Grigera Naón, President
2. Prof. José Carlos Fernández Rozas
3. Mr. Carlos Bernal Vereza

**Secretary of the Arbitral Tribunal**

4. Ms. Gabriela Alvarez Avila

**Técnicas Medioambientales TECMED S.A.**

5. Mr. Juan Carlos Calvo Corbella
6. Ms. Mercedes Fernández
7. Mr. José Daniel Fernández

**The United Mexican States**

8. Mr. Hugo Perezcano Díaz
9. Mr. Luis Alberto González García
10. Ms. Alejandra Treviño Solís
11. Mr. Sergio Ampudia
12. Mr. Carlos García
13. Mr. Rolando García

14. Cameron Mowatt, Esq.
15. Stephen Becker, Esq.
16. Sanjay Mullick, Esq.
17. Ms. Jacqueline Paniagua
18. Lars Christianson, Engineer
- 19 Ms. Ruth Benkley
20. Francisco Maytorena Fontes, Engineer
21. Christopher Thomas, Esq.

26. The hearing was held in accordance with the agenda fixed by the Arbitral Tribunal and within the time limit set for the Parties in Procedural Order No. 2 for the examination of witnesses and experts.

27. The following witnesses and experts were heard at the hearing after the opening statements made by the Claimant and the Respondent, respectively.

Offered by the Claimant

José Luis Calderón Bartheneuf

Javier Polanco Gómez Lavin

Enrique Diez Canedo Ruiz

José María Zapatero Vaquero

Jesús M. Pérez de Vega

Luis R. Vera Morales

José Visoso Lomelín

Offered by the Respondent

Alfonso Camacho Gómez

Cristina Cortinas de Nava

Jorge Sánchez Gómez

Lars Christianson

28. During the course of the hearing, the Arbitral Tribunal decided to agree to the inclusion of documents introduced by either the Respondent or the Claimant during the hearing. It further decided —after dismissing the Respondent’s objections in this regard— to agree to the inclusion of certain documents submitted in support of the statement made by Mr. Jesús M. Pérez de Vega as an expert proposed by the Claimant; nevertheless, it gave the Respondent an opportunity to examine such documents and exercise its right to question the expert once the inclusion of such documents had been decided. However, the Respondent declined to exercise such right.

29. At the end of the hearing, the Arbitral Tribunal heard the oral presentations made by the Parties, each of which was allowed 90 minutes.

30. On August 1, 2002, the Claimant and the Respondent submitted their respective closing statements.

31. In a note dated July 31, 2002, the Respondent had explained the reasons why it was annexing to its closing statement a “Declaration of Lars Christianson, Engineer”, accompanied by exhibits.

32. In a note dated August 2, 2002, the Claimant objected to the inclusion of such declaration and exhibits.

33. In its procedural order of August 12, 2002, the Arbitral Tribunal decided to agree to the inclusion of such statement and exhibits, not as part of the evidence offered and produced, but as part of the Respondent’s closing statement.

34. By note dated April 9, 2003, the Secretariat of ICSID notified the Parties that the Arbitral Tribunal had declared the proceedings closed in accordance with Article 45 of the Rules.



### **C. Summary of Facts and Allegations presented by the Parties**

35. The Claimant's claims are related to an investment in land, buildings and other assets in connection with a public auction called by Promotora Inmobiliaria del Ayuntamiento de Hermosillo (hereinafter referred to as "Promotora"), a decentralized municipal agency of the Municipality of Hermosillo, located in the State of Sonora, Mexico. The purpose of the auction was the sale of real property, buildings and facilities and other assets relating to "Cytrar", a controlled landfill of hazardous industrial waste. Tecmed was the awardee, pursuant to a decision adopted by the Management Board of Promotora on February 16, 1996. Later on, the holder of Tecmed's rights and obligations under the tender came to be Cytrar, a company organized by Tecmed for such purpose and to run the landfill operations.

36. The landfill was built in 1988 on land purchased by the Government of the State of Sonora, in the locality of Las Víboras, within the jurisdiction of the Municipality of Hermosillo, State of Sonora. The landfill had a renewable license to operate for a five-year term as from December 7, 1988, issued by the Ministry of Urban Development and Ecology (SEDUE) of the Federal Government of Mexico to Parques Industriales de Sonora, a decentralized agency of the Government of the State of Sonora. During this period, the landfill operator was not this agency but another entity, Parque Industrial de Hermosillo, another public agency of the State of Sonora. Ownership of the landfill was then transferred to a decentralized agency of the Municipality of Hermosillo, Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.; in this new phase, it had a new authorization to operate for an indefinite period of time. Such authorization had been granted on May 4, 1994, by the Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico (hereinafter referred to as INE), an agency of the Federal Government of the United Mexican States within the Ministry of the Environment, Natural Resources and Fisheries (SEMARNAP), which cancelled the previous authorization, granted on December 7, 1988. INE—both within the framework of SEDUE as well as of its successor SEMARNAP—is in charge of Mexico's national policy on ecology and environmental protection, and is also the regulatory body on environmental issues.

37. Upon the liquidation and dissolution of the above-mentioned decentralized agency, ordered by the Governor of the State of Sonora on July 6, 1995, in mid-1995, the assets of the landfill became the property of the Government of the State of Sonora. Subsequently, on November 27, 1995, through a donation agreement entered into between that Government and the Municipality of Hermosillo, the property was transferred to Promotora.

38. In a letter dated April 16, 1996, confirmed by letters of June 5, August 26 and September 5, 1996, Tecmed made a request to INE for the operating license of the landfill—then in the name of Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.—to be issued in the name of Cytrar. The Municipality of Hermosillo supported this request in its note to INE dated March 28, 1996, requesting INE to provide all possible assistance in connection with the name change procedure in the operating license in favor of Tecmed or of the company organized by it. In an official letter of September 24, 1996, INE notified

Cytrar, in connection with the application to change the name of the entity from Promotora to Cytrar, that Cytrar had been registered with INE. The official letter was then returned by Cytrar to INE as requested by INE after having been issued, and replaced by another one of the same date to which the authorization relating to the landfill was attached, dated November 11, 1996, stating the new name of the entity. Such authorization could be extended every year at the applicant's request 30 days prior to expiration. It was so extended for an additional year, until November 19, 1998.

39. The arbitration claim seeks damages, including compensation for damage to reputation, and interests in connection with damage alleged to have accrued as of November 25, 1998, on which date INE rejected the application for renewal of the authorization to operate the landfill, expiring on November 19, 1998, pursuant to an INE resolution on the same date, whereby INE further requested Cytrar to submit a program for the closure of the landfill. Subsidiarily, the Claimant has requested restitution in kind through the granting of permits to the Claimant enabling it to operate the Las Víboras landfill until the end of its useful life, in addition to compensation for damages.

40. The Claimant further argues that the successive permits granted by INE to Cytrar in connection with the operation of the landfill constitute a violation of the conditions on which the Claimant made its investment because (i) such permits, both as regards their duration as well as the conditions to which they were subject, were different from the permit given for operation of the landfill at the time the investment was made; and (ii) the price paid by Cytrar included the acquisition of intangible assets which involved the transfer to Cytrar of existing permits to operate the landfill and under which such landfill was being operated at the time of making the investment, and not the ones ultimately granted to it. The Claimant argues that such a violation of conditions also involves a violation of, among other provisions, Articles 2 and 3(1) of the Agreement and a violation of Mexican law. However, the Claimant states that it is not seeking in these arbitration proceedings a pronouncement or declaration regarding the lawfulness or unlawfulness, legality or illegality of acts or omissions attributable to the Respondent in connection with permits or authorizations relating to the operation of the Las Víboras landfill prior to the INE resolution of November 19, 1998, which terminated Cytrar's authorization to operate the landfill, considered in isolation, although it highlights the significance of such acts or omissions as preparatory acts for subsequent conduct attributable to the Respondent which, according to the Claimant, is in violation of the Agreement or facilitated such conduct.

41. The Claimant argues that the refusal to renew the landfill's operating permit, contained in the INE resolution of November 25, 1998, constitutes an expropriation of its investment, without any compensation or justification thereof, and further constitutes a violation of Articles 3(1), 3(2), 4(1), 4(5), 5(1), 5(2) and 5(3) of the Agreement, as well as a violation of Mexican law. According to the Claimant, such refusal would frustrate its justified expectation of the continuity and duration of the investment made and would impair recovery of the invested amounts and the expected rate of return.

42. The Claimant alleges that the conditions of the tender and the invitation to tender, the award or sale of the landfill or of the assets relating thereto and the investment made by the Claimant were substantially modified after the investment was made for reasons

attributable to acts or omissions of Mexican municipal, state and federal authorities. The Claimant claims that such modifications, with detrimental effects for its investment and which allegedly led to the denial by the Federal Government of an extension to operate the landfill, are, to a large extent, due to political circumstances essentially associated to the change of administration in the Municipality of Hermosillo, in which the landfill is physically situated, rather than to legal considerations. Specifically, the Claimant attributes such changes to the result of the election held in Mexico in July 1997, one of the consequences of which was the taking of office of a new Mayor of the Municipality of Hermosillo and similar changes in other municipal governments in the State of Sonora. According to the Claimant's allegations, the new authorities of Hermosillo encouraged a movement of citizens against the landfill, which sought the withdrawal or non-renewal of the landfill's operating permit and its closedown, and which also led to confrontation with the community, even leading to blocking access to the landfill. The authorities of the State of Sonora, where the Municipality of Hermosillo is located, are alleged to have expressly supported the position adopted by the Municipality.

43. The Claimant argues that the Federal Government yielded to the combined pressure of the municipal authorities of Hermosillo and of the State of Sonora along with the community movement opposed to the landfill, which, according to the Claimant, led to the INE Resolution of November 25, 1998, referred to above. This Resolution denied Cytrar authorization to operate the landfill and ordered its closedown. The Claimant argues that INE's refusal to extend the authorization to operate the landfill is an arbitrary act which violates the Agreement, international law and Mexican law. It further denies any misconduct or violation on its part of the terms under which the landfill permit was granted and which could justify a refusal to extend the authorization. The Claimant alleges that certain breaches of the conditions of the permit that expired on November 19, 1998, which was subsequently not extended by INE, did not warrant such an extreme decision. The Claimant points out that such breaches had been the subject matter of an investigation conducted by the Federal Environmental Protection Attorney's Office ("PROFEPA"), which, like INE, is an agency within the purview of SEMARNAP, but with powers, among other things, to monitor compliance with federal environmental rules and to impose sanctions, which may include a revocation of the operating license. It also stresses that PROFEPA had not found violations of such an extent that they might endanger the environment or the health of the population or which justified more stringent sanctions than the fines eventually imposed on Cytrar by PROFEPA as a result of its investigations.

44. The Claimant stresses the commitment of Cytrar, with the support of Tecmed, as from July 3, 1998, to relocate the hazardous waste landfill operation to another site on the basis of agreements reached with federal, state and municipal authorities as of such date, and denies the allegation that the fact that such relocation had not yet taken place at the time the extension of Cytrar's permit was refused could be validly argued among the grounds referred to by INE in its resolution of November 1998 denying the extension. The Claimant points out that Cytrar, with the support of Tecmed, subsequently added to its commitment to relocate the landfill another commitment to pay the costs and economic consequences involved in such relocation, and further denies that the delay or failure to relocate was attributable to it. The Claimant insists that the only condition to which Cytrar subjected its relocation commitment was that, pending such relocation, operation by Cytrar of the Las

Viboras landfill and the relevant operating permit should continue, and that such condition is a part of the relocation agreement entered into with the federal, state and municipal authorities of the Respondent. At any rate, the Respondent argues that Cytrar unsuccessfully applied to INE for a limited extension of its permit to operate the Las Viboras landfill (five months as from November 19, 1998), in order to come to an agreement, within such term, on the identification of the site to which the landfill operation would be relocated and to carry out the relocation.

45. According to the Claimant, the expropriation act and other violations of the Agreement which it deems to have suffered, have caused the Claimant to sustain a complete loss of the profits and income from the economic and commercial operation of the Las Viboras landfill as an on going business. Therefore the damage sustained includes the impossibility of recovering the cost incurred in the acquisition of assets for the landfill, its adaptation and preparation and, more generally, the investments relating to or required for this kind of industrial activity, including, but not limited to, constructions relating to the landfill; lost profits and business opportunities; the impossibility of performing contracts entered into with entities producing industrial waste, thus leading to termination of such contracts and to possible claims relating thereto; and the injury caused to the Claimant and to its subsidiaries in Mexico due to the adverse effect on its image in that country, with the consequent negative impact on the Claimant's capacity to expand and develop its activities in Mexico.

46. The Respondent, after pointing out that it does not consider that the powers of INE to deny the landfill's operating permit are regulated but discretionary, denies that such denial was a result of an arbitrary exercise of such discretionary powers. The Respondent claims that denial of the permit is a control measure in a highly regulated sector and which is very closely linked to public interests. Accordingly, the Respondent holds that such denial seeks to discourage certain types of conduct, but is not intended to penalize. The Respondent stresses that the matters debated in these arbitration proceedings are to be solved in a manner consistent with the provisions of the Agreement and of international law.

47. The Respondent denies that the subject matter of the tender and subsequent award to Tecmed was a landfill, understood as a group or pool of tangible and intangible assets including licenses or permits to operate a controlled landfill of hazardous waste. The Respondent argues that the assets tendered and sold by Promotora solely include certain facilities, land, infrastructure and equipment, but no permits, authorizations or licenses. With regard to the documents signed by Promotora, Tecmed and Cytrar in connection with the public auction of the assets relating to the landfill, the Respondent further argues that (i) the obligation or responsibility to obtain permits, licenses or authorizations to operate the landfill was vested in Cytrar; (ii) Promotora did not attempt to obtain or provide such permits, licenses and authorizations for the benefit of or in the name of Cytrar, of the Claimant or of Tecmed, nor did it guarantee that they would be obtained; (iii) Promotora's only commitment in this regard was to ensure that Cytrar could operate the landfill under the existing permits, authorizations or licenses, which remained vested in Confinamiento Parque Industrial de Hermosillo O.P.D. until Cytrar obtained its own permits, authorizations or licenses; (iv) it was always clear to Cytrar that it would require its own licenses, authorizations or permits in order to operate the landfill; and (v) neither Cytrar nor

Tecmed contacted the competent federal authorities for information regarding the possibility of transferring existing authorizations or permits. The Respondent denies the claim that the amount of \$ 24,047,988.26 (Mexican Pesos) was paid as price for the permits or authorizations to operate the landfill, or that Promotora's related invoice reflects the reality of the tender and of the subsequent sales transaction.

48. The Respondent challenges the Arbitral Tribunal's jurisdiction to decide in connection with conduct attributable or attributed to the Respondent which occurred before the entry into force of the Agreement, or that any interpretation thereof—particularly Article 2(2), which extends the application of the Agreement to investments made prior to its entry into force—could lead to a different conclusion. Likewise, based on Title II.5 of the Appendix to the Agreement, the Respondent rejects the Arbitral Tribunal's jurisdiction over acts or omissions attributed or attributable to the Respondent which were or could have been known to the Claimant, together with the resulting damages, prior to a fixed 3-year period, calculated as from the commencement date of this arbitration pursuant to the Agreement. The Respondent further denies that the conduct allegedly in violation of the Agreement attributed to the Respondent caused any damage to the Claimant, so the Claimant's claims would not fulfill the requirements of Title II.4 of the Appendix to the Agreement.

49. The Respondent claims that the granting and conditions of the license of November 11, 1996, were within the statutory powers of INE, and that such conditions were similar to the ones governing other permits granted by INE at the time. The Respondent stresses the negative attitude of the community towards the landfill due to its location and to the negative and highly critical view taken by the community with regard to the way Cytrar performed its task of transporting and confining the hazardous toxic waste originating in the former lead recycling and recovery plant of Alco Pacífico de México, S.A. de C.V. (hereinafter referred to as "Alco Pacífico"), located in Tijuana, Baja California, which would highlight the importance of demanding strict compliance with the new operating permit granted by INE to Cytrar on November 19, 1997.

50. The Respondent alleges that the municipal, state and federal authorities, as well as the security forces and courts of law addressed by Cytrar, acted diligently and in a manner consistent with the Respondent's obligations under the Agreement to offer protection to Cytrar, to its personnel and to the Claimant's investment relating to the landfill, in view of the different forms of social pressure exercised by groups or individuals opposed to the landfill, as well as to finding solutions to the problems resulting from such social pressure. The Respondent further denies that any acts or omissions on the part of such groups or individuals or any liability arising out of such acts or omissions are attributable to the Respondent under the Agreement or under international law. The Respondent underscores the distinct duties performed by PROFEPA and INE, and points out that only INE is competent to decide whether or not to renew an expired permit, based on an assessment of different elements and circumstances exclusively pertaining to INE. The Respondent therefore argues that it is irrelevant that PROFEPA did not revoke Cytrar's permit relating to the Landfill or that it did not close it down due to considerations taken into account by INE in order to decide not to extend the authorization, or that PROFEPA did not find that such matters were significant enough to justify more serious sanctions other than a fine.

However, the Respondent highlights the growing number of violations committed by PROFEPA in Cytrar's operation of the landfill.

51. The Respondent ultimately concludes that there is no conduct on the part of municipal, state or federal authorities of the United Mexican States in connection with Cytrar, Tecmed, the Claimant, the landfill or the Claimant's investments which constitutes a violation of the Agreement pursuant to its provisions or to the provisions of Mexican or international law. It specifically denies that refusing to give a new permit to Cytrar to operate the landfill is in the nature of an expropriation or that there has been a violation of Article 5 of the Agreement. The Respondent also denies that the Claimant suffered discrimination or that it was denied national treatment in violation of Article 4 of the Agreement. The Respondent denies having violated Article 2(1) of the Agreement regarding promotion or admission of investments or having committed any violation of Article 3 of the Agreement. Finally, the Respondent challenges the calculation basis for the compensation sought by the Claimant, which it considers absolutely inappropriate and inordinate.

#### **D. Preliminary Matters**

52. The Arbitral Tribunal will first examine the issues which, due to their nature or connection with its jurisdiction to decide this case or due to their close connection with other matters relating to the decisions that the Tribunal must make on the merits of the disputes between the Parties, need to be decided previously. Such matters are (i) the Respondent's challenges to the Arbitral Tribunal's jurisdiction; (ii) the Respondent's challenges to the timely submission by the Claimant of some of its claims; and (iii) the price and scope of the acquisition by Cytrar and Tecmed of assets relating to the Las Viboras landfill.

##### I. Jurisdiction of the Arbitral Tribunal

53. The Claimant argues,<sup>1</sup> based on Article 2(2) of the Agreement, that the Agreement applies retroactively to the Respondent's conduct prior to the effective date of the Agreement. Such provision stipulates that the Agreement "...shall also apply to investments made prior to its entry into force by the investors of a Contracting Party". According to the Claimant, under this provision, the Agreement covers all conduct or events relating to the investment giving rise to the disputes of this arbitration which took place before December 18, 1996, the entry into force of the Agreement pursuant to Article 12 thereof. Article 12 provides that the Agreement will enter into force on the date of mutual notification between the Contracting Parties of compliance with constitutional requirements for the entry into force of international agreements. Title X of the Appendix to the Agreement shows that this took place on December 18, 1996. The Claimant also alleges, based on Article 18 of the United Nations Vienna Convention of 1969 on the Law of Treaties (hereinafter referred to as the "Vienna Convention"),<sup>2</sup> that the Respondent was

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<sup>1</sup> Memorial, p. 84, note 109.

<sup>2</sup> United Nations Conference on the Law of Treaties, First and Second Sessions, Official Records-Documents of the Conference, A/CONF.39/11/Add.2, or 1155 U.N.T.S. 331.

bound, even before entry into force of the Agreement, to “...refrain from acts which would defeat the object matter and purpose...” of the Agreement.<sup>3</sup>

54. The Respondent, in turn,<sup>4</sup> contends that this Arbitral Tribunal has no jurisdiction *ratione temporis* to consider the application of the Agreement to the Respondent’s conduct prior to December 18, 1996. The Respondent alleges that any other interpretation would be inconsistent with the principle of non-retroactive application of treaties embodied in Article 28 of the Vienna Convention and with a basic rule of international law. In other words, the Respondent does not recognize the Arbitral Tribunal’s jurisdiction to decide in connection with matters or conduct taking place prior to such date.<sup>5</sup>

55. The Arbitral Tribunal does not deem it appropriate to establish the meaning, in abstract or general terms, of “retroactive application” of a legal provision, an expression that does not appear to meet generally accepted criteria.<sup>6</sup> Therefore, in this regard, in addition to following the claims of the Parties as indicated below, the Tribunal will follow the text of the Agreement itself and the rules governing the interpretation of treaties.<sup>7</sup>

56. Based on the standards that have just been defined, consideration of whether the Agreement is to be applied retroactively must first be determined in light of the claims of the Parties. The mandate of an arbitration tribunal is subject to limitations, among them those arising out of disputed issues specifically referred to it by the Parties in their claims. An arbitral tribunal cannot decide more or less than is necessary to settle the disputes referred to it. There is no doubt that the Parties have opposing views as to whether the Agreement applies retroactively or not, and they have extensively argued this point<sup>8</sup> —all the more reason to examine this matter in light of the express requests and arguments of the Parties.

57. The Respondent’s conduct prior to December 18, 1996, complained about by the Claimant, essentially consisted of (a) failure to transfer to Cytrar the permit already existing for the operation of the landfill or failure to grant to Cytrar a permit equal or equivalent to such permit, particularly as regards its indefinite duration,<sup>9</sup> and (b) INE’s alleged

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<sup>3</sup> In 109, p. 85 of its memorial, the Claimant misquotes Article 28 of the Vienna Convention, when in fact the correct reference, based on the text and content of such note, should have been to Article 18 of the Convention.

<sup>4</sup> Counter-memorial, pp. 116-120; 414 *et seq.*

<sup>5</sup> The text and case quoted on page 117, 418 of the counter-memorial and note 327, clearly evidence that the Respondent challenges the jurisdiction of the Arbitral Tribunal to the extent stated above.

<sup>6</sup> See Decision on Jurisdiction in *Tradex Hellas S.A. v. Republic of Albania*, December 24, 1996, ICSID case No. Arb/94/2, [http://www.worldbank.org/icsid/cases/tradex\\_decision.pdf](http://www.worldbank.org/icsid/cases/tradex_decision.pdf), p. 186, “there does not seem to be a common terminology as to what is “retroactive” application, and also the solutions found in substantive and procedural national and international law in this regard seem to make it very difficult, if at all possible, to agree on a common denominator as to where “retroactive” application is permissible and where not”.

<sup>7</sup> Award in *Mondev International Ltd. v. United States of America*, October 11, 2002, ICSID case No. ARB(AF)/99/2, p. 14, 43: [www.nafta.law.org](http://www.nafta.law.org).

<sup>8</sup> Counter-memorial, pp. 116-120, 414 *et seq.* Claimant’s closing statement, pp. 93-97. Respondent’s closing statement, pp. 4-6; 13 *et seq.*

<sup>9</sup> These events took place as follows: the first one on September 24, 1996 (note from INE to Cytrar informing that “it had been duly registered”), document A42, and the second one some time later, upon INE replacing the note by a new one on even date and with a substantially identical text, except that the new note evidences

ambiguous conduct, in that it first included Cytrar in an INE register in terms that could be deemed to be a transfer to Cytrar of the existing unlimited permit, subsequently revoking it by replacing it with another one, limited in its initial duration (a year) and the subsequent renewal of which was subject to approval by INE.<sup>10</sup>

58. In its memorial, the Claimant states as follows with regard to the conduct of INE with respect to the exchange or replacement of operating permits for the landfill:

However, this fact, although serious when we know what happened subsequently, did not cause immediate prejudice to the claimant which, after all, was still entitled to operate the Landfill acquired.<sup>11</sup>

Nevertheless, the Claimant highlights the following in this regard:

...the unwarranted change in the conditions of operation and as a result of a new and different permit being issued, unrelated to the plans and guarantees existing as of the time of the investment, is truly a discriminatory measure without any legal foundation, expressly prohibited by Article III of the ARPPI (Agreement on the Reciprocal Promotion and Protection of Investments).<sup>12</sup>

And a little later:

It should not be understood that the conversion of an authorization for an unlimited period of time into a temporary one legitimized or enabled the subsequent resolution contrary to renewal. That resolution of INE, challenged in this arbitration, is illegal and unlawful just like a revocation of the license on the same grounds. It is, however, beyond doubt that the precariousness (due to the short duration) and provisional nature of an authorization for such a limited time are greater than in the case of an authorization for an unlimited period of time.<sup>13</sup>

In connection with the same point, the Claimant explains the following:

However, CYTRAR, S.A. de C.V. and TECMED had an authorization covering the operation of the landfill and were not in a position to make complaints that could “displease” the competent officials. Still, in spite of undeniable differences between an authorization for an unlimited duration and a temporary one, the one granted in 1996 was a legitimate and sufficient title, operation of the landfill continued uninterrupted and relations between the personnel of the companies and the representatives of the Administration were cordial and fluid. Everyone’s intent was that the landfill should operate and be managed appropriately and that it should last. At the time, at least for the Claimant, it was unthinkable that it would be unlawfully deprived of its lawfully obtained authorization only two years later.<sup>14</sup>

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the granting of a new permit and notifies it to Cytrar (this permit, for a year and renewable, was dated November 11, 1996) as an annex, documents A43 and A44, Memorial, pp. 40-45; 107-109. Claimant’s closing statement, pp. 30-38.

<sup>10</sup> Claimant’s closing statement, pp. 110-115.

<sup>11</sup> Memorial, p. 42.

<sup>12</sup> Memorial, p. 108.

<sup>13</sup> Memorial, p. 109.

<sup>14</sup> Memorial, pp. 44-45. This was later reaffirmed by the Claimant when referring to the authorization granted by INE for the operation of the landfill by Cytrar, of November 19, 1997: “At any rate, we shall reiterate what has already been stated regarding the sufficiency of both authorizations to make operation of the landfill lawful and the practical considerations that caused CYTRAR S.A. de C.V. and TECMED to refrain from expressly protesting such changes in the conditions. The landfill continued to be operational; its duration potential, which depended on its useful life, had not been altered; and the competent authorities had expressed



Referring to INE's refusal to renew the authorization granted on November 19, 1997, the Claimant states that:

This is precisely the violation challenged in this arbitration —an Official Letter of the National Ecology Institute which deprived Cytrar, S.A. de C.V. of the asset that was the basis of its exclusive activity. A definitive and fundamental act accompanied by a number of proximate, previous and subsequent acts which completed the multiple violation of the ARPPI and which are claimed against in this arbitration.<sup>15</sup>

The Claimant further states:

However, the necessary accuracy with which the facts have been dealt in this memorial shows how the respondent's breach did not materialize in a single act, but was gradually prepared, implemented and strengthened until it was finally consummated in the act of refusing renewal.

It was certainly the refusal that caused damage and definitively prevented this company from obtaining a legitimate return on its investment. The preceding acts, particularly the ones leading to adverse modifications of the terms of the authorization, are in the nature of acts prior to that decisive breach which caused the damage for which compensation is requested. But the truth is that, although there is a difference between the operation of a landfill under a temporary authorization and under a license for an unlimited duration, in both cases there exists a title to undertake and lawfully continue operations, and the day-to-day activities are not curtailed by such time limitations.<sup>16</sup>

In connection with the refusal to renew the authorization of November 19, 1997, the Claimant further points out the following:

Therein lies the respondent's essential breach, which has caused the damage for which compensation is requested in this arbitration.<sup>17</sup>

Referring to the fair and equitable treatment under international law guaranteed by Article 4(1) of the Agreement, the Claimant claims that it encompasses the duty to act transparently and respecting the legitimate trust generated in the investor. In this regard, the Claimant states the following:

In sum, the legitimate trust generated in TECMED inducing it to make the investment was violated and seriously trampled upon. First, as a result of the change in the landfill's operating conditions and, subsequently and definitively, through the measure that led to its immediate standstill.

If Mexican law were to protect and permit the conversion of unlimited permits into annual ones, which we deny, the least that could be said is that such legislation is completely lacking in transparency, since none of its provisions specifies that licenses are limited in duration.<sup>18</sup>

The Claimant also argues that the replacement of the existing unlimited duration license, which in the past was given to state investors (municipal investors or investors from the

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no reservations with regard to the landfill or operation thereof, nor had they expressed any intention that might affect the extent or duration of such operation": Memorial, pp. 47-48.

<sup>15</sup> Memorial, p. 53.

<sup>16</sup> Memorial, p. 103-104.

<sup>17</sup> Memorial, p. 112.

<sup>18</sup> Memorial, p. 122.

State of Sonora) by a limited duration license when it was granted to Cytrar constituted a violation of the fair and equitable treatment guarantee set forth in Article 4(5) of the Agreement.<sup>19</sup>

Finally, the Claimant summarizes its claims as follows:

A declaration is sought from the Arbitral Tribunal regarding the breach committed by the United Mexican States as a result of the actions and decisions stated in this memorial, both as regards the breach itself and in connection with acts in preparation of such breach...<sup>20</sup>

After listing the main breaches of the Agreement alleged by the Claimant against the Respondent, which include “the substantial change in the conditions governing the operation of the landfill...” as a result of the replacement of the authorization existing at the time of making the investment and “...particularly due to the conversion of an unlimited duration permit into an annual or annually renewable one”,<sup>21</sup> the Claimant summarizes its claims as follows:

Such acts prepare and constitute an express, serious and blatant breach of the duty to protect foreign investments, declared in Article II of the ARPPI and of the duty to offer fair and equitable treatment to foreign investors, pursuant to Article IV of the Agreement; non-renewal is a measure having equivalent effects to the type of expropriation provided for in Article V of the ARPPI, carried out for political reasons and interests contrary to the public interest and without appropriate compensation.<sup>22</sup>

59. In its closing statement, the Claimant gives additional details of its requests and claims. Regarding the replacement of the unlimited duration license to operate the Landfill by a one-year license, and in view of the Respondent’s statement that the Claimant’s claims also seek to hold the Respondent liable for such replacement, the Claimant states as follows:

This is absolutely false. Suffice it to look at the request for relief in the claim, which contains the Claimant’s claims, to understand that the only declaration of breach sought from the Arbitral Tribunal relates to the refusal to renew the license for the operation of the CYTRAR Landfill.

Certainly, the Claimant has provided an account, and informed the Tribunal, of other facts occurring prior to November 25, 1998, because they are relevant and clearly illustrate the attitude and conduct of the Mexican authorities, but the Claimant has not requested a declaration of breach or liability in respect of only one of them.<sup>23</sup>

The Claimant then adds:

In sum, we hold that the act in connection with which an award is requested in this arbitration is the refusal to renew the permit with respect to the Landfill of Cytrar, aside from the fact that the Tribunal needs to know and assess the meaning of previous acts and measures of the Mexican authorities.

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<sup>19</sup> Memorial, p. 127.

<sup>20</sup> Memorial, p. 139.

<sup>21</sup> Memorial, p. 139.

<sup>22</sup> Memorial, pp. 139-140.

<sup>23</sup> Claimant’s closing statement, p. 93.

This claim is fully and expressly supported by the provisions on retroactivity contained in the ARPPI between Spain and Mexico, and does not need to rely on any other conventions.<sup>24</sup>

The Claimant further states that:

We stress that the only violation of the ARPPI requested to be penalized by the Tribunal is the decision not to renew the license, which caused the damage sustained by TECMED [...] However, this does not prevent, but rather determines, that the Arbitral Tribunal should examine and assess the preceding and even subsequent acts of the Mexican authorities.<sup>25</sup>

60. The Arbitral Tribunal sees a certain fluctuation in the Claimant's position as to whether the Respondent's conduct prior to December 18, 1996, can be taken into account in order to determine whether the Respondent has violated the Agreement. In any case, the Arbitral Tribunal concludes that the Claimant does not include in its claims submitted to this Tribunal acts or omissions of the Respondent prior to such date which, considered *in isolation*, could be deemed to be in violation of the Agreement prior to such date.

61. A more difficult issue is whether such acts or omissions, combined with acts or conduct of the Respondent after December 18, 1996, constitute a violation of the Agreement after that date.

62. The Claimant's considerations, particularly detailed in its memorial and transcribed in paragraph 58 above, show that the Claimant, in order to determine whether there has been a violation of the Agreement, holds that the investment and the Respondent's conduct are to be considered as a process and not as an unrelated sequence of isolated events. This position of the Claimant would have two consequences. The first one is that the Respondent, prior to December 18, 1996, and through the conduct of different agencies or entities in the state structure, gradually but increasingly appears to have weakened the rights and legal position of the Claimant as an investor. Such conduct would appear to have continued after the entry into force of the Agreement, and would have resulted in the refusal to extend the authorization on November 25, 1998, which would have caused the concrete damage suffered by the Claimant as a result of such conduct. The common thread weaving together each act or omission into a single conduct attributable to the Respondent is not a subjective element or intent, but a converging action towards the same result, i.e. depriving the investor of its investment, thereby violating the Agreement. The second consequence is that, before getting to know the final result of such conduct, this conduct could not be fully recognized as a violation or detriment for the purpose of a claim under the Agreement,<sup>26</sup> all the more so if, at the time a substantial part of such conduct occurred, the provisions of the Agreement could not be relied upon before an international arbitration tribunal because the Agreement was not yet in force.

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<sup>24</sup> Claimant's closing statement, p. 97.

<sup>25</sup> Claimant's closing statement, p. 98.

<sup>26</sup> Whether it be conduct that continues in time, or a complex act whose constituting elements are in a time period with different durations, it is only by observation as a whole or as a unit that it is possible to see to what extent a violation of a treaty or of international law rises or to what extent damage is caused: J. Crawford, *The International Law Commission's Articles on State Responsibility* (Cambridge University Press, 2002), pp. 136-137; 143.

63. Clearly, the basic principle in international law is that unless there is a different interpretation of the treaty or unless otherwise established in its provisions, such provisions are not binding in connection with an act or event which took place or a situation that ceased to exist before the date of its entry into force.<sup>27</sup> The burden of proving the existence of any exception to the principle of non-retroactive application established therein naturally lies with the party making the claim.

64. Although the Agreement applies to investments existing as of the date of its entry into force—which suggests as a logical conclusion that the situations surrounding investments existing at the time do not escape its provisions—the way the provisions on which the Claimant relies are drafted suggests that application thereof is forward-looking. Thus, for example,<sup>28</sup> Article 3(1) of the Agreement:

Each Contracting Party *shall offer* full protection and security...[...] and *shall not hinder*<sup>29</sup> [...] the management, maintenance, development, use, enjoyment, expansion, sale or, as the case may be, the liquidation of such investments.

The same can be said about Article 3(2) of the Agreement:

Each Contracting Party, within the framework of its own legislation, *shall grant*<sup>30</sup> any authorizations needed in connection with the investments...

Or about Article 4(1) and (2) with regard to fair and equitable treatment:

Each Contracting Party *shall guarantee*<sup>31</sup> fair and equitable treatment in its territory pursuant to international law for investments made by investors from another Contracting Party [...]. Such treatment *shall not be* less favorable than that afforded in similar circumstances by each Contracting Party to investments made in its territory by investors from a third party state.

The same is found in Article 4(5) in connection with national treatment:

...each Contracting party *shall offer*<sup>32</sup> to investors from the other Contracting Party treatment no less favorable than that afforded to its own investors.

Or in Article 5(1) in connection with nationalization or expropriation:

Nationalization, expropriation or any other measure of similar effects [...] *which may be adopted*<sup>33</sup> by the authorities of a Contracting Party against investments in its territory made by investors from the other Contracting Party...

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<sup>27</sup> Vienna Convention, Article 28. Award in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), 68, p. 22, [www.naftalaw.org](http://www.naftalaw.org). I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2<sup>nd</sup> Edition (Manchester University Press, 1984), p. 85.

<sup>28</sup> Italics in the quotations transcribed in paragraph 64 inserted by the Arbitral Tribunal.

<sup>29</sup> Emphasis added by the Arbitral Tribunal.

<sup>30</sup> Emphasis added by the Arbitral Tribunal.

<sup>31</sup> Emphasis added by the Arbitral Tribunal.

<sup>32</sup> Emphasis added by the Arbitral Tribunal.

<sup>33</sup> Emphasis added by the Arbitral Tribunal.

65. The continuous use of the future tense, which connotes the undertaking of an obligation linked to a time period, rules out any interpretation to the effect that the provisions of the Agreement, even in relation to investments existing as of the time of its entry into force, apply retroactively.<sup>34</sup>

66. However, it should not necessarily follow from this that events or conduct prior to the entry into force of the Agreement are not relevant for the purpose of determining whether the Respondent violated the Agreement through conduct which took place or reached its consummation point *after* its entry into force. For this purpose, it will still be necessary to identify conduct —acts or omissions— of the Respondent after the entry into force of the Agreement constituting a violation thereof.

...events or conduct prior to the entry into force of an obligation for the respondent State may be relevant in determining whether the State has subsequently committed a breach of the obligation. But it must still be possible to point to conduct of the State after that date which is itself a breach.<sup>35</sup>

In broader terms, Article 28 of the Vienna Convention reads as follows on this matter:

If, however, an act or fact or situation which took place or arose prior to the entry into force of a treaty continues to occur or exist after the treaty has come into force, it will be caught by the provisions of the treaty.(United Nations Conference on The Law of Treaties, First and Second Sessions, Official Records (Documents of the Conference, Draft Articles on the Law of Treaties with Commentaries, as adopted by the International Law Commission at its Eighteenth Session), pag. 32, (3) (United Nations publication, Sales No.:E.70V.5, A/CONF.39/11/Add.2))

67. In view of the above precedents and of the Claimant's specific requests, the Arbitral Tribunal will not consider any possible violations of the Agreement prior to its entry into force on December 18, 1996, as a result of isolated acts or omissions that took place previously or of conduct by the Respondent considered in whole as an isolated unit and that went by before such date. In order to reach such conclusion, a relevant fact is that Cytrar, Tecmed and the Claimant did not choose to make any claim in connection with conduct occurring prior to December 18, 1996, not even through a note addressed to the relevant Mexican authorities stating their objections to the measures or resolutions adopted,<sup>36</sup> although they were not under any violence or pressure at the time preventing them from doing so.

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<sup>34</sup> Decision on Jurisdiction in *Tradex Hellas S.A. v. Republic of Albania*, December 24, 1996, ICSID case No.Arb/94/2, p. 191, [http://www.worldbank.org/icsid/cases/tradex\\_decision.pdf](http://www.worldbank.org/icsid/cases/tradex_decision.pdf).

<sup>35</sup> Award in *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), 70, p. 23, [www.naftalaw.org](http://www.naftalaw.org).

<sup>36</sup> For instance, the Claimant chose not to make any claim in connection with the replacement of its operating permits in order not to damage its relationship with the Mexican authorities: see transcript of the Claimant's statements in paragraph 58. As pointed out by the arbitral tribunal in the case *Kuwait and the American Independent Oil Company (Aminoil)*, 21 I.L.M. p. 976 et seq. (1982), 44, p. 1008: "In truth, the Company made a choice; disagreeable as certain demands might be, it considered that it was better to accede to them because it was still possible to live with them. The whole conduct of the Company shows that the pressure it was under was not of a kind to inhibit its freedom of choice. The absence of protest during the years following [...], confirms the non-existence, or else the abandonment, of this ground of complaint." See also I. Brownlie, *Principles of International Law* (5<sup>th</sup> Ed., Oxford University Press, 1998), p. 642-644.

68. On the other hand, conduct, acts or omissions of the Respondent which, though they happened before the entry into force, may be considered a constituting part, concurrent factor or aggravating or mitigating element of conduct or acts or omissions of the Respondent which took place after such date do fall within the scope of this Arbitral Tribunal's jurisdiction. This is so, provided such conduct or acts, upon consummation or completion of their consummation after the entry into force of the Agreement constitute a breach of the Agreement, and particularly if the conduct, acts or omissions prior to December 18, 1996, could not reasonably have been fully assessed by the Claimant in their significance and effects when they took place, either because as the Agreement was not in force they could not be considered within the framework of a possible claim under its provisions or because it was not possible to assess them within the general context of conduct attributable to the Respondent in connection with the investment, the key point of which led to violations of the Agreement following its entry into force.

69. The Arbitral Tribunal is aware that the Claimant, relying on the decision in the case *Emilio Agustín Maffezini v. Kingdom of Spain*,<sup>37</sup> refers in its closing statement to the most favored nation treatment provided for in Article 8(1) of the Agreement in order to enable retroactive application in view of the more favorable treatment in connection with that matter which would be afforded to an Austrian investor under the bilateral treaty on investment protection between the United Mexican States and Austria of June 29, 1998. The Arbitral Tribunal will not examine the provisions of such Treaty in detail in light of such principle, because it deems that matters relating to the application over time of the Agreement, which involve more the time dimension of application of its substantive provisions rather than matters of procedure or jurisdiction, due to their significance and importance, go to the core of matters that must be deemed to be specifically negotiated by the Contracting Parties. These are determining factors for their acceptance of the Agreement, as they are directly linked to the identification of the substantive protection regime applicable to the foreign investor and, particularly, to the general (national or international) legal context within which such regime operates, as well as to the access of the foreign investor to the substantive provisions of such regime. Their application cannot therefore be impaired by the principle contained in the most favored nation clause.<sup>38</sup>

70. In assessing the Respondent's conduct, for the purpose of and with the scope provided for in paragraph 68 above, the Arbitral Tribunal shall take into account the principle of good faith, both as the general expression of a principle of international law embodied in Article 26 of the Vienna Convention and in its particular manifestation embodied in Article 18 of such Convention<sup>39</sup> with respect to the Respondent's conduct between June 23, 1995

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<sup>37</sup> ICSID Case No. ARB/97/7, decision on jurisdiction of January 25, 1999, <http://www.worldbank.org/icsid/cases/awards.htm>.

<sup>38</sup> *Ibid.*, *Maffezini case*, Decision on jurisdiction, p. 25-26, 62-63.

<sup>39</sup> Regarding the importance of the principle of good faith within the framework of the law of treaties, including the period between signing and ratification, see R. Kolb, *La bonne foi en droit international public*, Presses Universitaires de France, 179-207 (2000). Article 18 of the Vienna Convention arises out of a general rule of international law based on good faith, which it expresses; it is therefore independent, and does not constitute an exception to the principle of non-retroactive application of treaties: I. Sinclair, *The Vienna Convention on the Law of Treaties*, p. 99, Manchester University Press (2<sup>nd</sup> Edition, 1984).

—the date on which the Agreement was signed by the Contracting Parties— and the date of its entry into force mentioned above,<sup>40</sup> in that such Article provides that:

A State shall refrain from acts that defeat<sup>41</sup> the object and purpose of a treaty when:

a) it has signed the treaty or has exchanged instruments constituting the treaty subject to ratification, acceptance or approval, until it shall have made its intention clear not to become a party to the treaty...

71. Writings of publicists point out that Article 18 of the Vienna Convention does not only refer to the intentional acts of States but also to conduct which falls within its provisions,<sup>42</sup> which need not be intentional or manifestly damaging or fraudulent to go against the principle of good faith, but merely negligent or in disregard of the provisions of a treaty or of its underlying principles, or contradictory or unreasonable in light of such provisions or principles. It should be noted that the principle inspiring such article has been applied in order to settle, through international arbitration, disputes between States and individuals which, in order to be decided, required a pronouncement on obligations of the former vis-à-vis the latter based on the law of treaties. The Mixed Greek-Turkish Arbitral Tribunal, in the case *A.A. Megalidis v. Turkey*,<sup>43</sup> stated:

qu'il est de principe que déjà avec la signature d'un Traité et avant sa mise en vigueur, il existe pour les parties contractantes une obligation de ne rien faire qui puisse nuire au Traité en diminuant la portée de ses clauses.

Qu'il est intéressant de faire observer que ce principe —lequel en somme n'est qu'une manifestation de la bonne foi qui est la base de toute loi et de toute convention— a reçu un certain nombre d'applications...<sup>44</sup>

## II. Timely submission by the Claimant of its Claims against the Respondent

72. In Chapter III of its counter-memorial, in a general section entitled “C. Objections regarding Jurisdiction”, the Respondent introduces defenses based on the Claimant’s claims allegedly not satisfying the requirements of Title II(4) and Title II(5) of the Appendix to the Agreement, for which reason this Arbitral Tribunal would be prevented from dealing with such claims.

Title II(4) of the Appendix to the Agreement provides the following:

An investor from a Contracting Party may, either on its own behalf or representing a company owned by it or under its direct or indirect control, refer to arbitration a claim on the grounds that the other Contracting Party

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<sup>40</sup> See comment at the International Law Commission (United Nations Conference on the Law of Treaties, Official Records, Documents of the Conference, United Nations Publication A/CONF.39/11/Add.2), p. 22.

<sup>41</sup> It should be noted that the English version of this provision uses the expression “*defeat the object*”, which is not strictly equivalent to the notion of “frustrate” in English or “frustrar” in Spanish.

<sup>42</sup> A. Remiro Brotons, *Derecho Internacional Público. 2 Derecho de los Tratados* (Tecnos, Madrid, 1987), p. 246.

<sup>43</sup> Annual Digest of Public International Law Cases (1927-1928) [A. Mc Nair & H. Lauterpacht Editors], Vol. 4 (1931), 272, p. 395.

<sup>44</sup> Lord McNair, *The Law of Treaties* (Clarendon Press, Oxford, 1961), p. 202.

has violated an obligation under this Agreement, as long as the investor or its investment have suffered a loss or damage by reason or as a consequence of the breach.

Title II(5) of the Appendix to the Agreement provides the following:

The investor may not submit a claim under this Agreement if more than three years have elapsed since the date on which the investor had or should have had notice of the alleged violation, as well as of the loss or damage sustained.

73. In the opinion of the Arbitral Tribunal, the defenses filed by the Respondent, relying on Title II(4) and (5) of the Appendix to the Agreement, do not relate to the jurisdiction of the Arbitral Tribunal but rather to (non)compliance with certain requirements of the Agreement governing the admissibility of the foreign investor's claims. The Arbitral Tribunal notes that to the extent such defenses have been filed with respect to claims referring to conduct or acts or omissions of the Respondent which are excluded from the Arbitral Tribunal's jurisdiction or from the substantive scope of application of the Agreement pursuant to the decision contained in paragraphs 67 and 68 of this award, any determination as to whether such claims fulfill the requirements of Title II(4) and (5) of the Appendix to the Agreement would be superfluous.

74. When it comes to the Claimant's claims falling within the scope of this arbitration and of the provisions of the Agreement, the Arbitral Tribunal will decide if the admissibility requirements set forth in Title II(4) and (5) of the Appendix to the Agreement have been complied with or not with respect to the acts on which such claims are based, together with the remaining considerations or matters to be taken into account by the Arbitral Tribunal in deciding on the merits of the allegations of the Parties in this award. If the acts under review are deemed by the Arbitral Tribunal to be a part of more general, and not merely isolated conduct, the Arbitral Tribunal reserves the power to consider that the time when it will assess whether such acts have caused losses or damage for the purposes of Title II(4) of the Appendix to the Agreement, or whether they were deemed by the Claimant to be a breach of the Agreement or damaging within the three-year term provided for in Title II(5), will not be earlier than the point of consummation of the conduct encompassing and giving an overarching sense to such acts. In any case, and within the general framework of considerations already made when deciding whether the provisions of the Agreement are to be applied retroactively or not, the Arbitral Tribunal is of the view that Title II(4) and (5) of the Appendix to the Agreement contains requirements relating to the substantive admissibility of claims by the foreign investor, i.e. its access to the substantive protection regime contemplated under the Agreement. Consequently, such requirements are necessarily a part of the essential core of negotiations of the Contracting Parties; it should therefore be presumed that they would not have entered into the Agreement in the absence of such provisions. Such provisions, in the opinion of the Arbitral Tribunal, therefore fall outside the scope of the most favored nation clause contained in Article 8(1) of the Agreement.

### III. The Scope of the Purchase Transaction



75. The Claimant alleges, mainly on the basis of documents signed with Promotora in the process of award and transfer of the assets under which it operated the landfill of hazardous waste physically located in Las Víboras, Municipality of Hermosillo, State of Sonora, that what the Claimant acquired through that process was actually a pool of personal and real property and intangibles, the latter consisting of permits issued by municipal and federal authorities of the Respondent which enabled and empowered the Claimant to operate the Las Víboras site as a hazardous waste landfill. According to the Claimant, out of the total price of \$34,047,988.26 (Mexican Pesos) paid to Promotora for the acquisition of the assets relating to the landfill, the most substantial part, \$24,047,988.26 (Mexican Pesos), was paid by the Claimant in kind —by closing down an existing landfill for urban waste and constructing and advising in respect of the operation of a new landfill for the same purpose— in exchange for the permits and authorizations to operate the Las Víboras site as a landfill for hazardous waste.<sup>45</sup> Both the landfill that was closed down as well as the new one currently in operation are located in land owned by the Municipality of Hermosillo, under the jurisdiction of that Municipality and this location is other than the site for landfill of hazardous waste at Las Víboras, acquired by the Claimant as a result of the public bidding.<sup>46</sup>

76. The Respondent, on the other hand, argues that Promotora only tendered and sold to the Claimant a pool of personal and real property “relating to the Industrial Park” of the city of Hermosillo, which did not include permits or licenses to operate the landfill.<sup>47</sup> According to the Respondent, the public bidding and award of assets relating to the landfill at the Las Víboras site to Tecmed and Cytrar also included acquisition by another company of the Tecmed group of a concession for a landfill —a municipal dump also situated in the Municipality of Hermosillo—, for which Cytrar allegedly paid the above-mentioned amount of \$ 24,047,988.26 (Mexican Pesos). The Respondent specifically argues the following:

Tecmed (Mexico) acquired two things in the tender of February 1996. A pool of personal and real property relating to the landfill of hazardous waste, which consisted of a piece of land, existing constructions and machinery and equipment clearly described in the supporting documents of the transaction. It paid 10 million pesos in cash for them, as reflected in the financial statements submitted in these proceedings.

Secondly, it acquired the concession of a landfill, the municipal dump, for which it offered 24 million pesos, a concession which it still holds and continues to operate. What Dr. Calvo Corbella said a moment ago is true, not in respect of Cytrar but in respect of the company [sic], as confirmed by engineer Polanco, who attended the Tecmed (Mexico) tender. This was also confirmed by engineer Diez-Canedo, in reply to a question I expressly made when I asked him if, in addition to the amount of ten million pesos, he had offered a non-monetary contribution consisting of the construction and comprising the general facilities and the first phase of operations. Engineer Díaz Canedo answered that that was true.<sup>48</sup>

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<sup>45</sup> Memorial, pp. 20-40. Claimant’s closing statement, pp. 10-30.

<sup>46</sup> Declaration of Javier Polanco Gómez Lavin, Hearing of May 20-24, 2002; transcription of May 20, 2002, pp. 31 overleaf/33.

<sup>47</sup> Counter-memorial, pp. 24-31; N° 90 *et seq.*

<sup>48</sup> Oral statement by the Claimant at the Hearing of May 20, 2002, transcript of May 24, 2002, pp. 27-28.

In sum, the Respondent not only holds that that amount, or contribution in kind valued at such amount, was not paid or made in exchange for intangible assets (the permits, authorizations or licenses to which Claimant refers), but also that it was not even a part of the price paid for assets relating to the landfill in Las Víboras. According to the Respondent, such amount or contribution was paid or made in exchange for the concession to operate the urban waste landfill of Hermosillo.

77. Based on the allegations of the Parties and of the facts presented before this Arbitral Tribunal, it is to be concluded that the award, the public bidding and sales transaction of assets relating to the Las Víboras landfill and the rights and obligations for each of the parties to such transaction and resulting therefrom were embodied in different instruments requiring joint consideration in order to determine the scope of the operation and its effects.

78. The award by Promotora of assets relating to the Las Víboras landfill to Tecmed as a result of the tender of such assets by Promotora was followed by the signing of a “promise to sell” contract dated February 20, 1996, entered into between Promotora and Tecmed, the fourth clause of which provides that at the time of executing the notarial deed of conveyance, the assets conveyed would include copies of permits, licenses and authorizations relating to the assets specified in the agreement.<sup>49</sup> In item or representation No. III of such instrument, it is stated that the Board of Directors of Promotora unanimously approved the following proposal:

Price offer for the purchase of Cytrar, alternative number two, consisting of 10 million pesos plus a non-monetary contribution to the Municipality of Hermosillo in the form of a project for the construction of and advice in connection with the operation of the new landfill in accordance with the attached project which comprises the general facilities and their first phase of operation, including the closedown of the current landfill, services valued at \$ 24,155,185.00 (Mexican Pesos). Total offer: \$34,155,185 (Mexican Pesos).

The second clause of the document stipulates that part of the price - \$ 10,000,000 (Mexican Pesos)- would be paid in cash, part upon signing the promise to sell and part upon signing the notarized deed of conveyance of the tendered real property, with the balance, amounting to \$24,155,185.00 (Mexican Pesos), to be paid in kind, by providing the service of closing down the existing landfill and constructing and providing advice in connection with the operation of a new one as mentioned above and referred to in item or representation number III of the “promise to sell” contract. As regards payment in kind of that part of the price, the second clause of the promise to sell expressly states as follows:

The difference relates to the cost of constructing a new landfill and closing down the existing one, in accordance with the approved proposal, which would be at the time of completing the construction of the new landfill to the satisfaction of Promotora Inmobiliaria of the Municipality of Hermosillo based on the construction project submitted by the buyer, upon which time the reservation of ownership would end; in the case of sale of the personal property located in the “landfill”, it will be billed by seller to buyer upon formalization of the final transaction, such formalities being the responsibility of Promotora Inmobiliaria of the Municipality of Hermosillo.

In turn, the fifth clause of the “promise to sell” contract provides the following:

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<sup>49</sup> Document A23.

The parties specify that as from now the use to be given to the hazardous waste landfill shall be precisely that, failing which the property will revert back to the seller, in which case the buyer shall automatically forfeit any advances or payments made, unless the buyer “Tecmed, Técnicas Medioambientales de México S.A. de C.V.” fails to obtain the government permits and licenses required for lawful operation, in which case it may change the mode of operation by using the existing original license for operation of the landfill by “Tecmed, Técnicas Medioambientales de México S.A. de C.V.”.

79. In addition to the above, on the same date, Promotora, Tecmed and Cytrar entered into an agreement “to determine the method and terms of payment of the consideration arising out of the ‘promise to sell’ contract with reservation of ownership, dated February 20, 1996”.<sup>50</sup> Under such agreement, the total price to be paid by Cytrar amounted to \$ 24,047,988.26 (Mexican Pesos), broken down as follows: \$6,277,409.50 (Mexican Pesos) for land and constructions; \$237,034.00 (Mexican Pesos) for machinery and equipment; \$24,047,988.26 (Mexican Pesos) for intangibles. The agreement sets forth that Promotora shall issue an invoice covering the intangibles and that Cytrar shall issue invoices for the part of the price payable through the construction of the new landfill and closedown of the Hermosillo municipal dump, such invoices to be issued upon completion of the works. Clauses three and four of the agreement specifically provide the following:

Third: Promotora Inmobiliaria of the Municipality of Hermosillo OPD further undertakes to issue an invoice for the intangibles upon full compliance by Cytrar S.A. de C.V. of the obligation set forth in clause two of the above-mentioned agreement of February 20, 1996. The invoice value will be \$24,047,988.26 (Mexican Pesos) plus \$ 3,607,198.24 (Mexican Pesos) VAT, totaling \$ 27,655,186.50 (Mexican Pesos).

Fourth: Cytrar S.A. de C.V. agrees to the terms of the preceding clauses and in turn undertakes to issue invoices for the part it will pay with the construction and delivery of the new landfill of the Municipality of Hermosillo and the closedown of the current municipal dump. Such invoices will be issued upon formal delivery of the works.

80. Finally, pursuant to the award conditions, through a notarial deed of March 27, 1996,<sup>51</sup> Cytrar acquired from Promotora the real property, constructions and personal property relating to the landfill. Item or representation number 1 of the deed specifies that the seller (Promotora). “..tendered various assets held by it, in particular the ‘hazardous waste landfill situated at the Las Víboras’ site in the Hermosillo Industrial Park.” In item or representation II of such deed, reference is made to the meeting of the Board of Directors of Promotora, which unanimously approved the proposal submitted by Tecmed on the following terms:

“Price Offer for Acquisition of Cytrar”, alternative number two, consisting of \$10,000,000 (ten million pesos), plus a non-monetary contribution to the Municipality of Hermosillo, approval recorded in minutes, stating that it was unanimous, and including the closedown of the current landfill, the project and the construction of the first phase of the new landfill, pursuant to the resolutions approving performance, issued by the Board of Directors...”

The requirements for approval by the Board of Directors of Promotora include, as point c) of item or representation II the following:

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<sup>50</sup> Document A24.

<sup>51</sup> Document A25.

Identifying the responsibility of each party and the timing for obtaining operating licenses.

The second clause of the deed states a cash amount of \$ 10,000,000 (Mexican Pesos) as the price, which is broken down into different amounts paid for the constructions already existing, personal property and land. Such clause also provides that:

... regardless of the price fixed, the PURCHASER undertakes to perform non-monetary obligations consisting of the project and construction of the first phase of the new landfill and closedown of the existing one, to the satisfaction of “Promotora Inmobiliaria of the Municipality of Hermosillo”, in accordance with the approved proposal.

The fourth clause of the deed provides that the reservation of ownership subject to which the sale is made will be lifted

... upon completion of the construction works for the new landfill and the closing down of the existing one, to the entire satisfaction of “Promotora Inmobiliaria of the Municipality of Hermosillo”, in accordance with the approved proposal.

Clause 5a) of the deed provides that the transferee (Cytrar) must undertake to perform its obligations under the public bidding in full, including the following obligations:

Specification that the acquired assets will be used solely as a landfill for hazardous waste, failing which they shall revert back to Promotora Inmobiliaria of the Municipality of Hermosillo, and any payments made will be forfeited, if the buyer “Cytrar” S.A. de C.V. should fail to obtain the government permits and licenses required for lawful operation; in such case, the mode of operation may be changed by using the existing original license for operation of the landfill by “Cytrar” S.A. de C.V.

Clause 5d) also provides that:

The steps required to be taken in order to obtain the government permits and licenses necessary for operation of the hazardous waste landfill shall be the sole responsibility of the transferee, Promotora Inmobiliaria of the Municipality of Hermosillo hereby being released from any liability with regard to the official authorizations required to be requested from the Municipality of Hermosillo. Promotora Inmobiliaria will lend its support to secure approval.

81. In a rectifying notarial deed of December 16, 1996,<sup>52</sup> Promotora and Cytrar corrected the amount of the part of the price relating to the acquisition of the real property as described in the original deed of conveyance of March 27, 1996, which was thus rectified and fixed at \$ 6,132,530 (Mexican Pesos), but the prices for the other items were not rectified. The deed also specified that real property and intangibles would be invoiced separately as follows:

As specified in the agreement signed between the parties on March 20, 1996, which fixes the terms and conditions under which the transaction will be settled, an involuntary error led to a mistaken and insufficient breakdown of values and calculation of Value Added Tax, AS THE TECHNICAL DESCRIPTION<sup>53</sup> of such assets WAS NOT TAKEN INTO ACCOUNT, i.e. the necessary topographic survey and description of

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<sup>52</sup> Document A26.

<sup>53</sup> Emphasis in the original.

constructions and intangibles, since it was agreed that personal property and intangibles would be invoiced separately.

82. In a service contract of March 28, 1996,<sup>54</sup> between Promotora and Cytrar, in consideration of Cytrar's provision of "environmental advice services to the Municipality of Hermosillo" (clause 6), Promotora undertook, among other things (clause 2 d), to:

Keep in force any federal, state and municipal licenses and other permits required for operation of the landfill.

83. After the contribution in kind provided for as part of the purchase price of the assets relating to the landfill having been made, and apparently pursuant to the procedure set forth in the second clause of the "promise to buy" contract of February 20, 1996, the third and fourth clauses of the agreement regarding the method and terms of payment on the same date and the rectifying notarially-recorded deed of December 16, 1996, Promotora issued on July 24, 1997, Invoice No. 304 to Cytrar<sup>55</sup> for the amount of \$24,047,988.26 (Mexican Pesos) plus the applicable value added tax (VAT). The invoice comprises:

An authorization granted by the National Ecology Institute for the operation of a controlled landfill, through the collection, transport, treatment, temporary storage, and disposal of hazardous waste; the authorization also includes an authorization for soil use on the part of the Municipality of Hermosillo.

84. The different provisions laid down above and included in several documents signed by Promotora and Tecmed or Cytrar to record their mutual rights and obligations in connection with the sale and operation of the Las Víboras landfill show that performance of the works and services that were the responsibility of Cytrar relating to the landfill of urban waste, valued at \$ 24,047,988.26 (Mexican Pesos), was a payment in kind that was part of the consideration to be furnished by Cytrar for the award and sale to it of different assets for Cytrar to operate the hazardous waste landfill at Las Víboras; in other words, it was part of the price for which the assets of the Las Víboras landfill were awarded and sold to Tecmed and ultimately to Cytrar. So much so that the reservation of ownership to which such sale was subject would only terminate when such consideration had been furnished in full.<sup>56</sup> The audited financial statements of Cytrar as of December 31, 1997 enclosed with the expert witness report of American Appraisal<sup>57</sup> offered by the Claimant, particularly note 6, leads to the same conclusion; no evidence to the contrary has been provided based on the accounting books of Promotora or on statements of its management that took part in the sale of assets relating to the hazardous waste landfill of Las Víboras, nor evidence of any judicial challenges, for fiscal or any other reasons, with respect to the part of the sales price paid in kind, or the value or amount thereof, or the public tender offer proposed by Tecmed on the basis of such price, or its division into a cash component and a component in kind, nor denying that such payment in kind is all part of the price payable for assets relating to the Las Víboras landfill. The expert witness proposed by the Respondent does not state otherwise in his reports, when he says that "The urban waste landfill was an operation arising out of the payment in kind to be made by Tecmed for the acquisition of Cytrar".<sup>58</sup>

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<sup>54</sup> Document A33.

<sup>55</sup> Document A31

<sup>56</sup> Deed of purchase and sale of March 27, 1996, fourth clause (Document A25).

<sup>57</sup> Document A117.

<sup>58</sup> Report by Fausto García y Asociados, p. 26.

85. It is the view of the Arbitral Tribunal that the minutes of the board meeting of Promotora of March 15, 1996,<sup>59</sup> which reflect Promotora's decision to approve the offer made by Tecmed, clearly establish, in accordance with alternative 2 of the Tecmed acquisition offer,<sup>60</sup> that the contribution in kind, valued at \$ 24,155,185.00 (Mexican Pesos), which was to take place through the performance of different works and services relating to the municipal dump of Hermosillo for urban waste, was part of the price paid for the assets of the Las Víboras landfill, concerned with hazardous waste, as can be read on the second page of the minutes:

In item two, RODOLFO SALAZAR PLATT (an engineer) reads out the resolution adopted at the preceding meeting which reads (verbatim): After these reviews, the Board declares the following proposal to be unanimously approved: "Price offer for the acquisition of CYTRAR, alternative 2 (two), consisting of \$10,000,000.00 (TEN MILLION MEXICAN PESOS) and a non-monetary contribution to the Municipality of Hermosillo in the form of a construction project and provision of advice to the operation of the new landfill in accordance with the enclosed project, which comprises the general installations and the first phase of operation. It includes the closing of the current landfill, work valued at \$24,155,185.00 (Mexican Pesos) [...] Total value of offer is \$34,155,185.00 (Mexican Pesos) [...], the opinion of the full Board being that it is the most convenient offer from the economic and technical point of view and that it is beneficial for all the community of Hermosillo.

86. There is no doubt that payment of the sales price was to be made by the purchaser of the tendered assets,<sup>61</sup> regardless of the individual or corporation holding or being the beneficiary of the concession for the operation of the Hermosillo urban waste landfill, and that such obligation was vested in Cytrar.<sup>62</sup> The approval of the tender by Promotora's management board already contemplated the acquisition by Cytrar of the Las Víboras landfill assets awarded to Tecmed, and further that Cytrar should become "...a joint and several obligee with respect to the rights and obligations acquired by the successful awardee..."<sup>63</sup> without excluding from such obligations the ones relating to the furnishing of the consideration in kind, referred to above. The declaration of Mr. Javier Polanco Gómez Lavín—which has not been challenged or refuted in this regard by any other evidence produced in this arbitration— confirms the above.<sup>64</sup>

87. Having been concluded that the consideration in kind to be furnished by the purchaser of the assets relating to the hazardous waste landfill of Las Víboras in connection with the urban waste landfill of the Municipality of Hermosillo is part of the purchase price of such assets, it remains to be determined to what extent all or part of such consideration is allocable to the acquisition of the intangible assets referred to by the Claimant.

88. A rational and logical interpretation of the documentation presented by the Parties shows that what Promotora, on the one hand, and Tecmed and Cytrar, on the other, had in

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<sup>59</sup> Document A21.

<sup>60</sup> Document A17

<sup>61</sup> Page 5, notarial deed of conveyance, document A25.

<sup>62</sup> Second clause of the "promise-to-buy" contract (document A23); third clause of the Agreement (document A24).

<sup>63</sup> Document A21, p. 4

<sup>64</sup> Declaration of Javier Polanco Gómez Lavín, transcript of the Hearing for the Production of Evidence of May 20-24, 2002, section on May 20, 2002, pp. 31-33.

mind when entering into the agreement (from the standpoint of the latter, also when contemplating an investment in Mexico and in the Las Víboras landfill), was not simply the transfer of certain personal and real property but also to create the means for Cytrar to be able to operate the Las Víboras site as a hazardous waste landfill —i.e. to accomplish a public use purpose fully consistent with the activity that this landfill had been serving since its beginning in 1988— and to continue the same activity. Such were necessarily the legitimate expectations of Cytrar and of the Claimant, not only because the site and facilities being acquired as well as the commitments in terms of use and operation undertaken upon doing so, were to serve the normal purpose of operations of Tecmed and Cytrar, but also because the documentation of the tender whereby Tecmed was awarded the landfill assets, and the subsequent documentation signed with Promotora, highlighted that this was the only possible use for the assets being acquired, to such an extent that they would revert to Promotora if Cytrar failed to use them for the exclusive public use purpose for which such assets had been earmarked long before. This was, certainly, the expectation of Promotora and of the Municipality of Hermosillo, which controlled it, as they were both certainly interested in ensuring that the assets of the Las Víboras landfill continued being allocated to the hazardous waste landfill in view of their having been set aside for the protection of the environment and public health, as evidenced by the conditions of the tender of the assets of the landfill<sup>65</sup> and the terms and conditions of the documents whereby the sale was executed.<sup>66</sup> For example, paragraph eleven of the tender specifications required (and this requirement was fulfilled) that the notarial deed of conveyance include a clause whereby the purchaser agreed to include as an advisor, appointed by the Municipality of Hermosillo, with a voice but no vote, on an “indefinite and irrevocable” basis, in addition to ensuring that the landfill would be operated in accordance with the highest national and international standards. The Respondent points out<sup>67</sup> that this clause evidences

the interest and powers of the Municipality, as a government agency formed by representatives elected by the people, by and for the purpose of supervising the proper operation of the landfill in accordance with the highest applicable national and international standards.

The appointment of the advisor was thus directly linked to the Municipality’s interest in ensuring that the assets purchased should be treated as a unit for landfill of hazardous waste pursuant to the legal provisions, which was obviously not possible without the permits authorizing the operation.

89. Promotora could not, in good faith, impose such a drastic requirement or such a harsh sanction on Cytrar as the reversion to Promotora of the assets relating to the Las Víboras landfill if Cytrar was not authorized to use them in accordance with the agreed use, without assuming that access to the permits and licenses for the operation of the Las Víboras landfill in a manner consistent with their historical use was a fundamental part of the operation and of the expectations of Cytrar, Tecmed and, ultimately, the Claimant, and without assuming certain commitments to vest Cytrar with minimum rights that would prevent an outcome as adverse to such expectations and interests as the reversion of assets

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<sup>65</sup> Document A16, paragraph 6.

<sup>66</sup> Document A25, notarial deed of March 27, 1996, fifth clause.

<sup>67</sup> Counter-memorial, pp. 24-25, 95.

and at the same time the loss of amounts paid in cash or consideration furnished until then as payment of the price. Neither could INE ignore that the real property and tangible personal property relating to the Las Víboras landfill—and the investment relating to the Las Víboras landfill— would be devoid of economic value if Cytrar did not obtain the permits, licenses or authorizations required for operation. The note of the Municipality of Hermosillo addressed to INE on March 28, 1996,<sup>68</sup> whereby the Municipality “most respectfully” requests the Institute

to provide to TECMED Técnicas Medioambientales de México, S.A. de C.V., or to the company organized by it to operate the landfill, all necessary assistance to comply with the formalities for changing the name appearing in the operating license, which is currently Confinamiento Controlado Parque Industrial de Hermosillo<sup>69</sup>

not only confirms the above, but also evidences that no doubts were being cast as to the fact that the change of the license holder’s name was considered to be the lawful, normal and logical procedure in order to ensure that Cytrar could operate the Las Víboras site in accordance with the purpose mandated to it under the tender, sale and transfer documents.

90. However, Promotora did not guarantee to Cytrar or to Tecmed that Cytrar would obtain from INE the outcome certainly desired by Cytrar and apparently –at least at that time- by Promotora and by the Municipality of Hermosillo, i.e. that Cytrar would secure an authorization to operate a hazardous waste landfill at Las Víboras, or, if granted, that such authorization would conform to certain expected requirements such as its duration. Promotora did not guarantee to Cytrar either that the transfer to the latter’s name of the license given to Confinamiento Controlado Parque Industrial de Hermosillo O.P.D. would definitely take place. This does not, however, mean that Promotora was not willing to maintain the existing permits and licenses and their potential use by Cytrar in the event that that authorization or transfer did not materialize, as evidenced in clause 5 (a) of the contract of sale of March 27, 1996, between Promotora and Cytrar, mentioned above. Nor does it mean that Cytrar, through the transaction entered into with Promotora, only acquired real property and tangible personal property considered as such in isolation, i.e. unrelated to their historical and structural use and to the functional and economic dimension intimately associated to such use. As stated by Tecmed in its offer when it made it conditional to obtaining the authorizations for the use of such assets as a hazardous waste landfill,<sup>70</sup> neither Tecmed nor Cytrar would have acquired the assets without access to the authorizations and permits that would enable them to use them for a hazardous waste landfill. Accordingly, pursuant to clause five of the promise to sell contract signed with Tecmed on February 20, 1996, and clause 5 a) of the notarially recorded deed executed by Promotora, Tecmed and Cytrar on March 27, 1996 (transcribed above), Promotora consented to the potential use, in the case of the first document, by Tecmed, and in the second case, by Cytrar, of the existing licenses, authorizations or permits (mainly the authorization granted by INE on May 4, 1994, to Confinamiento Controlado Parque Industrial de Hermosillo O.P.D.) in the event of the failure of – as applicable – Cytrar or Tecmed to obtain the permits, licenses or authorizations required for the operation of the

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<sup>68</sup> Document A41.

<sup>69</sup> Emphasis in the original.

<sup>70</sup> Document A17.



landfill. Under clause 2 d) of the service contract of March 28, 1996, Promotora also undertook to keep current the existing licenses and authorizations, including the federal ones, for the operation of the Las Víboras landfill until Cytrar could do so on its own. These provisions show beyond any doubt that access by Cytrar to the licenses, authorizations or permits enabling it to operate the landfill was a central part of the tender and acquisition of assets relating to the Las Víboras landfill and of the expectations of Tecmed and Cytrar when the decision was made to invest in the landfill.

91. The documentation produced evidences that such licenses, authorizations and permits, and the right to use them for the operation of the Las Víboras landfill were vested in Promotora as a result of the winding-up of Confinamiento Controlado.<sup>71</sup> Accordingly, and also in view of the precedent of such landfill having already been operated by an entity other than that authorized,<sup>72</sup> it is also inferred that Promotora could allow the operation of the Las Víboras landfill by third parties under such authorizations, licenses or permits (to the extent such third parties adapted their operation to the framework allowed thereunder), as well as the transfer to third parties of the real property and tangible personal property of the Las Víboras landfill. This is a logical conclusion not only from a functional point of view, because the personal and real property of such landfill cannot be put to use for the benefit of the public or to the advantage of the community in accordance with or pursuant to the function on the basis and in furtherance of which they are technically structured and organized as an autonomous unit, without the required authorizations, licenses or permits, but also from an economic or business point of view, as the value of the real property and tangible personal property of the landfill—which, in practical terms, have been invalidated for any use other than the landfill of hazardous waste— depends on the existence or subsistence of such authorizations, licenses and permits. Consequently, from the perspective of Promotora, the price of those assets is, at the time of sale, enhanced by the possibility of use under such authorizations or permits. It should therefore be concluded that the consideration in kind valued at \$ 24,155,185.00 (Mexican Pesos) was paid as a lump sum in consideration of, on the one hand, Promotora’s undertakings relating to the maintenance of the licenses, permits and authorizations and of their being made available to Cytrar for the operation, as a hazardous waste landfill, of the Las Víboras site and other assets allocated to it in the event of Cytrar not obtaining new authorizations or licenses,<sup>73</sup> or the transfer to Cytrar of existing ones; and on the other hand, in recognition of the higher value of the real property and tangible personal property acquired in anticipation of the expectation to use them under such authorizations, permits and licenses and, consequently, as part of the purchase price of such personal and real property, as such value was not just

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<sup>71</sup> Administrative record of the winding-up of Confinamiento Controlado Parque Industrial de Hermosillo O.P.D. of August 31, 1995, Point IV, Annex No. 15 (Document A13); donation contract between the Government of the State of Sonora and Promotora, evidencing transfer to Promotora of the personal property listed in the record, which in Point IV, Annex 15, includes a list of permits for operation of the Las Víboras landfill, including the authorization granted by INE on May 4, 1994 (Document A14, introductory paragraphs III and IV; third clause).

<sup>72</sup> See paragraph 36 of this award.

<sup>73</sup> Regardless of the way in which this commitment on the part of Promotora should be complied with, even if compliance was as suggested by the Respondent: Cytrar being hired by Promotora –the latter, as holder of the authorizations, licenses and permits for the operation of the Las Víboras landfill- for Cytrar to operate it under them (“Admissions and Denials”, pleading filed by the Respondent, p. 25).

their inherent value but also the value resulting from the possibility of being functionally applied to the storage and management of hazardous waste within the framework of a legally authorized landfill operation. From this perspective, payment of a higher price is justified by the expectation of Tecmed and Cytrar —highlighted by the expert witness appointed by the Respondent— at the time of the tender and sale of the assets relating to the Las Víboras landfill and of their acquisition by such companies, to use it “with an “unlimited duration” license”.<sup>74</sup> It has also been established that the part in kind of the purchase price for the landfill was fully paid by its purchaser, Cytrar.

92. Upon replacement of the first official letter of INE dated September 24, 1996, by a subsequent new letter of the same date, but accompanied by an INE authorization, different not only in terms of its duration and in other respects, but which also revoked the existing authorization that had been issued to Confinamiento Controlado Parque Industrial de Hermosillo OPD under which the landfill had operated since May 4, 1994, an important change in the existing situation took place, because Promotora could no longer make such authorization available to Cytrar, nor would Cytrar probably be able to hold Promotora responsible because presumably, under both the “promise-to-buy” contract of February 20, 1996 and the notarial deed of March 27, 1996, Cytrar could only demand the performance of Promotora’s obligation to make the 1994 license available if Cytrar had failed to obtain a license “required for the lawful operation of the landfill”. Although of limited duration, the license of November 11, 1996, obtained by Cytrar from INE enabled the legal operation of the landfill and therefore did not give Cytrar rights against Promotora under the deed. In any event, this Arbitral Tribunal is not called to decide on these issues.

### **E. The Merits of the Dispute**

93. The Claimant alleges that the Respondent’s conduct violates the following provisions of the Agreement:

- 1) Article 2(1) on the promotion and admission of investments;
- 2) Article 3 on protection of investments;
- 3) Article 4(1) on fair and equitable treatment;
- 4) Article 4(2) on the most favorable treatment;
- 5) Article 4(5) on national treatment; and
- 6) Article 5 on nationalization and expropriation.

94. The Arbitral Tribunal deems it appropriate to consider and resolve upon the issues referred to above in the following order:

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<sup>74</sup> Report of Fausto García y Asociados, p. 48.

- 1) The obligation to refrain from expropriating or nationalizing in violation of the Agreement;
- 2) The obligation to assure fair and equitable treatment in accordance with international law; and
- 3) The obligation to grant full security and protection to investments under international law, and the other violations to the Agreement alleged by the Claimant.

#### I. Expropriation

95. The Claimant alleges that, when the INE did not renew the permit to operate the Las Viboras Landfill (the «Landfill») through its resolution dated November 25, 1998 (hereinafter the «Resolution»), it expropriated the Claimant's investment and that such expropriation has caused damage to the Claimant. The Claimant relates the expropriation—which according to the Claimant is the exclusive cause of the damage—to the prior actions of a number of organizations and entities at the federal, state and municipal levels, and also states that those actions are attributable to the Respondent and that they are adverse to the Claimant's rights under the Agreement and to the protection awarded to its investment thereunder. The Claimant further alleges that those actions objectively facilitated or prepared the subsequent expropriatory action carried out by INE.

96. The Claimant alleges that the Agreement protects foreign investors and their investments from direct and indirect expropriation; i.e. not only expropriation aimed at real or tangible personal property whereby the owner thereof is deprived of interests over such property, but also actions consisting of measures tantamount to an expropriation with respect to such property and also to intangible property. The Claimant states that, as the resolution deprived Cytrar of its rights to use and enjoy the real and personal property forming the Landfill in accordance with its sole intended purpose, the Resolution put an end to the operation of the Landfill as an on going business exclusively engaged in the landfill of hazardous waste, an activity that is only feasible under a permit, the renewal of which was denied. Therefore, Cytrar alleges that it was deprived of the benefits and economic use of its investment. The Claimant highlights that without such permit the personal and real property had no individual or aggregate market value and that the existence of the Landfill as an on going business, as well as its value as such, were completely destroyed due to such Resolution which, in addition, ordered the closing of the Landfill.<sup>75</sup>

97. The Respondent alleges that INE had the discretionary powers required to grant and deny permits, and that such issues, except in special cases, are exclusively governed by domestic and not international law. On the other hand, the Respondent states that there was no progressive taking of the rights related to the permit to operate the Las Viboras landfill by means of a legislative change that could have destroyed the *status quo*, and that the Resolution was neither arbitrary nor discriminatory. It also states that the Resolution was a regulatory measure issued in compliance with the State's police power within the highly regulated and extremely sensitive framework of environmental protection and public

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<sup>75</sup> Memorial, p. 53.

health. In those circumstances, the Respondent alleges that the Resolution is a legitimate action of the State that does not amount to an expropriation under international law.<sup>76</sup>

98. The Claimant affirms that the Resolution is arbitrary because the reasons invoked therein to deny the renewal of the permit that had been granted on November 19, 1997 (the «Permit»), under which the Claimant had operated the Landfill over the last year, are not proportional to the decision not to renew the Permit.

99. The Resolution<sup>77</sup> refuses renewal of the Permit on the following grounds: (i) the Landfill was only authorized to receive waste from agrochemicals or pesticides or containers and materials contaminated with such elements; (ii) PROFEPA's delegates in Sonora had informed, in the official communication dated November 11, 1998,<sup>78</sup> that the waste confined far exceeded the landfill limits established for one of the Landfill's active cells, cell No. 2; (iii) the Landfill temporarily stored hazardous waste destined for a place outside the Landfill, acting as a «transfer center», an activity for which the Landfill did not have the required authorization; Cytrar was requested on October 16, 1997 to file reports in connection with this activity, but to date the relevant authorization had not been issued; and (iv) liquid and biological-infectious waste was received at the Landfill, an activity that was prohibited and that amounted to a breach of the obligation to notify in advance any change or modification in the scope of the Permit, and to unauthorized storage at the Landfill of liquid and biological-infectious waste. The Resolution also textually provides as follows:

Furthermore, CYTRAR S.A. de C.V. agreed with the different levels of the Federal, State and Municipal Government and communicated to the public the relocation of the landfill.

100. The Claimant challenges those statements because, among other things, the excess of the authorized landfill levels of cell no. 2 was the subject matter of an investigation and an audit by PROFEPA, as a result of which a fine was imposed on Cytrar by means of an official communication dated December 16, 1999.<sup>79</sup> That fine was a minor penalty, substantially smaller than the maximum fine established by law. The Claimant also highlights that the official communication issued by PROFEPA to impose the fine stated that the infringement did not have a «significant effect on public health or generate an ecological imbalance».<sup>80</sup> The Claimant also stated that in another similar official communication issued by PROFEPA,<sup>81</sup> in which a fine was imposed on Cytrar for a number of infringements—including acting as a temporary storage of hazardous waste to be sent to other companies and operating as a transfer center, circumstances that were invoked by INE in the Resolution that denied the renewal of the Permit—<sup>82</sup>, PROFEPA expressly stated that

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<sup>76</sup> Counter-memorial, pp.160-162, 550 *et seq.* Respondent's closing statement, pp. 24-25, 56 *et seq.*

<sup>77</sup> Document A59.

<sup>78</sup> Document A62.

<sup>79</sup> Official communication No. PFPA-DS-UJ-2625/99 issued by Profepa, December 16, 1999; document A61.

<sup>80</sup> PROFEPA's official communication already cited, document A61, p. 16.

<sup>81</sup> Official communication No. PFPA-DS-UJ-1105/99 dated May 25, 1999. Document A63.

<sup>82</sup> PROFEPA's official communication already cited, page 55, paragraph (ah). Document A63.

... the infringements committed by the company involved are not sufficient to immediately cancel, suspend or revoke the permit for carrying out hazardous material and/or waste management activities, nor do they have an impact on public health or generate an ecological imbalance.<sup>83</sup>

101. The Claimant also states that, through the notes dated June 25<sup>84</sup> and July 15<sup>85</sup> 1998, Cytrar had already requested from INE the permit to expand cell No. 2 of the Landfill and build another cell. INE replied to this request on October 23, 1998,<sup>86</sup> stating, among other things, that the expansion request would be resolved together with the decision on renewal of the Permit. The Claimant claims that this decision adversely affected it because INE partly used the same reasons for which it already knew that the authorization to expand cell No. 2 would be denied (the same reasons used by PROFEPA to impose a fine on Cytrar by means of an official communication dated December 16, 1999, mentioned above), but deferred its decision to be able to use those reasons as the grounds for the Resolution under which INE refused to renew the Permit.<sup>87</sup>

102. The Claimant also states that in the letter dated September 5, 1996,<sup>88</sup> upon requesting «the change of name», Tecmed had reported to INE, among other things, that the processes carried out at the Landfill included the collection of waste in a specialized means of transportation, the preparation, packaging and labelling of waste for its subsequent transportation and the «temporary storage of waste (oil and solvents)» and that INE made no objection or reservation. Tecmed also reported that the operation of the transfer center and temporary storage of biological-infectious waste at the Landfill was not carried out by Cytrar, but by an affiliate, Técnicas Medioambientales Winco S.A. de CV,<sup>89</sup> which was authorized to engage in those activities at that site under a permit granted by INE for that purpose,<sup>90</sup> circumstances that could not be ignored by INE upon issuing the Resolution.

103. The Respondent highlights that Cytrar had not met the requirements to allow INE to evaluate an authorization to expand cell No. 2, since Cytrar had not submitted the related plans. The Respondent also states that as Cytrar had not submitted these plans and, regardless of such a breach, had commenced the cell's expansion activities, Cytrar had not complied with one of the Permit's conditions. The Respondent states that on October 23, 1998, INE requested additional information from Cytrar to decide on the expansion of cell No. 2 and on the construction of cell No. 3, and requested that Cytrar present the engineering project and the related drawings.<sup>91</sup> The Claimant complied with such requirement on November 4, 1998.<sup>92</sup>

104. The Respondent also refers to a number of circumstances related to the Landfill and its operation. The Claimant also refers to such circumstances, and substantial evidence has

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<sup>83</sup> PROFEPA's official communication already cited, paragraph A, page 50. Document A63.

<sup>84</sup> Document A49

<sup>85</sup> Document A50

<sup>86</sup> Official Communication No. D00.800/005262, document A51.

<sup>87</sup> Memorial, pp.58-59.

<sup>88</sup> Document A39.

<sup>89</sup> Claimant's closing statement, p. 65 *et seq.*

<sup>90</sup> Memorial, p. 62.

<sup>91</sup> Counter-memorial, p. 78, 282; document D142.

<sup>92</sup> Counter-memorial, p. 79, 287; document D146.

been produced in that regard. Such circumstances underlie the Resolution or had a significant effect thereon, although not all such circumstances have been mentioned in the text of the Resolution.

105. According to the Respondent, those circumstances are:<sup>93</sup>

1) the site of the Landfill did not comply with applicable Mexican regulations in terms of its location and characteristics;

2) in 1998, Cytrar had committed a number of irregularities while operating the Landfill, mainly related to the transportation of waste from Alco Pacífico, and such irregularities triggered strong community pressure against the Landfill;

3) Mexican authorities, mainly from the Municipality of Hermosillo, expressed their doubts as to the Landfill's operations;

4) there was the risk that community pressure might increase if operation of the Landfill continued; and

5) Since 1997 Cytrar had reportedly been aware that community pressure suggested that the operation of the Landfill was not feasible due to its location, and that is why it agreed to relocate it at its own cost.

106. The opposing community groups claimed that the Landfill was only 8 km from the urban center of Hermosillo, and that such proximity breached the regulations that required a distance of at least 25 km from any settlement of more than 10,000 residents. Legally, however, such circumstance could not be invoked against Cytrar because the Landfill had been located and authorized to operate at such site before the adoption of such regulations, which are not retroactive. Reportedly, in deciding to refuse to renew the Permit, INE took into account the fact that the location of the site did not comply with the regulations as well as the resulting community pressure.<sup>94</sup>

107. The Parties agree that community opposition to the Landfill was due not to the manner in which Cytrar operated it, but to the transportation to the Landfill of contaminated and abandoned soil from the Alco Pacífico plant located in the state of Baja California, Mexico. Owing to a series of events that are not relevant at this point, Cytrar was in charge of the collection, transportation and landfill of Alco Pacífico's hazardous waste and contaminated soil pursuant to an agreement dated November 19, 1996, executed between PROFEPA, Los Angeles County, USA, Fomento de Ingeniería S.A. de C.V. (Fomín) and Cytrar.<sup>95</sup> Fomín was entrusted with the supervision of the transportation and discharge services that Cytrar had to provide under such agreement, in compliance with the contract and the applicable legal provisions, and had to report its findings to PROFEPA. The shipments of toxic materials and soil destined for the Landfill began under an initial transport permit

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<sup>93</sup> Counter-memorial, pp. 88-89, 315.

<sup>94</sup> Memorial, pp. 72-74; Counter-memorial, p. 89, 315-316.

<sup>95</sup> Document D64

issued by INE<sup>96</sup> in early 1997.<sup>97</sup> In view of the claims of the community, PROFEPA conducted inspections of the trucks in October 1997, which essentially determined that there were open hazardous material packaging bags. PROFEPA therefore adopted urgent measures for Cytrar to rectify the situation, which were complied with by Cytrar. There were similar situations in November 1997, and, at the time, in addition to adopting urgent measures affecting Cytrar, PROFEPA applied a fine to Cytrar.<sup>98</sup> In April 1998, PROFEPA found some irregularities in the discharge of Alco Pacifico's waste and levied a fine on Cytrar, stating that «there are circumstances that pose or may pose a risk to the environment or to health». A similar situation was found in May 1998 in connection with the transportation and discharge of waste from the company Siderúrgica de California, which also gave rise to the issuance of urgent measures by PROFEPA, which were also complied with by Cytrar.<sup>99</sup>

108. The community's opposition to the Landfill, in its public manifestations, was widespread and aggressive, as evidenced by several events at different times. In November 1997, the association *Alianza Cívica de Hermosillo* (Hermosillo's Alliance for Civic Affairs) publicly denounced Cytrar's "actions and omissions" particularly in connection with waste transportation from Alco Pacifico, and requested that Cytrar's permit to operate the Landfill be cancelled and the extension thereof be denied.<sup>100</sup> Also in November<sup>101</sup> "...around 200 people organized a demonstration, marching to the landfill and closing it down symbolically... ", and then, a meeting was held with federal, state, and municipal public officials including the President of INE, the Deputy Director of the PROFEPA Environmental Audit Bureau, the Minister of SEMARNAP and representatives of the community organizations. In December 1997, the association *Academia Sonorense de Derechos Humanos* (Sonora Human Rights Academy) filed a criminal complaint against Cytrar for the commission of acts that could be defined as "environmental crimes".<sup>102</sup> In January 1998, the same association " ...filed a challenge... " against the Municipality of Hermosillo for the permit granted by that Municipality in 1994 to operate the Landfill.<sup>103</sup> In late January 1998 "...members of the community and of the different community organizations ...." organized a blockade of the Landfill which lasted until March 7, 1998, when the police intervened under orders of the Attorney's General Office. After the police intervention, the community organizations that questioned such measures organized a sit-in at Hermosillo's Town Hall<sup>104</sup> that lasted 192 days. By late March 1998, the same opposition groups issued a communication condemning the actions of the authorities that had put an end to the blockade of the Landfill.<sup>105</sup> In April 1998, a group of demonstrators attempted to block access to the Landfill but the police thwarted this action.<sup>106</sup> In

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<sup>96</sup> Official Communication D00-800/000269 dated January 23, 1997; document D65.

<sup>97</sup> Counter-memorial, pp. 43-44, 161 *et. seq.*; particularly 166.

<sup>98</sup> Counter-memorial, pp. 48-52, 180 *et. seq.*

<sup>99</sup> Counter-memorial, pp. 67-70, 240 *et. seq.*

<sup>100</sup> Counter-memorial, pp. 51-52, 191 *et. seq.*

<sup>101</sup> Article published in Hermosillo newspaper *El Imparcial* on November 23, 1997. Document D88.

<sup>102</sup> Counter-memorial, p. 55, 203

<sup>103</sup> Counter-memorial, p. 56, 207

<sup>104</sup> Counter-memorial, pp. 57-59, 210 *et. seq.*

<sup>105</sup> Counter-memorial, p. 63, 232

<sup>106</sup> Counter-memorial, p. 66, 237

September 1998, a certain *Asociación de Organismos No Gubernamentales en Lucha contra el CYTRAR* (Association of NGOs Against CYTRAR) filed a claim before the State Commission of Human Rights against the authorities of the State of Sonora and the Municipality of Hermosillo for having intervened to put an end to the 192-day sit-in organized at the Town Hall<sup>107</sup>. In October 1998, a “family demonstration for the defense of health and dignity” and against “the landfill and the authorities’ position in that regard” was organized and a public communication contrary to the Landfill was issued.<sup>108</sup> According to the news media, about 400 people participated in the demonstration.<sup>109</sup> In November 1998, community organizations submitted a petition to the local office of SEMARNAP so that expressions of such associations and individual citizens be considered upon evaluating the renewal of the Permit. During that period —as evidenced by the “Press Dossier (I)” included in the documents offered by the Claimant—<sup>110</sup> these developments were covered by the local press and Hermosillo’s radio and television.

109. The authorities of the Municipality of Hermosillo were the direct target of “community pressure”. The Municipality was one of INE’s interlocutors at the time of consideration of the Permit’s renewal. In view of the pressure that questioned the Municipality’s grant of the permit to use the land where the Landfill was operated, the Municipality rendered an opinion on March 31, 1998, which explained that at the time of granting such permit the current legal provisions were not applicable and that those provisions came into force subsequently, establishing a minimum distance between landfills and urban centers which the Landfill did not comply with. However, the Municipality expressed its agreement with the community about the need to relocate Cytrar’s hazardous waste landfill operation to a different site and its support to conduct an audit of operations to determine whether the Landfill’s operation entailed any risks. That same day, the Health Commission of the Municipality rendered an opinion confirming that, although Cytrar’s operation at the Las Víboras site met the legal requirements for functioning and there were no “legal, ethical or logical arguments” to seek the closing of the Landfill, all necessary efforts should be made to relocate Cytrar’s operations. After this, several other decisions to the same effect were issued by the Municipality, additionally highlighting that only the federal Mexican authorities were competent in “...events relating to toxic waste”.<sup>111</sup> INE also consulted with the Municipality on November 18, 1998 about Cytrar’s requests to, among other things, expand cell No. 2 and build another one. The Municipality did not agree to the construction of a third cell, but accepted expansion subject to:<sup>112</sup>

....a detailed and legal relocation commitment agreed upon between the three levels of Government and the company

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<sup>107</sup> Counter-memorial, pp. 74-75, 265 *et. seq.*

<sup>108</sup> Counter-memorial, p. 79, 285

<sup>109</sup> Article published in Hermosillo newspaper *El Imparcial* on October 26, 1998. Press dossier (I), annex A70.

<sup>110</sup> Under annex A70

<sup>111</sup> Counter-memorial, pp. 63-65, 233 *et. seq.*

<sup>112</sup> Counter-memorial, pp. 86-97, 311 *et. seq.*; note of the Mayor of the Municipality of Hermosillo to INE’s President dated November 18, 1998, document D157.



and provided that:

...a commission with representatives from each party be formed; and that, prior to that, an audit of operations be conducted and the final close down of the landfill be carried out; and that it would have to be made clear that that would be the last authorization for the current site.

The consultation with the Municipality and with the authorities of the State of Sonora and its results have been summarized as follows in the declaration of Dra. Cristina Cortinas de Nava,<sup>113</sup> who was at the time INE's General Director for Hazardous Materials, Waste and Activities and issued the Resolution, during the Hearing held from May 20 to May 24, 2002:

.... the gentleman is right to point out that I consulted with the municipal authority and with the state authority before making my decision about the company's application for an authorization to expand its capacity while relocation was pending[...]. Let me inform you that the reply that I obtained from the authorities was "let them fill in the cell, that's all right. But don't let them build anything else because we have waited too long for their relocation to allow them to have more space at the site they are at".

110. The relocation of Cytrar's operations as a response to community pressure was therefore also one of the factors taken into account by INE, and mentioned incidentally in the Resolution, upon deciding whether to renew the Permit. By late 1997, owing to the community pressure against the Landfill, Cytrar and the Municipality of Hermosillo started negotiations about the relocation, which, indeed, entailed the final close down of the hazardous waste landfill operation at the Las Viboras site, and that was undoubtedly the aim pursued by the community groups and the authorities of the Municipality. The relocation and the final close down of the Landfill, as it has been seen, were also the express claims of the Municipality of Hermosillo, apparently in response to the complaints about the Landfill and Cytrar's operation described above. The Claimant underscores that, as from the commencement of the negotiations, it did not object to the relocation but accepted it on the condition that a new site be identified before closing the operation at Las Viboras, and that the continuity of the operation at the new site and premises be guaranteed with the necessary permits.<sup>114</sup> On March 16, 1998, in a notice published by the local press, Cytrar ratified, among other things, its agreement to relocate its operation.<sup>115</sup> On July 3, 1998, at a meeting called by the Governor of the State of Sonora and attended by the Minister of SEMARNAP, Ms. Julia Carabias Lillo and the authorities of the Municipality of Hermosillo, Cytrar was informed of a joint declaration issued by the federal, state and municipal authorities stating that although the inspections conducted did not provide "...evidence of any risk to health and the ecosystems..." arising out of the Landfill, the relocation was necessary to "secure environmental safety in view of the rapid urban growth of Hermosillo, provide a response to the concerns that had been expressed and guarantee, in the long term, the environmental infrastructure to handle and dispose of industrial waste".<sup>116</sup>

The declaration also states that:

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<sup>113</sup> Hearing held from May 20 to May 24, 2002, transcript of the session of May 21, 2002, p. 82 overleaf.

<sup>114</sup> Memorial, pp. 77-78

<sup>115</sup> Counter-memorial, p. 61, 228; document D111

<sup>116</sup> Document A92; Memorial, pp. 78-79

...As a consequence, the present landfill operated by CYTRAR shall cease to operate as soon as the new premises are ready to start operations...

111. Later, IMADES (Sonora's Environmental and Sustainable Development Institute), a government entity, focused on the search for a new site in the State of Sonora on the basis of a broader and more ambitious landfill proposal as to the scope, activities and functions related to the landfill of hazardous waste, or CIMARI (integral center for the management of industrial waste).<sup>117</sup> By October 1998, IMADES had "... shortlisted three possible areas...". After visiting the sites, together with Cytrar, INE considered that, with the approval of Cytrar, "carrying out the applicable studies" in a site located in the Municipality of Benjamín Hill<sup>118</sup> would be feasible.

112. When INE considered the renewal of the Permit, the relocation had not taken place and, reportedly, the final relocation site had not been identified, i.e. a site which had tested positive to all feasibility studies for the purpose for which it would be used, and a site qualified to be authorized as hazardous waste landfill. On November 9, 1998, a few days before issuance of the Resolution, Cytrar sent a note to the Governor of the State of Sonora—following the procedure stated by INE through the official communication of October 23, 1998, sent by Dr. Cristina Cortinas Nava—<sup>119</sup> ratifying its relocation commitment, stating also that it would relocate to any site indicated to it. In this note Cytrar also expressed that it would assume all costs related to the acquisition of the land, constructions and transfer of the landfill's waste to the new site, all the above without resigning to its position that the Permit should remain in full force and effect until the relocation had effectively taken place.<sup>120</sup> Similar commitments were reaffirmed by Tecmed in the notes dated November 12, 1998, to Julia Carabias Lillo, head of SEMARNAP,<sup>121</sup> and November 17, 1998, to Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities.<sup>122</sup> This last note was also sent by Cytrar to Sonora's governor and to the mayor of the Municipality of Hermosillo by means of communications where Cytrar highlighted its relocation commitment included in point 7 of the original note.<sup>123</sup> After issuance of the Resolution that denied the renewal of the Permit, there were a number of discussions and actions, which involved Tecmed, intended to carry out the relocation. These discussions and actions extended to January 2000 but have currently ceased.<sup>124</sup>

113. The Agreement does not define the term "expropriation", nor does it establish the measures, actions or behaviors that would be equivalent to an expropriation or that would

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<sup>117</sup> Counter-memorial, p. 67, 239.

<sup>118</sup> Counter-memorial, p. 75, 270

<sup>119</sup> Document A51. This official communication makes reference to the relocation agreement and makes a proposal to Cytrar so that it "...contact the authorities of the State and Municipal Government to define the steps to be followed as to the landfill relocation."

<sup>120</sup> Document A89. Counter-memorial, pp. 84-85, 303 *et seq.* Memorial, pp. 80-81.

<sup>121</sup> Document A 90.

<sup>122</sup> Document A55.

<sup>123</sup> Document A 54.

<sup>124</sup> Counter-memorial, p. 96, 337.

have similar characteristics. Although formally an expropriation means a forcible taking by the Government of tangible or intangible property owned by private persons by means of administrative or legislative action to that effect, the term also covers a number of situations defined as *de facto* expropriation, where such actions or laws transfer assets to third parties different from the expropriating State or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government.<sup>125</sup>

114. Generally, it is understood that the term “...equivalent to expropriation...” or “tantamount to expropriation” included in the Agreement and in other international treaties related to the protection of foreign investors refers to the so-called “indirect expropriation” or “creeping expropriation”, as well as to the above-mentioned *de facto* expropriation.<sup>126</sup> Although these forms of expropriation do not have a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect. This type of expropriation does not necessarily take place gradually or stealthily — the term “creeping” refers only to a type of indirect expropriation—and may be carried out through a single action, through a series of actions in a short period of time or through simultaneous actions. Therefore, a difference should be made between creeping expropriation and *de facto* expropriation,<sup>127</sup> although they are usually included within the broader concept of “indirect expropriation” and although both expropriation methods may take place by means of a broad number of actions that have to be examined on a case-by-case basis to conclude if one of such expropriation methods has taken place.<sup>128</sup>

115. To establish whether the Resolution is a measure equivalent to an expropriation under the terms of section 5(1) of the Agreement, it must be first determined if the Claimant, due to the Resolution, was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto —such as the income or benefits related to the Landfill or to its exploitation— had ceased to exist. In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss.<sup>129</sup> This determination is important because it is one of the main elements to distinguish, from the point of view of an international tribunal, between a regulatory measure, which is an ordinary expression of the exercise of the state’s police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives

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<sup>125</sup> Award dated August 30, 2000, in ICSID case No. ARB(AF)/97/1 *Metalclad v. United Mexican States*, 16 Mealey’s International Arbitration Report (2000), pp. A-1 *et seq.*; p. A-13 (p. 33 of the award, 103): «Thus, expropriation [...] includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor 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. »

<sup>126</sup> G. Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 269 *Recueil des cours*, Académie de droit international de La Haye, 255, 385-386 (1997).

<sup>127</sup> *Ibid.* p. 383.

<sup>128</sup> R. Dolzer & M. Stevens, *Bilateral Investment Treaties*, pp. 99-100 (1995).

<sup>129</sup> Partial award in the case *Pope Talbot Inc v. Government of Canada*, 102-104, pp. 36-38, [www.naftalaw.org](http://www.naftalaw.org); and II Restatement of the Law (Third) Restatement of the Foreign Relations Law of the United States, § 712, pp. 200-201; notes 6-7, pp. 211-212 (1987).

those assets and rights of any real substance. Upon determining the degree to which the investor is deprived of its goods or rights, whether such deprivation should be compensated and whether it amounts or not to a *de facto* expropriation is also determined. Thus, the effects of the actions or behavior under analysis are not irrelevant to determine whether the action or behavior is an expropriation. Section 5(1) of the Agreement confirms the above, as it covers expropriations, nationalizations or

...any other measure with similar characteristics or *effects*...<sup>130</sup>

The following has been stated in that respect:

In determining whether a taking constitutes an «indirect expropriation», it is particularly important to examine the effect that such taking may have had on the investor's rights. Where the effect is similar to what might have occurred under an outright expropriation, the investor could in all likelihood be covered under most BIT provisions.<sup>131</sup>

116. In addition to the provisions of the Agreement, the Arbitral Tribunal has to resolve any dispute submitted to it by applying international law provisions (Title VI.1 of the Appendix to the Agreement), for which purpose the Arbitral Tribunal understands that disputes are to be resolved by resorting to the sources described in Article 38 of the Statute of the International Court of Justice<sup>132</sup> considered, also in the case of customary international law, not as frozen in time, but in their evolution.<sup>133</sup> Therefore, it is understood that the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that "...any form of exploitation thereof..." has disappeared; i.e. the economic value of the use, enjoyment or disposition of the assets or rights affected by the administrative action or decision have been neutralized or destroyed.<sup>134</sup> Under international law, the owner is also deprived of property where the use or enjoyment of benefits related thereto is exacted or interfered with to a similar extent, even where legal ownership over the assets in question is not affected, and so long as the deprivation is not temporary. The government's intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects.<sup>135</sup> To determine whether such an expropriation has taken place, the Arbitral Tribunal should not

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<sup>130</sup> Emphasis added by the Arbitral Tribunal.

<sup>131</sup> R. Dolzer & M. Stevens, *Bilateral Investment Treaties*, p. 100 (1995).

<sup>132</sup> I. Brownlie, *Principles of International Law* (5<sup>th</sup> Edition, 1998) p.3: «These provisions [...] represent the previous practice of arbitral tribunals, and Article 38 is generally regarded as a complete statement of the sources of international law ».

<sup>133</sup> *Mondev International Ltd v. United States of America* award, October 11, 2002, ICSID case No. ARB(AF)/99/2, p. 40, 116

<sup>134</sup> European Court of Human Rights, *In the case of Matos e Silva, Lda., and Others v. Portugal*, judgment of September 16, 1996, 85, p. 18, <http://hudoc.echr.coe.int>

<sup>135</sup> See Iran-USA Claims Tribunal, *Tippetts, Abbet, McCarthy, Stratton v. TAMS/Affa Consulting Engineers of Iran et al.*, decision of June 29, 1984; 6 Iran-United States Rep., p. 219 *et seq.*; p. 225 (1984-II); of the same Tribunal, *Phelps Dodge Corp. et al. v. Iran*, 10 Iran-U.S.Cl. Trib. Rep. p. 121 *et seq.*; esp. 22, p.130 (1986-I).

.... restrict itself to evaluating whether a formal dispossession or expropriation took place, but should look beyond mere appearances and establish the real situation behind the situation that was denounced.<sup>136</sup>

117. The Resolution meets the characteristics mentioned above: undoubtedly it has provided for the non-renewal of the Permit and the closing of the Landfill permanently and irrevocably, not only due to the imperative, affirmative and irrevocable terms under which the INE's decision included in the Resolution is formulated, which constitutes an action — and not a mere omission— attributable to the Respondent, with negative effects on the Claimant's investment and its rights to obtain the benefits arising therefrom, but also because after the non-renewal of the Permit, the Mexican regulations issued by INE become fully applicable. Such regulations prevent the use of the site where the Landfill is located to confine hazardous waste due to the proximity to the urban center of Hermosillo. Since it has been proved in this case that one of the essential causes for which the renewal of the Permit was denied was its proximity and the community pressure related thereto, there is no doubt that in the future the Landfill may not be used for the activity for which it has been used in the past and that Cytrar's economic and commercial operations in the Landfill after such denial have been fully and irrevocably destroyed, just as the benefits and profits expected or projected by the Claimant as a result of the operation of the Landfill. Moreover, the Landfill could not be used for a different purpose since hazardous waste has accumulated and been confined there for ten years. Undoubtedly, this reason would rule out any possible sale of the premises in the real estate market. Finally, the destruction of the economic value of the site should be assessed from the investor's point of view at the time it made such an investment. In consideration of the activities carried out, of its corporate purpose and of the terms and conditions under which assets related to the Landfill were acquired from Promotora, the Claimant, through Tecmed and Cytrar, invested in such assets only to engage in hazardous waste landfill activities and to profit from such activities. When the Resolution put an end to such operations and activities at the Las Viboras site, the economic or commercial value directly or indirectly associated with those operations and activities and with the assets earmarked for such operations and activities was irremediably destroyed. The above conclusions are not jeopardized by the fact that the Resolution has not prevented Cytrar from continuing operating the Landfill until completion of the authorized installed capacity existing as of the Resolution's date. Such limited, temporary and partial continuation of operation of the Landfill does not modify the definitive and detrimental effects of the Resolution with respect to the long-term investment made in the Landfill. As far as the effects of such Resolution are concerned, the decision can be treated as an expropriation under Article 5(1) of the Agreement.

118. However, the Arbitral Tribunal deems it appropriate to examine, in light of Article 5(1) of the Agreement, whether the Resolution, due to its characteristics and considering not only its effects, is an expropriatory decision.

119. The principle that the State's exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable. Another undisputed issue is that within the framework or from the viewpoint of the

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<sup>136</sup> Interamerican Court of Human Rights, *Ivcher Bronstein Case (Baruch Ivcher Bronstein vs. Peru)*, judgment of February 6, 2001, 124, p. 56; [www.corteidh.or.cr](http://www.corteidh.or.cr).

domestic laws of the State, it is only in accordance with domestic laws and before the courts of the State that the determination of whether the exercise of such power is legitimate may take place. And such determination includes that of the limits which, if infringed, would give rise to the obligation to compensate an owner for the violation of its property rights.

120. However, the perspective of this Arbitral Tribunal is different. Its function is to examine whether the Resolution violates the Agreement in light of its provisions and of international law. The Arbitral Tribunal will not review the grounds or motives of the Resolution in order to determine whether it could be or was legally issued. However, it must consider such matters to determine if the Agreement was violated. That the actions of the Respondent are legitimate or lawful or in compliance with the law from the standpoint of the Respondent's domestic laws does not mean that they conform to the Agreement or to international law.<sup>137</sup>

An Act of State must be characterized as internationally wrongful if it constitutes a breach of an international obligation, even if the act does not contravene the State's internal law – even if under that law, the State was actually bound to act that way.<sup>138</sup>

121. After reading Article 5(1) of the Agreement and interpreting its terms according to the ordinary meaning to be given to them (Article 31(1) of the Vienna Convention), we find no principle stating that regulatory administrative actions are *per se* excluded from the scope of the Agreement, even if they are beneficial to society as a whole —such as environmental protection—, particularly if the negative economic impact of such actions on the financial position of the investor is sufficient to neutralize in full the value, or economic or commercial use of its investment without receiving any compensation whatsoever. It has been stated that:

Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.<sup>139</sup>

122. After establishing that regulatory actions and measures will not be initially excluded from the definition of expropriatory acts, in addition to the negative financial impact of such actions or measures, the Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.<sup>140</sup> Although the analysis starts at the due deference owing to

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<sup>137</sup> International Court of Justice, *Elettronica Sicula s.p.a. (ELSI) (United States v. Italy)* case, judgment dated July 20, 1989, ICJ Reports, 1989, 73. ICSID Case No. ARB(AF)/99/1, *Marvin Feldman v. Mexico*, award of December 16, 2002, p.26, 78, [www.naftalaw.org](http://www.naftalaw.org).

<sup>138</sup> J. Crawford, *The International Law Commission's Articles on State Responsibility*, p. 84 (Cambridge University Press, 2002).

<sup>139</sup> Award: *Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica*, ICSID case No. ARB/96/1, 15 ICSID Review-Foreign Investment Law Journal, 72, p.192 (2000).

<sup>140</sup> European Court of Human Rights, *In the case of Matos e Silva, Lda., and Others v. Portugal*, judgment of September 16, 1996, 92, p. 19, <http://hudoc.echr.coe.int>.

the State when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values, such situation does not prevent the Arbitral Tribunal, without thereby questioning such due deference, from examining the actions of the State in light of Article 5(1) of the Agreement to determine whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation. There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.<sup>141</sup> To value such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the state and whether such deprivation was compensated or not.<sup>142</sup> On the basis of a number of legal and practical factors, it should be also considered that the foreign investor has a reduced or nil participation in the taking of the decisions that affect it, partly because the investors are not entitled to exercise political rights reserved to the nationals of the State, such as voting for the authorities that will issue the decisions that affect such investors.

The European Court of Human Rights has defined such circumstances as follows:

Not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim « in the public interest », but there must also be a reasonable relationship of proportionality between the means employed and the aim sought to be realised...[...]. The requisite balance will not be found if the person concerned has had to bear “an individual and excessive burden” [...] The Court considers that a measure must be both appropriate for achieving its aim and not disproportionate thereto.<sup>143</sup>

...non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption. Secondly, although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals.<sup>144</sup>

The Arbitral Tribunal understands that such statements of the Strasburg Court apply to the actions of the State in its capacity as administrator, not only to its capacity as law-making body.

123. During its operation of the Landfill, Cytrar breached a number of the conditions under which the Permit was issued, which have been referred to above. Such breaches were verified by PROFEPA. In the opinion of the Arbitral Tribunal, these are the breaches to the Permit that triggered the issuance of the Resolution, since those are the breaches on which the Resolution is based and to which it refers. This is the conclusion to be reached under

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<sup>141</sup> European Court of Human Rights, *In the case of Mellacher and Others v. Austria*, judgment of December 19, 1989, 48, p.24; In the case of *Pressos Compañía Naviera and Others v. Belgium*, judgment of November 20, 1995, 38, p. 19, <http://hudoc.echr.coe.int>

<sup>142</sup> It has been stated that: “...on the whole [...] notwithstanding compliance with the public interest requirement, the failure to pay fair compensation would render the deprivation of property inconsistent with the condition of proportionality”, Y. Dinstein, *Deprivation of Property of Foreigners under International Law*, 2 Liber Amicorum Judge Shigeru Oda, p. 849 *et seq.*; esp. p. 868 (2002).

<sup>143</sup> European Court of Human Rights, *In the case of James and Others*, judgment of February 21, 1986, 50, pp.19-20, <http://hudoc.echr.coe.int>

<sup>144</sup> *ibid.*, 63, pp. 24.

Mexican law, according to which administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies.<sup>145</sup> The Resolution has not referred to the events related to the transportation and discharge of the hazardous waste of Alco Pacífico, as they took place under the terms of the permits and authorizations granted by the Mexican authorities, including INE, other than the Permit, and the violations committed by Cytrar in the performance of such activities have not been proved or penalized as infringements to the Permit. Therefore, without prejudice to the possibility of taking into account later on the effects of such events on the political and social considerations taken into account by INE upon issuing the Resolution—such considerations are generally referred to in the Resolution and in INE’s correspondence addressed to Cytrar immediately before such Resolution—the Arbitral Tribunal considers that such infringements, that did not trigger the revocation or termination of the permits under which such transportation and discharge took place and that are not defined in the Permit’s conditions, are not determinants of the Resolution. On the other hand, PROFEPA and SEMARNAP also stated that the violations in the transportation and discharge of the hazardous waste of Alco Pacífico should not be taken into account to determine if the Landfill’s permit should be revoked upon answering a claim to that effect filed by a social group adverse to the Landfill.<sup>146</sup>

124. This Arbitral Tribunal considers that the violations to the Permit mentioned in the Resolution, to the extent they have been verified by PROFEPA or INE under the applicable Mexican law, are issues that the Tribunal does not need to review. However, the Arbitral Tribunal points out that such Resolution does not suggest that the violations compromise public health, impair ecological balance or protection of the environment, or that they may be the reason for a genuine social crisis. Additionally, when PROFEPA verified the existence of such violations in 1999, it applied the pertinent sanctions in the proportion it deemed appropriate to the importance of the violation. The sanction applied was in the form of a fine imposed after evaluating whether a greater or more serious sanction would have been applicable, such as the revocation of the Permit, and underscoring the fact that such violations did not compromise the condition of the environment, the ecological balance or the health of the population. With that, PROFEPA confirmed its statements in the note dated February 11, 1998, sent to Cytrar.<sup>147</sup>

The inspections conducted by this Office to the landfill referred to several times, have not shown [sic in the Spanish original] any indication that risks for the population’s health or the environment might exist.

On various occasions, the Municipality of Hermosillo<sup>148</sup> and the Minister of SEMARNAP, Ms. Julia Carabías Lillo,<sup>149</sup> have insisted that Cytrar’s Landfill operation complies with the

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<sup>145</sup> Declaration of expert witness Alfonso Camacho Gómez, Hearing held from May 20 to May 24, 2002, transcript of May 22, 2002, pp. 36-36 overleaf.

<sup>146</sup> Note signed by PROFEPA and SEMARNAP of December 18, 1997, 44, p. 21; document D93.

<sup>147</sup> Document D101, p. 2.

<sup>148</sup> Communication issued by the Municipality of Hermosillo dated March 26, 1998, document D114; Declaration 300398 issued by the Commission of Public Health of the Municipality of Hermosillo dated April 1998, document D116, Communication Forms of the Municipality of Hermosillo, document D117.

<sup>149</sup> Stenographic transcript of the declaration given by Julia Carabías Lillo in her appearance before the House of Representatives of the Federal Congress on September 10, 1999; pp. 10-11; document A69.



Mexican legal provisions on environmental protection and public health preservation or meets the requirements necessary not to impair the environment or public health. More specifically, in a document dated September 3, 1998,<sup>150</sup> SEMARNAP—which comprises both INE and PROFEPA as autonomous divisions—, on the basis of the statements made by PROFEPA, stated as follows:

...CYTRAR's handles hazardous waste in strict compliance with the law, that the last stage of the landfill has the maximum safety conditions required, which provide the necessary grounds to authorize the relevant operations.

125. In addition to the reference made to the infractions to conditions for the Permit and a brief statement about Cytrar's commitment to relocate, the Resolution does not specify any reasons of public interest, public use or public emergency that may justify it. According to the Respondent's allegations, such reasons would basically be the following:

1. The protection of the environment and public health, and
2. The need to provide a response to the community pressure resulting from the location of the Landfill and Cytrar's violations during the operation, which some groups interpreted as harmful to the environment or the public health and the social unease in Hermosillo originated in these circumstances.

126. One of the factors that undoubtedly underlies such reasons is the location of the Landfill with respect to Hermosillo's urban center. As the Respondent's counsel stated in its oral allegation:

I have stated several times and insisted that the problem was not a problem with a company or with an investor, but with a specific site.<sup>151</sup>

Such declaration does not differ from the statements made by Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities in this regard:

I insist once again that, for us, the position was: let's come to a close with this site; it is the reason for the conflict. People keep coming to the place to see how it's being operated; they won't even let it operate with all that community pressure. Let's start from scratch in some other place, in the right manner and with all the mechanisms that we think might ensure that this operation could be acceptable for society.<sup>152</sup>

127. Actually, according to the evidence submitted in this arbitration proceeding, it is irrefutable that there were factors other than compliance or non-compliance by Cytrar with the Permit's conditions or the Mexican environmental protection laws and that such factors had a decisive effect in the decision to deny the Permit's renewal. These factors included

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<sup>150</sup> Document A92.

<sup>151</sup> Oral allegation by the Respondent's counsel. Hearing held from May 20 to May 24, 2002. Transcript of the session of May 24, 2002, p. 37 overleaf.

<sup>152</sup> Hearing held from May 20 to May 24, 2002. Transcript of the session of May 21, 2002, p. 78.

“political circumstances”. As stated by Dr. Cristina Cortinas Nava in the official communication sent to Cytrar on October 23, 1998,<sup>153</sup>

It is publicly known that your company has assumed a relocation commitment as to the landfill you operate and that, as you have stated in point seven of the brief dated July, 15, 1998, there are political issues that have to be taken into account to render a resolution as to the renewal of the operation permit and an increase in the landfill capacity. Therefore, we suggest that you contact the authorities of the State and of the Municipality to define the steps to be followed to relocate the landfill.

In its note dated July 15, 1998, addressed to INE, Cytrar requests that INE issue its decision on Cytrar’s application for an increase in the landfill capacity according to the alternatives that Cytrar had presented to INE while

....the actions to be taken are defined on the basis of the political events affecting Cytrar (relocation)...<sup>154</sup>

128. Therefore the Arbitral Tribunal has to evaluate, pursuant to Article 5(1) of the Agreement and from the perspective of international law, the extent to which such political circumstances —that in the opinion of the Arbitral Tribunal, on the basis of the evidence submitted, do not seem to go beyond the circumstances arising from community pressure— are the basis of the Resolution, in order to assess whether the Resolution is proportional to such circumstances and to other circumstances, and to the neutralization of the economic and commercial value of the Claimant’s investment caused by the Resolution.

129. These socio-political circumstances are the reason why INE has considered the renewal of the Permit as an “exceptional case”. As a consequence, INE, instead of deciding by itself —as it was empowered by law— as to the Permit’s renewal on the basis of considerations exclusively related to INE’s specific function linked to the protection of the environment, ecological balance and public health, it consulted with the mayor of the Municipality of Hermosillo and the Governor of the State of Sonora as to Cytrar’s requests related to the expansion of cell N° 2 and the construction of cell N° 3 in the Landfill.<sup>155</sup> The only conclusion possible is that such consultation or inquiries were driven by INE’s socio-political concerns, since it is not in dispute that INE and PROFEPA were the only entities legally authorized and technically competent to have a role in issues in which public health and the protection of the environment in connection with the Landfill were involved. None of the parties to which INE makes the inquiry expresses concerns as to the danger that the Landfill may pose to public health, ecological balance or the environment. To the contrary, their concerns are to ensure the relocation of the Landfill to a different site far away from Hermosillo, the immediate closing of the Landfill and, after depleting its authorized and installed capacity, the prohibition to grant new permits to confine hazardous waste at the Las Víboras site;<sup>156</sup> i.e. to put an end to the political problems —defined as “community

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<sup>153</sup> Document A51.

<sup>154</sup> Document A50.

<sup>155</sup> Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 70 overleaf /71.

<sup>156</sup> Note of November 18, 1998, of the Mayor of the Municipality of Hermosillo to INE’s President, document D157.

pressure”— caused by the Landfill to the federal, state and municipal authorities, by permanently closing the Landfill.

130. The INE’s General Director of Hazardous Materials, Waste and Activities, Dr. Cristina Cortinas Nava, sustains the political or social factor “...was one of the factors involved but not the main factor...”,<sup>157</sup> and to the question of whether the influence on the Resolution of the unauthorized expansion of cell no. 2 was “strong, small, insignificant, decisive”, the answer was “I would say it was important”.<sup>158</sup> However, in fact, the absence of any statement in the Resolution and in the opinions rendered by the municipal and state officers consulted by INE prior to issuing the Resolution about these or the other infringements committed by Cytrar and mentioned in the Resolution being infringements seriously or imminently affecting public health, ecological balance or the environment, together with the confirmation by PROFEPA that such infringements did not pose such dangers, reveal that the Resolution was mainly driven by socio-political factors. Even the significance awarded by INE to the technical infringements committed during the operation of the Landfill, on which the Resolution is based, and therefore the relative relevance awarded by INE to such factors upon issuing the Resolution, were actually strongly influenced by the community pressure and the political consequences faced by INE since municipal and state authorities and opposing community associations interpreted the expansion of the Landfill and any other action intended to expand the Landfill capacity as a signal that such facility would not be relocated and that the Las Víboras site, close to Hermosillo’s urban center, would continue to be a hazardous waste landfill site in violation of existing rules and regulations.<sup>159</sup> Indeed, Dr. Cristina Cortinas Nava considered that continuation by Cytrar of the expansion of cell no. 2 did not create current or future hazards for the protection of the environment or public health; she considered that such expansion increased INE’s difficulties to manage community pressure and the related political consequences adverse to the Landfill:

..... as I had issued no written resolution authorizing the expansion of the cell, the fact that [Cytrar] commenced to expand the cell was a concern to me and I took it as evidence that the company was doing things before obtaining the permit it had applied for [...] I took that into account as one of the elements, but I insist: the circumstance that the company had not helped me create trust among local authorities as it expanded the cells without any authorization, whether issued by me or local authorities, was included among such elements...<sup>160</sup>

131. This item has been confirmed by the importance attributed to the relocation of Cytrar’s operations to a site different from the Landfill. Such importance was actually motivated by the community’s opposition to the Landfill’s existing site and was not related to the fact that Cytrar’s operations in the site or the site’s appropriateness<sup>161</sup> or the way in which the Landfill was operated—as the municipal and state authorities and PROFEPA themselves

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<sup>157</sup> Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 71, overleaf.

<sup>158</sup> *Ibid.*, p. 80.

<sup>159</sup> *Ibid.*, p.82 overleaf.

<sup>160</sup> *Ibid.*, p.82 overleaf.

<sup>161</sup> *Ibid.*, p.90 overleaf. “Because our interest was to recover the infrastructure that had already been created, and, as I have always held and still believe today, those premises were necessary for this State, they were located at the right site and, with an environmentally safe handling of hazardous waste; it was a good option”.

admitted— entailed a risk for the environment or for the public health. The Landfill's still unresolved relocation, which, according to Dr. Cristina Cortinas Nava, was one of the motivations for the Resolution in that denying the renewal of the Permit —thus preventing Cytrar from operating the Landfill— was a strategy to put pressure on Cytrar to relocate, was then one of the factors that were closely related to the social and political tense circumstances surrounding the Landfill and its operation. INE thought it would placate such tensions by denying the renewal of the Permit instead of keeping the preservation of public health, ecological balance or the environment in mind.<sup>162</sup>

132. To sum up, the reasons that prevailed in INE's decision to deny the renewal of the Permit were reasons related to the social or political circumstances and the pressure exerted on municipal and state authorities and even on INE itself created by such circumstances. It will be necessary, then, for the purpose of establishing whether the Respondent breached Article 5(1) of the Agreement, to evaluate such reasons as a whole to determine whether the Resolution is proportional to the deprivation of rights sustained by Cytrar and with the negative economic impact on the Claimant arising from such deprivation.

133. There is no doubt as to the existence of community or political pressure —as both Parties have acknowledged and as made public by the local mass media and shown by the evidence submitted in these arbitral proceedings— against the Landfill. However, a substantial portion of the community opposition is based on objective situations that are beyond Cytrar or Tecmed's control or even beyond the Claimant's control. On the other hand, the Arbitral Tribunal should consider whether community pressure and its consequences, which presumably gave rise to the government action qualified as expropriatory by the Claimant, were so great as to lead to a serious emergency situation, social crisis or public unrest, in addition to the economic impact of such a government action, which in this case deprived the foreign investor of its investment with no compensation whatsoever. These factors must be weighed when trying to assess the proportionality of the action adopted with respect to the purpose pursued by such measure.

134. As highlighted before, the events related to the transportation and discharge of hazardous waste from Alco Pacífico belong to an operation safeguarded by legal instruments, licenses and permits that are different from the ones governing the Landfill. Therefore, any infringement or sanction imposed in connection with operations covered by such instruments, licenses and permits may not be regarded as infringements committed or sanctions imposed under the Permit or the legal provisions applicable to the activities specifically contemplated by such Permit. For that very same reason, any violation to such transport operation could not be part of the Resolution's grounds as the Resolution is based exclusively on violations to the legal provisions applicable to the activities covered by the Permit. However —as both Parties have admitted— the negative attitude that some social groups had with respect to the Landfill was taken as a result of the events related to the waste transportation from Alco Pacífico. Consequently, upon an overall examination of the impact of socio-political factors on the Resolution, such adverse attitude should be considered together with the real weight it had.

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<sup>162</sup> Hearing held from May 20 to May 24, 2002. Declaration of Dr. Cristina Cortinas Nava, transcript of the session of May 21, 2002, pp. 72 overleaf-73, 75 oveleaf-76.

135. Actually, the negative reactions to the transportation of waste from Alco Pacífico to Hermosillo became apparent even before PROFEPA verified that Cytrar had committed certain violations when carrying out this operation. In the Respondent's words:

The landfill of Alco Pacífico's waste in Sonora generated reactions almost immediately. On January 14, 1997, a local newspaper published an article stating that Cytrar would confine imported hazardous waste that had been abandoned in Alco Pacífico's premises [...]. On March 7, 1997, another article was published about the landfill of Alco Pacífico's hazardous waste in Sonora. On March 9, 1997, Manuel Llano Ortega, an engineer and a resident of Hermosillo, requested that the State Governor provide a response to the community's concerns about the landfill of Alco Pacífico's waste [...]. On May 2, 1997, Sonora's Human Rights Academy filed a complaint against SEMARNAP, PROFEPA, the State Legislature and the State Governor. It held that the authorities had violated the State's sovereignty by authorizing the deposit of toxic waste from Baja California without the relevant permit by the competent local authorities. On May 15, 1997, the same association filed a complaint before the National Commission of Human Rights.<sup>163</sup>

136. Thus, community opposition to Cytrar's activities of transportation and discharge of Alco Pacífico's waste must be analyzed in light of the initial opposition shown by some citizens or associations to the decision of PROFEPA—which hired the transportation to Hermosillo of such waste with Cytrar—and INE—which granted the relevant permits for Cytrar to undertake such transportation activities—<sup>164</sup> as to whether such waste could be confined in Hermosillo. Undoubtedly, the Mexican authorities opted to choose or accept Hermosillo, Sonora, as the appropriate site for the landfill of Alco Pacífico's waste and they were responsible for that decision. The criticism by groups from Sonora on Cytrar's management of Alco Pacífico's waste transportation cannot be separated from such groups' repudiation of the authorities' decision to transport the waste from Alco Pacífico to Hermosillo, Sonora, to have it confined there, and at the same time such criticism was the evident expression of such repudiation. And it is not possible to state that it was Cytrar's management of such transportation activities, and not the previous decision of the authorities to have Alco Pacífico's waste confined in Hermosillo, the determinant of community opposition.

137. The truth is that PROFEPA did not choose the early termination of the agreement entered into with Cytrar because of community opposition; and under no circumstance did INE cancel or otherwise remove Cytrar's permit for the transportation or discharge of Alco Pacífico's waste. The infringements or irregularities found by PROFEPA in connection with these operations triggered the imposition of fines on Cytrar or brought about orders to amend its manner of operation, but apparently they did not originate any recommendation or action by PROFEPA for the cancellation of the permit or the termination of the agreement under which Cytrar operated. Neither Cytrar's shortcomings as to Alco Pacífico's waste transportation nor the community opposition that such transportation brought about seem to have originated emergency situations, genuine social crisis or public unrest or urgency, which, due to their severity, could have led the competent authorities to terminate the contractual relationship governing the transport operation or to revoke or

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<sup>163</sup> Counter-memorial, pp. 44-45; 164 *et. seq.*

<sup>164</sup> INE's permit of January 23, 1997 for the transportation and discharge of waste from Alco Pacífico. Clause 11 (p. 3), (document D65) of this permit also allowed for the termination of the permit in the event of justified complaints or risk to the environment or to human life.

deny the renewal of the licenses or permits under which such transport operation was carried out. Upon the termination of Alco Pacífico's waste transportation agreement with Cytrar, PROFEPA did not make note of any breach or obligation under such agreement. Although in one of the provisions of the minutes evidencing the cessation of Cytrar's services under the agreement PROFEPA reserved its right to subsequently hold Cytrar liable "... for any hidden defects or non-performance and non-fulfillment of its obligations...",<sup>165</sup> no evidence has been brought forth to indicate that PROFEPA has enforced that right against Cytrar. There is no evidence that during the effective term of the agreement any actions against Cytrar were filed by the other parties to the contract for breach, whether seeking to terminate the contract on sufficient grounds as authorized by its clause 6,<sup>166</sup> to interrupt payments owed under the contract or to seek any other type of redress or compensation for breach of contract. There is no evidence either that Fomín, the company that under clause 5-D (p. 5) of such agreement was responsible for the supervision of Cytrar's services provided under the agreement, made any reservations, negative remarks or warnings about Cytrar's performance of its contractual obligations during the effective term of the agreement.

138. Therefore, if the level of opposition generated by the transportation and discharge by Cytrar of Alco Pacífico's waste did not trigger any decisive action by the competent federal authorities, including PROFEPA —such as revocation of the relevant permits or authorizations, the commencement of legal actions or the early termination of the agreement— to put an end to such activities and if such opposition is not of the essence in the Resolution, it is not appropriate to attribute any considerable significance to it upon taking into account and weighing factors to determine if the Resolution *per se* amounts to a violation of the Agreement.

139. Those events —not related to the transportation and discharge of Alco Pacifico's waste by Cytrar— which constitute material evidence of the opposition put up by community entities and associations to the Landfill or its operation by Cytrar, do not give rise, in the opinion of the Arbitral Tribunal, to a serious urgent situation, crisis, need or social emergency that, weighed against the deprivation or neutralization of the economic or commercial value of the Claimant's investment, permits reaching the conclusion that the Resolution did not amount to an expropriation under the Agreement and international law.

140. First of all, such opposition was mainly based —as recognized by the Respondent itself— on the site's proximity to Hermosillo's urban center and on the circumstance, not attributable to Cytrar, that the site's location violated the applicable Mexican regulations —i.e. NOM-055-ECOL-1993 issued by INE—,<sup>167</sup> a circumstance that was certainly known by Promotora upon selling the Landfill's assets to Cytrar and also by INE upon granting the different permits to operate the Landfill. As expressed by the Respondent, the Landfill's proximity to Hermosillo's urban center, and not concrete evidence that the Landfill's operation is harmful for the environment or public health, is the issue that concentrates the opposition of the groups that are against the Landfill. Therefore, since such groups could not obtain the Permit's revocation due to the lack of such evidence —as explained to them

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<sup>165</sup> Document A76: Minutes executed by PROFEPA, Cytrar and Fomin on July 6, 1999. Provision 11.

<sup>166</sup> Agreement dated November 19, 1996, p. 6, document D64.

<sup>167</sup> Counter-memorial, 33, p. 9

by INE and the municipal authorities— their ultimate goal was to close down the Landfill and make Cytrar relocate its operations. SEMARNAP, INE, and the authorities of the Municipality and of the State of Sonora finally agreed with these objectives.

141. Tecmed and Cytrar were certainly aware of the existence of those regulations, but it is clear that those regulations did not apply to the Landfill, since when the Landfill was designed and built and specific technical procedures governing the Landfill's operation were established, such regulations were not effective and their application could not be retroactive, as confirmed by a note from PROFEPA to Cytrar.<sup>168</sup> Therefore, at the time the investment was made, Cytrar and Tecmed had no reason to doubt the lawfulness of the Landfill's location, regardless of the social and political pressure that appeared subsequently. These companies were not negligent upon analyzing the legal issues related to the Landfill's location.

142. As a result of the community pressure it ran into, Cytrar also agreed that the relocation—actively sought by the municipal and state authorities and by SEMARNAP— should take place. However, Cytrar conditioned the relocation, as was obviously to be expected from any operator of an on going business, to being able to transfer its activities to a new site. The minimum requirements for the relocation were the identification of the site, the completion of the studies to prove the site's adequacy for the landfill of hazardous waste, the acquisition of the site and the granting of the relevant authorizations and permits required to operate a hazardous waste landfill prior to closing down the Las Víboras site. As time went by, due to the growing pressure arising from the above-mentioned events and from the Mexican federal, state and municipal authorities, Cytrar or Tecmed agreed to assume a substantial portion of the cost of the acquisition and start-up of the new site as a hazardous waste landfill and of the cost of transferring the waste confined at the Las Víboras site to the new landfill site. The Mexican authorities were to find the site and issue the relevant permits, and they focused the search on the state of Sonora. An institution from Sonora, IMADES (Sonora's Environmental and Sustainable Development Institute) was in charge to look for the site. The evidence submitted has not proved that Cytrar breached, or had the intention to breach, any of its relocation commitments. In addition, there is not proof, and no evidence has been submitted, that the federal or state authorities or IMADES sent any notice to Cytrar or Tecmed demanding compliance with their relocation commitment to a concrete site identified by such authorities with or without the consent of Cytrar. Evidence is only available as to a number of sites identified by the state and federal authorities in the Municipality of Benjamín Hill which, in principle, were fit for the relocation of the Landfill, subject to the related studies. Cytrar agreed that the sites identified in such place were fit for the Landfill<sup>169</sup>. However, for reasons that, based on the evidence available, cannot be attributed to Cytrar, the relocation did not take place at such time or subsequently within that Municipality. Reportedly, such reasons were the community pressures that Mexican authorities did not deem advisable to contradict.<sup>170</sup>

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<sup>168</sup> Note dated February 11, 1998. document D101.

<sup>169</sup> Counter-memorial, 270, p. 75.

<sup>170</sup> Opposition to the Landfill's relocation to Benjamín Hill, reportedly coming from the same groups that also opposed to the Las Víboras Landfill, continued even after the Resolution was issued, as shown by the journalistic evidence submitted: readers' opinions and articles published in Hermosillo newspaper *El Imparcial*, dated March 30, April 23, and May 4, 1999; letter from an environmental activist, Francisco

143. The evidence submitted does not lead to concluding that Cytrar's petitions to expand cell N° 2 of the Landfill were actually a surreptitious way to postpone the relocation in order to continue operating the Landfill for the longest time possible, rather than a way to pursue an alternative solution to operating needs until the relocation was effective. In Cytrar's note to INE dated July 15, 1998,<sup>171</sup> in which Cytrar states the need to increase the Landfill's volume capacity by expanding cell N° 2, Cytrar expressly relates such increase to the time required to continue operating the Landfill for a year, which was necessary for the relocation. That was precisely the minimum term estimated for that purpose by the Municipality of Hermosillo. INE never denied that that was the appropriate term to relocate nor did it state that the proposed additional landfill capacity was excessive compared to the Landfill's proposed additional term for operation by Cytrar until relocation or that it may have had the purpose of prolonging the Landfill's exploitation for a period longer than necessary –or indefinitely– to achieve such relocation. If the construction of cell N° 3 — the authorization of which was also requested by Cytrar to INE “only in the event relocation was not completed after expanded cell N° 2 was full”<sup>172</sup>— meant giving Cytrar landfill capacity at the Las Víboras site for a term longer than necessary to relocate, it would have been enough for INE to refuse to grant such authorization in order to dissuade Cytrar from delaying the relocation and it would not have been necessary for that purpose to dismiss the application for renewal of the Permit. INE, by itself or in association with IMADES, the Government of Sonora or the Municipality of Hermosillo, did not respond to the proposal included in the note dated July 15, 1998, with any other counter-offer. Until a few days before the Resolution, both Cytrar and Tecmed reaffirmed, through communications dated November 9, 12 and 17, 1998, their commitment to relocate the Landfill to any of the areas identified by the Mexican authorities and to bear the most significant costs associated with the relocation, including any costs related to the

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Pavlovich, published in *El Imparcial* on April 16, 1999, (Press Dossier (I) exhibit A70). The same happened in connection with other places or sites located in Sonora according to the press information submitted by IMADES: note published in *El Imparcial* on March 25, 1999, about the towns of Carbó and Guaymas; notes published in *El Imparcial* on March 4 and April 15, 1999, about the town of Carbó, article published in *El Imparcial* on November 6, 1998 about the Agua Blanca site located in Benjamín Hill) (Press Dossier (I) exhibit A70). The approval by the Municipality of Benjamín Hill and the Mayor of this Municipality to commence the studies related to the identification of the site and the preliminary contract of sale of «El Pinito», a plot located in this Municipality, occurred in April 1999, i.e. quite a long time after the date of the Resolution. Such actions continue to be preparatory acts that have apparently not been implemented through concrete decisions or relocation proposals made by the authorities: Counter-memorial, 337, p. 96. On the other hand, according to the article published in *El Imparcial* on May 4, 1999, mentioned above, as well as to the article published in such newspaper on April 15, 1999, related to the construction of a landfill in “El Pinito”, despite the resolutions of the authorities of Benjamín Hill, the community opposition to the relocation of the Landfill to that town continues and the issue does not seem to be definitively resolved. It is striking that as of February 22, 2000, almost a year later, the identification studies to determine whether that site would be definitely chosen by the authorities as a place fit for the relocation of the Landfill (letter of the Government of Sonora to Dra. Cristina Cortinas de Nava dated February 22, 2000, document D165) are still pending. In April 1999, IMADES had referred to another site located in Benjamín Hill, called “El Tilico”. IMADES had reportedly obtained the permit of the authorities of such Municipality to construct the landfill (article published in *El Imparcial* on April 16, 1999, Press Dossier (I), exhibit A70). However, it seems that the authorities never carried this out.

<sup>171</sup> Document A50, 7.

<sup>172</sup> Cytrar's note to INE dated November 16, 1998, 5, p. 2, document A54.



construction of the new premises in the new site and the payment of part of the purchase price of the land.<sup>173</sup> INE and the Mexican authorities involved in the relocation arrangements did not indicate, in view of this statement and before the Resolution was issued, any site for such commitment, nor did they challenge Cytrar's technical, economic or operational capacity to fulfill its relocation commitment and operate in the new site under conditions that would guarantee the protection of the environment and the preservation of public health. The fact that such capacities were not controversial is confirmed by the fact that Cytrar and Tecmed continued negotiating to relocate the Landfill even after the Permit's renewal had been denied, at least during January 2000.<sup>174</sup>

144. Finally, the Respondent has not presented any evidence that community opposition to the Landfill—however intense, aggressive and sustained—was in any way massive or went any further than the positions assumed by some individuals or the members of some groups that were opposed to the Landfill. Even after having gained substantial momentum, community opposition, although it had been sustained by its advocates through an insistent, active and continuous public campaign in the mass media, could gather on two occasions a crowd of only two hundred people the first time and of four hundred people, the second time out of a community with a population of almost one million inhabitants, "... which makes it the city with the highest population in the state of Sonora".<sup>175</sup> Additionally, the "blockage" of the Landfill was carried out by small groups of no more than forty people.<sup>176</sup> The absence of any evidence that the operation of the Landfill was a real or potential threat to the environment or to the public health, coupled with the absence of massive opposition, limits "community pressure" to a series of events, which, although they amount to significant pressure on the Mexican authorities, do not constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.

145. The fact that the real problem was the site of the Landfill and not the manner in which the Landfill was operated by Cytrar is confirmed by the fact that the Mexican federal, state and municipal authorities, including INE, did not hesitate to entrust Cytrar with the construction and operation of a new hazardous waste landfill located outside Hermosillo, with characteristics, activities and a scope apparently wider and more ambitious than the operation in Las Víboras. If these authorities had considered that Cytrar was not a suitable company to operate the Landfill in a prudent and responsible manner, and under technical conditions that ensured the protection of the environment, ecological balance and the health of the population, these authorities could not have agreed to—or even proposed—Cytrar's relocation, in good faith and without committing a breach of their obligations. That would entail the possible and almost certain risk that Cytrar's unscrupulous and careless

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<sup>173</sup> Counter-memorial, pp. 85, 304. Cytrar's note to the President of INE, dated November 9, 1998, document D94; Tecmed's notes dated November 12, 1998 sent to the Governor of Sonora, document D149 and to the Minister of SEMARNAP, Ms. Julia Carabias Lillo, document D150; Tecmed's note dated November 17, 1998 sent to the Director of INE, Ms. Cristina Cortinas Nava, document D154.

<sup>174</sup> Counter-memorial, p. 96, 337.

<sup>175</sup> Counter-memorial, p. 15, 54.

<sup>176</sup> Hearing held from May 20 to May 24, 2002. Transcript of the session of May 20, 2002. Declaration of Javier Polanco Lavín, pp 33 overleaf, 35, 42-43; transcript of the session of May 21, 2002, declaration of José María Zapatero Vaquero, p. 57 overleaf.

action, allegedly lacking meticulousness in public relations management or in the relationship with the people, would lead to new expressions of condemnation in addition to the predictable damage to the environment and public health. This confirms that it was political pressure mainly revolving around the physical location of the site rather than a condemnation of major consequences expressed by the community or a situation originating a serious social emergency due to Cytrar's behavior that motivated the refusal to renew the Permit.

146. The situation described above is not comparable to the situation that led to the case *Elettronica Sicula S.p.A.(Elsi)*, invoked by the Respondent.<sup>177</sup> First, the decision of the Mayor of Palermo, which brought about the US claim against Italy filed before the International Court of Justice<sup>178</sup> upon ordering that the foreign investor's plant be requisitioned, is expressly based on—and the preambular clauses thereof refer to—a serious emergency and social crisis related to the closing of the plant located in Palermo, Italy (the closing down of an important job source—the second one in significance of the district—with the consequent dismissal of around one thousand workers and negative consequences on the same number of families and the Palermo community in general, which added to the suffering caused by the earthquakes that had occurred in the area a few months before).<sup>179</sup> This emergency was also recognized by the Palermo courts in terms of significant public hardship related to the plant's closing and of the unexpected urgent need to adopt measures to alleviate the crisis.<sup>180</sup> Second, the closing and mass firing of workers were directly attributable to the decision of the controlling shareholders of the company that owned the plant—i.e. the foreign investors—not to make new capital contributions or to execute the necessary bonds as security to obtain financial resources that would allow the company to stay in business.<sup>181</sup>

147. In this case, there are no similar or comparable circumstances of emergency, no serious social situation, nor any urgency related to such situations, in addition to the fact that the Mexican courts have not identified any crisis. The actions undertaken by the authorities to face these socio-political difficulties, where these difficulties do not have serious emergency or public hardship connotations, or wide-ranging and serious consequences, may not be considered from the standpoint of the Agreement or international law to be sufficient justification to deprive the foreign investor of its investment with no compensation, particularly if it has not been proved that Cytrar or Tecmed's behavior has been the determinant of the political pressure or the demonstrations that led to such deprivation, which underlie the Resolution and conclusively conditioned it. On the contrary, the commitment by such companies to relocate the Las Víboras operation to a different site, although immediately motivated in the deeply reasonable—though non-altruistic—concern of being able to continue with the commercial exploitation they were engaged in makes it clear that, objectively, such commitment was intended to make a positive contribution to mitigate the socio-political pressure and to continue providing

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<sup>177</sup> E.g., see p. 127, 452, Counter-memorial.

<sup>178</sup> Case *Elettronica Sicula S.p.A (ELSI) (United States of America v. Italy)*, July 20, 1989, ICJ Reports, 1989.

<sup>179</sup> *Ibid.* 30, pp. 21-22

<sup>180</sup> *Ibid.* 75, pp. 40-41

<sup>181</sup> *Ibid.* 17, p. 14

Mexico with hazardous waste landfill services from a new site. It should be underscored that, as argued in these arbitration proceedings, Mexico urgently needs these services due to a serious lack thereof.

148. Another factor should be added: Cytrar's operation of the Landfill never compromised the ecological balance, the protection of the environment or the health of the people, and all the infringements committed were either remediable or remediated or subject to minor penalties. The Resolution not only terminates the Permit, but also resolves to permanently close down the site at Las Víboras, and such circumstance irrefutably confirms that the problem concerned the location of the Landfill rather than Cytrar's operation of it. This is so, as such closing means that the Landfill may not be operated by Cytrar or by anyone else, even if it complied with INE's requirements as to the expansion of cell N° 2, the prohibition to act as a transfer center or the requirements as to the type of waste to be confined or the temporary storage of such hazardous waste or any other action on which the Resolution was based. Such an extreme measure, the effects of which will have a permanent impact on the future, in view of the fact that the violations did not give rise to irreparable deficiencies in the operation of the Landfill, shows that INE concluded that the Permit granted to Cytrar should not be renewed and also that from then on nobody should be authorized to operate a hazardous waste landfill at the Las Víboras site, even if it was an operator whose behavior was so flawless that it could not give rise even to minor faults. Such conclusion was consistent with the requests of the Municipality of Hermosillo and the authorities of the state of Sonora with whom INE consulted.

149. While the Resolution is based on some of these violations to deny the renewal of the Permit, apparently through a literal and strict interpretation of the conditions under which the Permit was granted,<sup>182</sup> it would be excessively formalistic, in light of the above considerations, the Agreement and international law, to understand that the Resolution is proportional to such violations when such infringements do not pose a present or imminent risk to the ecological balance or to people's health, and the Resolution, without providing for the payment of compensation as required by Article 5 of the Agreement, leads to the neutralization of the investment's economic and business value and the Claimant's return on investment and profitability expectations upon making the investment. The Arbitral Tribunal does not agree with the Respondent's position denying that upon making its investment, the Claimant had legitimate reasons to believe that the operation of the Landfill would extend over the long term.<sup>183</sup> The political and social circumstances referred to above, which conclusively conditioned the issuance of the Resolution, were shown with all their magnitude after a substantial part of the investment had been made and could not have reasonably been foreseen by the Claimant with the scope, effects and consequences that those circumstances had. There is no doubt that, even if Cytrar did not have an indefinite permit but a permit renewable every year, the Claimant's expectation was that of a long-term investment relying on the recovery of its investment and the estimated return through the operation of the Landfill during its entire useful life.

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<sup>182</sup> Counter-memorial, 314 *et. seq.*, pp. 87-93; 489, p.143

<sup>183</sup> Closing statement of the Respondent's counsel, 124-126, pp. 65-66

150. Such circumstances are also included in the bid offer submitted by Tecmed under the bidding auction of the assets related to the Landfill, where it states that the investment will be applied for the benefit of the “...industries of the state of Sonora in the short, medium and long terms, and that to that effect no policies that might deplete the full capacity of the Landfill in the short term will be adopted...”, and that “...Cytrar will increase its role as a regional plant, self-limiting its annual volume of waste acceptance from extra-regional sources to the level required to maintain a minimum profitability level ...”.<sup>184</sup> In view of the above, it is clear the Cytrar would not have an operation level to reach a break-even point and obtain the expected rate of return in a short time. INE could not be unaware of this and of the need to act in line with such expectations to avoid rendering unfeasible any private investment of the scale required to confine hazardous waste in the United Mexican States under acceptable technical operating conditions. Both the authorization to operate as a landfill, dated May 1994, and the subsequent permits granted by INE, including the Permit, were based on the Environmental Impact Declaration of 1994, which projected a useful life of ten years for the Landfill.<sup>185</sup> This shows that even before the Claimant made its investment, it was widely known that the investor expected its investments in the Landfill to last for a long term and that it took this into account to estimate the time and business required to recover such investment and obtain the expected return upon making its tender offer for the acquisition of the assets related to the Landfill. To evaluate if the actions attributable to the Respondent —as well as the Resolution— violate the Agreement, such expectations should be considered legitimate and should be evaluated in light of the Agreement and of international law.

151. Based on the above; and furthermore considering that INE’s actions (an entity of the United Mexican States “...in charge of designing Mexican ecological and environmental policy and of concentrating the issuance of all environmental regulations and standards”)<sup>186</sup> are attributable to the Respondent under international law<sup>187</sup> and have caused damage to the Claimant, and the fact that the claim related to the violation of Article 5(1) of the Agreement attributable to the Respondent is admissible under Title II(5) of its Appendix because the date of the damage and the date on which the Claimant should have become aware of the alleged violation of Article 5(1) of the Agreement is the date of the expropriatory act —i.e. the Resolution— subsequent to the entry into force of the Agreement but always within three years before the date the request for arbitration was filed,<sup>188</sup> the Arbitral Tribunal finds and resolves that the Resolution and its effects amount to an expropriation in violation of Article 5 of the Agreement and international law.

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<sup>184</sup> Tecmed’s tender offer, Sections 1.1.1; 1.1.2, document A17.

<sup>185</sup> Document D21, 51, p. 33. Counter-memorial, 43, p. 13.

<sup>186</sup> Counter-memorial, p. 2, 11.

<sup>187</sup> J. Crawford, *The International Law Commission’s Articles on State Responsibility*, 94-99 (Cambridge University Press, 2002).

<sup>188</sup> According to the certificate of registration issued on August 28, 2002, by the ICSID Interim Secretary-General, the Claimant’s notice to commence this arbitration was received by the ICSID Secretariat on August 7, 2000. The three-year term established in Title II(5) of the Appendix to the Agreement, within which the Claimant became aware or should have become aware of the alleged violations of the Agreement on which its claims are based and of the related damage, is the period commencing on August 7 1997, and ending on August 7, 2000.

## II. Fair and Equitable Treatment

### 152. According to Article 4(1) of the Agreement:

Each Contracting Party will guarantee in its territory fair and equitable treatment, according to International Law, for the investments made by investors of the other Contracting Party.

153. The Arbitral Tribunal finds that the commitment of fair and equitable treatment included in Article 4(1) of the Agreement is an expression and part of the *bona fide* principle recognized in international law,<sup>189</sup> although bad faith from the State is not required for its violation:

To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.<sup>190</sup>

154. The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle. Therefore, compliance by the host State with such pattern of conduct is closely related to the above-mentioned principle, to the actual chances of enforcing such principle, and to excluding the possibility that state action be characterized as arbitrary; i.e. as presenting insufficiencies that would

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<sup>189</sup> I. Brownlie, *Principles of Public International Law*, Oxford, 5<sup>th</sup>. Edition (1989), p. 19. It is understood that the fair and equitable treatment principle included in international agreements for the protection of foreign investments expresses "...the international law requirements of due process, economic rights, obligations of good faith and natural justice": arbitration case *S.D. Myers, Inc.v. Government of Canada*, partial award of November 13, 2000; 134, p. 29 ; [www.naftalaw.org](http://www.naftalaw.org).

<sup>190</sup> ICSID Arbitration no. ARB(AF)/99/2, *Mondev International Ltd v United States of America*, p.40, 116, October 11, 2002, [www.naftalaw.org](http://www.naftalaw.org).

be recognized “...by any reasonable and impartial man,”<sup>191</sup> or, although not in violation of specific regulations, as being contrary to the law because:

...(it) shocks, or at least surprises, a sense of juridical propriety.<sup>192</sup>

155. The Arbitral Tribunal understands that the scope of the undertaking of fair and equitable treatment under Article 4(1) of the Agreement described above is that resulting from an autonomous interpretation, taking into account the text of Article 4(1) of the Agreement according to its ordinary meaning (Article 31(1) of the Vienna Convention), or from international law and the good faith principle, on the basis of which the scope of the obligation assumed under the Agreement and the actions related to compliance therewith are to be assessed.

156. If the above were not its intended scope, Article 4(1) of the Agreement would be deprived of any semantic content or practical utility of its own, which would surely be against the intention of the Contracting Parties upon executing and ratifying the Agreement since, by including this provision in the Agreement, the parties intended to strengthen and increase the security and trust of foreign investors that invest in the member States, thus maximizing the use of the economic resources of each Contracting Party by facilitating the economic contributions of their economic operators. This is the goal of such undertaking in light of the Agreement’s preambular paragraphs which express the will and intention of the member States to “...intensify economic cooperation for the benefit of both countries...” and the resolve of the member States, within such framework, “....to create favorable conditions for investments made by each of the Contracting Parties in the territory of the other ...”.

157. Upon making its investment, the fair expectations of the Claimant were that the Mexican laws applicable to such investment, as well as the supervision, control, prevention and punitive powers granted to the authorities in charge of managing such system, would be used for the purpose of assuring compliance with environmental protection, human health and ecological balance goals underlying such laws.

158. The evidence submitted reveals that when the authorities of the Municipality of Hermosillo, in the state of Sonora, of SEMARNAP and INE, perceived that the political problems mentioned above, closely related to the community opposition already described, made it necessary to relocate Cytrar’s activities in the Landfill to a place outside Hermosillo, Cytrar, with Tecmed’s support, agreed that its publicly known relocation proposal would become a commitment of Cytrar and of the Mexican federal, state and municipal authorities. Such evidence also shows that although Cytrar accepted or agreed to such relocation, it made it conditional upon having a new site to carry out its technical and business activities and that it expressed this condition before the Mexican authorities on several occasions. In its note dated June 25, 1998, to the President of INE, Cytrar defines the distribution of duties and obligations related to the relocation as follows:

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<sup>191</sup> *Neer v. México* case, (1926) R.I.A.A. iv. 60.

<sup>192</sup> International Court of Justice Case: *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, 128, p. 65, July 20, 1989, ICJ, General List No. 76.

...[Cytrar] will accept its relocation and, to that end, the municipal and state authorities will be in charge of finding, acquiring and delivering a new site, and they will also be in charge of carrying out any and all pertinent studies and of granting the related permits and licenses.<sup>193</sup>

159. There is no proof that INE or the state and municipal authorities challenged the distribution of the relocation obligations. Such allocation was only changed to the extent that Cytrar offered to assume a significant portion of the financial cost of the relocation. At no time, from the time the authorities communicated to the public the relocation of the Landfill to the date of the Resolution, did such authorities or IMADES express any disagreement as to conditioning the operation of the Landfill by Cytrar to the relocation of such operations to a different place, nor did they deny that the relocation was the result of an agreement with Cytrar on the basis of conditions agreed upon between Cytrar and such authorities. Dr. Cristina Cortinas Nava, INE's General Director of Hazardous Materials, Waste and Activities recognized this as follows:

.....I recognize that the company stated that the relocation would take place after finding a new site. Therefore, the company expected to continue operating the Landfill at its current site until then. [...] I recognize that, and if you ask me why, then, at the time I made the decision that implied an interruption of the continuity sought by the company, why did I do it? [...] my answer is that it was because the circumstances in November were such that I am sure that if I had renewed the permit I would not have been able to guarantee to the company the continuity of its operations there. Because there were many objections to the continuity of the company's operations there.<sup>194</sup>

160. Cytrar may have understood in good faith that its operations at Las Víboras under the Permit would continue for a reasonable time until effective relocation. Although it is true that the relocation agreement has not been memorialized in an instrument signed by all the parties involved, the evidence submitted leads to the conclusion that there was such an agreement, as evidenced by the joint declaration of SEMARNAP, the Government of the state of Sonora and the Honorable Municipality of Hermosillo to that effect. Section 4 of such declaration states that "...the current landfill operated by CYTRAR shall be closed as soon as the new facilities are ready to operate".<sup>195</sup> On the other hand, the Resolution<sup>196</sup> itself stated that:

Furthermore, CYTRAR S.A. de C.V. agreed with the different levels of the federal, state and municipal government that the landfill would be relocated and made this agreement public.

There is no doubt that the agreement commenced to be performed, as evidenced by the joint visits of Cytrar and IMADES to sites that were possible locations for the relocated landfill. There is no evidence stating or suggesting that the parties to such agreement agreed that external factors stemming from community pressure—which the Mexican authorities were fully aware of upon reaching the agreement— would cause the closing of Cytrar's business

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<sup>193</sup> Document A49. The relocation commitment project between the Mexican authorities and Cytrar referred to by the Respondent in the Counter-memorial, n. 324-329, pp. 93-94, which reportedly gives rise to a change in the allocation of obligations described above, has never been executed and was still subject to comments as of January 13, 1999. Therefore, such commitment cannot be taken into account to measure the allocation of the relocation obligations assumed by the parties in the stage prior to the issuance of the Resolution.

<sup>194</sup> Hearing held from May 20 to May 24, 2002; transcript of the session of May 21, 2002, pp. 77-77 overleaf.

<sup>195</sup> Document A88.

<sup>196</sup> Document A59.

at the Landfill without complying with the prior relocation of this business to another place. The incidental statements as to the Landfill's relocation in the correspondence exchanged between INE and Cytrar or Tecmed, and that constitute the immediate precedents of the Resolution, cannot be considered to be a clear and unequivocal expression of the will of the Mexican authorities to change their position as to the extension of the Permit so long as Cytrar's business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to Cytrar from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of Cytrar's operations at the Landfill to another place, a rejection that should not have been expressed only by INE, but also by the other authorities responsible for deciding on the Landfill's relocation; i.e. the Municipality of Hermosillo, the Government of Sonora and SEMARNAP. The conclusion is that Cytrar may have reasonably trusted, on the basis of existing agreements and of the good faith principle, that the Permit would continue in full force and effect until the effective relocation date.

161. As stated above, on July 15, 1998, in a letter sent to the General Director of Hazardous Materials, Waste and Activities of INE, Dr. Cristina Cortinas Nava, Cytrar presented a number of proposals related to the expansion of cell N° 2 and the construction of cell N° 3 to address the company's commitments while the process to relocate its operations to a different site was carried out.<sup>197</sup> In spite of the urgency of the case and of the letter that Cytrar had sent to INE's President on June 25, 1998, reporting the need to increase the Landfill's capacity for those very reasons,<sup>198</sup> and reiterating Cytrar's commitment to relocate subject to the conditions expressed therein, INE took about three months to issue its reply to Cytrar. In its response, included in an official communication sent to Cytrar on October 23, 1998,<sup>199</sup> i.e. scarcely more than one month before the expiration of the Permit's term and when Cytrar had already requested the Permit's renewal in a letter sent to INE on October 19, 1998,<sup>200</sup> INE did not express the existence of any irregularity committed by Cytrar in the Landfill's operation or of any default by Cytrar of the conditions under which the Permit was granted that, in the opinion of INE, might jeopardize the Permit's renewal or its limited extension for a reasonable time so as to permit the relocation as proposed by Cytrar. INE could not have been unaware at the time of the existence of irregularities or infringements related to the expansion of cell N° 2. The expansions seemed to be the biggest concern of the sectors that opposed the Landfill, as their interpretation was that the expansions, which had been communicated by PROFEPA to INE by means of an official communication received by INE on September 14, 1998,<sup>201</sup> were *sine die* the cause for the delay in closing the Landfill. As INE only stated that it would evaluate the request for the expansion of cell N° 2 and construction of cell N° 3 upon considering renewal of the Permit, without warning Cytrar of any breach or irregularity in the expansion of the Landfill's capacity that, in the opinion of INE, jeopardized the renewal of the Permit, INE significantly affected Cytrar's ability to cure such defaults or irregularities in due time and prevent the denial of the Permit's renewal upon its expiration. Although INE, in its official

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<sup>197</sup> Letter sent to Dr. Cristina Cortinas Nava, document A50.

<sup>198</sup> Letter sent to Enrique Provencio, document A49.

<sup>199</sup> Official communication no. DOO-800/005262 of October 23, 1998, document A51.

<sup>200</sup> Cytrar's letter to Dr. Cristina Cortinas Nava, document A52.

<sup>201</sup> Document D133.



communication addressed to Cytrar on November 13, 1998,<sup>202</sup> in reply to the note sent by Cytrar on October 19, 1998, whereby it requested the renewal of the Permit, refers to these and other infringements, only six days before expiration of the Permit, it seems evident that, at that time, any meaningful effort to cure such infringement and prevent a denial of the permit's renewal was not feasible.

162. INE did not report, in clear and express terms, to Cytrar or Tecmed, before issuing the Resolution, its position as to the effect of these infringements on the renewal of the Permit. As a consequence, it prevented Cytrar from being able to express its position as to such issue and to agree with INE about the measures required to cure the defaults that INE considered significant when it denied the renewal without allowing a reasonable time to relocate Cytrar to another site. Providing an opportunity to Cytrar was reasonable and equitable, since at all times the parties considered that Cytrar would relocate the Landfill to another place, and such relocation and the necessity for the Landfill to continue operating at Las Víboras until the effective relocation, was the purpose of the recent correspondence exchanged between the parties. There was no disagreement that relocation could not be immediate and that it would require continued efforts, probably for many months, even for more than a year. There are clear inconsistencies or contradictions in the attitude of INE, which, on the one hand, did not challenge the technical capacity and operating qualifications of Cytrar upon entrusting it with the operation of a hazardous waste landfill that would be relocated to another site and that would operate under the more ambitious conditions—and surely with more responsibilities for the operator—of a Comprehensive Center for the Management of Industrial Waste, or CIMARI, and that, on the other hand, did not warn Cytrar about the curable defaults in its operations at Las Víboras sufficiently in advance so as to avoid the denial of the Permit's renewal. As shown, such defaults have not endangered public health, ecological balance or the environment. It should be noted that, although the official communication sent by INE to Cytrar on November 13, 1998, refers to an alleged violation by Cytrar of the specific condition 1.12 of the Permit, under which “...the presentation of repeated and justified complaints against the company or the occurrence of events due to problems in the Landfill's operation that may endanger public health...” (without going any deeper into this subject or expressly mentioning such events) are sufficient events to «cancel» the Permit (not to *deny its renewal*), such condition was not invoked among the grounds of the Resolution. After analyzing such inconsistencies, it may be concluded that the contradictions and lack of transparency in INE's attitudes vis-à-vis Cytrar, and the absence of clear signs from INE, did not permit Cytrar to adopt a behavior to prevent the non-renewal of the Permit, or that might at least guarantee the continuity of the permit for the period required to relocate the Landfill to a new site.

163. If INE's position was that relocation was to take place within a given period—which, as stated above, according to the Mexican authorities, should be about twelve months—<sup>203</sup> after the expiration of which the Permit would not be renewed, it would be reasonable to expect such situation to be reported to or agreed upon by Cytrar. Certainly, it is surprising that INE did not unequivocally and clearly specify the deadlines, terms and conditions that would apply to the relocation, as requested by the authorities of the Municipality of

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<sup>202</sup> Document A53.

<sup>203</sup> Communication of the Mayor of the Municipality of Hermosillo, document D113.

Hermosillo a day before the Permit's expiration,<sup>204</sup> even when Cytrar and Tecmed had agreed to relocate Cytrar's business to any site selected by the Mexican authorities and regardless of the note sent by Tecmed to INE on November 17, 1998, in which Tecmed clearly requests the execution of an agreement with INE and the Mexican federal, state and municipal authorities containing a certain and specific relocation schedule.<sup>205</sup> There are also express inconsistencies between, on the one hand, the absence of such specifications and a notice to Cytrar warning it to agree to or abide by such conditions and, on the other hand, the use of the denial to renew the Permit as a factor to pressure Cytrar to relocate, as declared by INE's General Director of Hazardous Materials, Waste and Activities, who authored the Resolution:

.....for them [the local authorities] if I continued renewing the Permit, that would [sic] extend ... For as long as the company could continue receiving waste, it would not assume a full commitment to perform the studies required to relocate the site ...<sup>206</sup>

This statement reveals the two goals pursued by INE upon issuing the Resolution. On the one hand it denies the renewal of Cytrar's Permit without any compensation whatsoever for the loss of the financial and commercial value of the investment. On the other hand, this denial is described as a means to pressure Cytrar and force it to assume a similar operation in another site, bearing the costs and risks of a new business, mainly because by adopting such course of action, INE expected to overcome the social and political difficulties directly related to the Landfill's relocation. Under such circumstances, such pressure involves forms of coercion that may be considered inconsistent with the fair and equitable treatment to be given to international investments under Article 4(1) of the Agreement and objectionable from the perspective of international law.<sup>207</sup>

164. If, on the other hand, INE's position was —as has actually been established— to close the Landfill inevitably, with or without relocation, INE should have expressed such position clearly. Regardless of the hypothesis contemplated, the decisive factor —for which Cytrar was not responsible— was the Landfill's location at the Las Víboras site and its proximity to Hermosillo's urban center, which was in violation of Mexican regulations and a source of community opposition and political unrest, but which was not —as confirmed by Mexican authorities— against the legitimacy of the Landfill's operation under Mexican law. If the inevitable consequence of this situation, evaluated by the Mexican authorities, was the refusal to renew the Permit and the closing of the site, such determination, from the Agreement's standpoint, should have been accompanied, as has already been decided, by the payment of the appropriate compensation. The lack of transparency in INE's behavior and intention throughout the process that led to the Resolution, which does not reflect in full the reasons that led to the non-renewal of the Permit, cover up the final and real

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<sup>204</sup> Communication sent to INE's President by the Mayor of the Municipality of Hermosillo on November 18, 1998, in which the Mayor requests "the execution of a landfill relocation agreement between the Federation, the State, the Municipality and the company. A detailed, signed, legal agreement containing a schedule and fixed dates." Document D157.

<sup>205</sup> Document A 91.

<sup>206</sup> Hearing held from May 20 to May 24, 2002; transcript of the session held on May 21, 2002, p. 72.

<sup>207</sup> D.F.Vagts, *Coercion and Foreign Investment Rearrangements*, 72. *The American Journal of International Law*, pp. 17 *et seq.*, specially p. 28 (1978) : "...the threat of cancellation of the right to do business might well be considered coercion."

consequence of such actions and of the Resolution: the definitive closing of the activities at the Las Víboras landfill without any compensation whatsoever, whether Cytrar agreed or not, in spite of the expectations created, and without considering ways enabling it to neutralize or mitigate the negative economic effect of such closing by continuing with its economic and business activities at a different place. Within the general context of the circumstances mentioned above, the ambiguity of INE's actions was even greater when it resorted to the non-renewal of the Permit to overcome obstacles not related to the preservation of health and the environment although, according to the evidence submitted, the protection of public health and the environment is where INE's preventive function should be focused. To the question about the factors or parameters that INE should take into account to decide on the renewal of authorizations such as the Permit, witness Dr. Cristina Cortina Navas answered:

Provisions can have two different purposes: to evaluate environmental performance and to assess the management of companies. Thus, you will distinguish, among the conditions established, such conditions that allowed for the evaluation of the former and the conditions that allowed for the assessment of the latter. As regards management, there were a series of instruments, reports, records and issues that the company had to take care of. In turn, performance involved providing sufficient security that there would not be escapes, leaks or accidents during hazardous waste management, including transportation and storage. Any of these issues could be verified, and, in fact, before issuing any resolution we tried to gather all the elements necessary to be able to pass judgment on whether or not such purposes had been fulfilled.<sup>208</sup>

The refusal to renew the Permit in this case was actually used to permanently close down a site whose operation had become a nuisance due to political reasons relating to the community's opposition expressed in a variety of forms, regardless of the company in charge of the operation and regardless of whether or not it was being properly operated.

165. The Arbitral Tribunal considers that INE's behavior described above with respect to Cytrar, which had a material adverse effect on Cytrar's ability to get to know clearly the real circumstances on which the maintenance or validity of the Permit depended—it must be recalled that Cytrar could not operate without this Permit—is not an unprecedented action. INE's denial to renew the Permit belongs to the wider framework of the general conduct taken by INE towards Cytrar, Tecmed and, ultimately, the Claimant's investment.

166. The Arbitral Tribunal finds that INE's behavior, as analyzed in paragraphs 153-164 above and because of the "deficiencies" explained therein, conflicts with what a reasonable and unbiased observer would consider fair and equitable, and that this amounts to a violation of Article 4(1) of the Agreement. The Arbitral Tribunal also finds that such a behavior can be related, in terms of its prejudicial consequences, to the consequences of the Resolution; and that only after the Resolution was issued could the Claimant fully realize the breach of the Agreement incurred by such behavior and the resulting damage. Consequently, the Claimant's claims in connection with such behavior satisfy the requirements for admissibility contemplated in Title II(4) and (5) of the Appendix to the Agreement.

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<sup>208</sup> *Ibidem*, pp. 68-68 overleaf

167. Notwithstanding the above, the Arbitral Tribunal considers it equally appropriate to place this behavior within the context of INE's prior conduct on the basis of the abundant arguments and evidence presented by the Parties in connection with such prior conduct and in view of the undeniable fact that the legal relationship between INE and Cytrar or Tecmed associated with the Landfill is one and only one, starting with the initial procedures in connection with the authorization to operate the Landfill and finishing with the Resolution—the immediate cause for the damage sustained by the Claimant. This conduct should also be analyzed in light of the fact that throughout a relationship of such nature, necessarily prolonged in time, the Claimant was entitled to expect that the government's actions would be free from any ambiguity that might affect the early assessment made by the foreign investor of its real legal situation or the situation affecting its investment and the actions the investor should take to act accordingly.

168. As a result of the judicial sale of the Landfill's assets, Tecmed and the Municipality of Hermosillo request from INE the "change of name" or the facilitation of such change, which, according to the administrative practice up to date, at least in connection with the Landfill, entailed the replacement of the holder of the permits necessary for the operation of the landfill at Las Viboras by such holder's successors. There is no evidence that INE has responded to such communications stating that Cytrar had actually to request a new permit, which may differ from the existing one, instead of requesting the replacement of the old holder with a new one; and no convincing evidence has been offered to support the Respondent's allegations as to the fact that, from the beginning, INE's officers instructed Cytrar to obtain a new "operating license" because, for example, as stated by the Respondent, the nature of the operation undertaken by Cytrar and the consequent expansion of the Landfill's installed capacity would so require it.<sup>209</sup> Among others, in the note dated June 5, 1996, sent to INE by Tecmed together with the MRP Form, containing information that INE should evaluate in connection with the individual or entity that was to be in charge of a hazardous waste landfill operation, Tecmed specifically requested from INE "...the change of the name appearing in the permit granted by INE to the new company for such purpose, CYTRAR S.A. de C.V.". Attached as Annex "A" to such presentation and Form, are the Establishment License granted on December 7, 1988, and the permit to operate the already existing Controlled Landfill, dated May 4, 1994, together with its expansion of August 25, 1994.<sup>210</sup>

169. Thus, there was no possible margin for error with respect to the request made by Tecmed and Cytrar with the support of the Municipality of Hermosillo in connection with the existing licenses or permits by virtue of which the Landfill had operated and was still operating. Considering such very clear requests, there is no evidence that INE had warned Cytrar that such requests could only be interpreted as petitions to be included in INE's listing of companies that would qualify for the operation of CIMARIS or Comprehensive Centers for Industrial Waste Management—to which the witness Jorge Sánchez Gómez, the INE's General Director of Hazardous Materials, Waste and Activities at that time<sup>211</sup> had made reference—or evidence of practices, resolutions or administrative regulations or legal

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<sup>209</sup> Counter-memorial, 127, pp. 34-35

<sup>210</sup> Document D46

<sup>211</sup> Hearing held from May 20 to May 24, 2002. Transcript of the session of May 23, 2002, p. 57.

provisions leading to such sole and exclusive interpretation. On September 24, 1996, INE sent Cytrar an official communication signed by Jorge Sánchez Gómez, whereby Cytrar was informed that “In view of the request filed by the company Promotora e Inmobiliaria del Municipio de Hermosillo, OPD to change its name to Cytrar S.A. de C.V.,” and considering that according to the recommendations of INE’s “...Legal Affairs Department ...” Cytrar had furnished “...the documents required by this General Office and had fulfilled all legal requirements that, in such Department’s understanding, are essential *for carrying out the necessary procedure*,”<sup>212</sup> Cytrar “... for all legal and administrative purposes...” had been “duly registered in this General Office under my charge”.<sup>213</sup> It is not surprising that from this communication, Cytrar interpreted that INE had changed the corporate name appearing on the permits to operate the Landfill, as requested by Cytrar, Tecmed and the Municipality of Hermosillo.

170. Subsequently, it is no wonder to see Cytrar surprised when after Cytrar had been operating the Landfill under the existing permit dated May 4, 1994, in its capacity as new company authorized under the permit pursuant to INE’s official communication dated September 24, 1996, as Cytrar was entitled to believe in good faith, INE demanded Cytrar to return such communication to be replaced by another, with the same date and an almost identical text, except for an annex whereby Cytrar was granted a permit to operate the Las Víboras landfill, dated November 11, 1996.<sup>214</sup> Such permit, in addition to terminating the prior permit dated May 4, 1994, in which Cytrar had requested the change of name, differed from the last one in some material respects. The most outstanding difference, which would only be appreciated upon refusal to renew the Permit in 1998, was that the permit of May 1994 had an indefinite duration and the permit of November 1996 had a term of one year that could be extended. As highlighted by the witness Jorge Sánchez Gómez, the purpose behind the annual renewal of permits was to facilitate INE’s actions to put an end to the operations carried out by companies that, in INE’s understanding, did not adjust their actions to the applicable legal provisions; the INE could refuse the extension or refuse to renew such permits at the end of each year. According to the witness, this allowed INE to dispense with the more cumbersome procedure —of uncertain success— of obtaining the revocation of the permit by PROFEPA, which required that a case be opened and that the party subject to sanctions be given the opportunity to express its argumentations and defenses:

....apparently, there is an alternative: that the agency that had to enforce the law; in this case, PROFEPA, carried out the execution. However, it was very difficult to have a company’s registration withdrawn if there were no elements that would clearly allow verification of a breach. Revocation of permits is a very complicated procedure.....<sup>215</sup>

To emphasize INE’s discretionary powers as to the continuation of Cytrar’s operation of the Landfill and in accordance with INE’s policy of facilitating the possibility of putting an end to such operation without having to start the proceeding to withdraw the permit, when

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<sup>212</sup> Emphasis added by the Arbitral Tribunal

<sup>213</sup> Document A42

<sup>214</sup> Documents A43 and A44

<sup>215</sup> Hearing held from May 20 to May 24, 2002. Declaration of Jorge Sánchez Gómez, transcript for the session of May 23, 2002, p. 53 overleaf.

the Permit was granted —on November 19, 1997— it was determined that this Permit, instead of being “subject to extension” (as the previous permit stated), was subject to “renewal” upon request of the interested party. That is to say, it required a new permit at the end of each year, instead of extending its validity at the end of such period. In the words of the witness Jorge Sánchez Gómez:

...the notion of renewal is much easier to handle for the purpose of refusing a permit to a company that is not complying with the requirements.<sup>216</sup>

171. If the indefinite-duration permit dated May 4, 1994 had been transferred to Cytrar as requested to INE by Cytrar, Tecmed and the Municipality of Hermosillo, INE would not have been able to put an end to Cytrar’s operation of the Landfill by means of the Resolution and the only remedy available for that purpose would have been the revocation of the Permit by PROFEPA. But such revocation would probably have not been successful on the basis of the infringements of the Permit used to justify the Resolution, which were not even considered by PROFEPA as deserving any sanction other than a fine. To sum up, INE unilaterally transformed a previous administrative act, which, as such, was presumed to be legitimate, had immediate effects and could only be interpreted in good faith as having accepted Cytrar’s petition to be the transferee of the existing permits for the operation of the Landfill. The objective consequence of such transformation was to grant Cytrar a permit to operate the Landfill, which reduced Cytrar’s entitlement to question actions that deprived it of the Permit or that had such effect. Subsequently, INE —also unilaterally— classified the petition as a request to be registered in a listing that Cytrar was not aware of, and regarding which, in any case, Cytrar had shown no interest. The same objective consequence is to be attributed to the transformation as from November 19, 1997, of Cytrar’s permit to operate the Landfill, from a permit that was subject to extension to a permit that was subject to renewal.

172. The contradiction and uncertainty inherent in INE’s actions as to Cytrar and Tecmed is evidenced, then, both in the initial stage of the processing of the necessary permits to operate the Landfill and when INE decided to put an end to such operation by means of the Resolution. Such actions belong to one and the same course of conduct characterized by its ambiguity and uncertainty which are prejudicial to the investor in terms of its advance assessment of the legal situation surrounding its investment and the planning of its business activity and its adjustment to preserve its rights. Such ambiguity and uncertainty are also present in the last stage of the relationship, analyzed under paragraphs 153-164 above, which led to the Resolution, and added their harmful effects to the damage resulting from the denial to grant the Permit. Although INE’s initial behavior was before the effective date of the Agreement and the Arbitral Tribunal will not pass judgment on whether at that stage such conduct, considered in isolation, amounted to a breach of the provisions thereof before its entry into force, it cannot be ignored, in light of the good faith principle (Articles 18 and 26 of the Vienna Convention), that the conduct of the Respondent between the date of execution of the Agreement (in view of the Respondent’s determination to ratify it subsequently) and the effective date thereof, is incompatible with the imperative rules deriving from Article 4(1) of the Agreement as to fair and equitable treatment. This is

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<sup>216</sup> Transcript of the session of May 23, 2002, p. 59 overleaf.

particularly so since, according to Article 2(2) of the Agreement, it is applicable to investments made before its entry into force, a circumstance to be certainly considered when analyzing the conduct attributable to the Respondent that took place before that time but after the Respondent having executed the Agreement. INE's contradictory and ambiguous conduct at the beginning of the relationship between INE, Cytrar and Tecmed before the entry into force of the Agreement has the same deficiencies as those encountered in such conduct during the last stage of the relationship, immediately preceding the Resolution. Thus, INE's conduct during such time is added to the prejudicial effects of its conduct during the last stage, which breached Article 4(1) of the Agreement.

173. Briefly, INE's described behavior frustrated Cytrar's fair expectations upon which Cytrar's actions were based and upon the basis of which the Claimant's investment was made, or negatively affected the generation of clear guidelines that would allow the Claimant or Cytrar to direct its actions or behavior to prevent the non-renewal of the Permit, or weakened its position to enforce rights or explore ways to maintain the Permit. During the term immediately preceding the Resolution, INE did not enter into any form of dialogue through which Cytrar or Tecmed would become aware of INE's position with regard to the possible non-renewal of the Permit and the deficiencies attributed to Cytrar's behavior—including those attributed in the process of relocation of operations—which would be the grounds for such a drastic measure and, thus, Cytrar or Tecmed did not have the opportunity, prior to the Resolution, to inform of, in turn, their position or provide an explanation with respect to such deficiencies, or the way to solve such deficiencies to avoid the denial of renewal and, ultimately, the deprivation of the Claimant's investment. Despite Cytrar's good faith expectation that the Permit's total or partial renewal would be granted to maintain Cytrar's operation of the Landfill effective until the relocation to a new site had been completed, INE did not consider Cytrar's proposals in that regard and not only did it deny the renewal of the Permit although the relocation had not yet taken place, but it also did so in the understanding that this would lead Cytrar to relocate.

174. Such behavior on the part of INE, which is attributable to the Respondent, results in losses and damage<sup>217</sup> for the investor and the investment pursuant to Title II(4) of the Appendix to the Agreement coinciding both as to essence and time with those derived from the Resolution, whether such behavior is considered generically or only as to the stages mentioned and analyzed by the Arbitral Tribunal in paragraphs 153-164 above. The Respondent's behavior in such stages amounts, in itself, to a violation of the duty to accord fair and equitable treatment to the Claimant's investment as set forth in Article 4(1) of the Agreement and such behavior constitutes sufficient basis for the Claimant's claims founded on such violation to be admissible, given the time at which the damage occurred and the time when the damage and the violation of the Agreement were necessarily perceived by the Claimant (on the date of issuance of the Resolution), pursuant to Title II(4) and (5) of the Appendix to the Agreement.

### III. Full Protection and Security and Other Guarantees under the Agreement

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<sup>217</sup> "Damage" is not limited to the economic loss or detriment and shall be interpreted in a broad sense (J. Crawford, *The International Law Commission's Articles on State Responsibility*, 29-31 (Cambridge University Press, 2002).

175. The Claimant alleges that Mexican municipal and state authorities encouraged the community's adverse movements against the Landfill and its operation by Tecmed or Cytrar, as well as the transport by Cytrar of Alco Pacifico's waste. Further, the Claimant alleges that Mexican authorities, including the police and the judicial authorities, did not act as quickly, efficiently and thoroughly as they should have to avoid, prevent or put an end to the adverse social demonstrations expressed through disturbances in the operation of the Landfill or access thereto, or the personal security or freedom to move about of the members of Cytrar's staff related to the Landfill. It is the opinion of the Claimant that such behavior of the Mexican authorities, attributable to the Respondent, amounts to a violation of Article 3(1) of the Agreement, which provides that:

Each Contracting Party shall accord full protection and security to the investments made by the other Contracting Party's investors, in accordance with International Law and shall not, through legally groundless actions or discriminatory measures, hinder the management, maintenance, development, usage, enjoyment, expansion, sale, or, where applicable, disposition of such investments.

176. The Arbitral Tribunal considers that the Claimant has not furnished evidence to prove that the Mexican authorities, regardless of their level, have encouraged, fostered, or contributed their support to the people or groups that conducted the community and political movements against the Landfill, or that such authorities have participated in such movement. Also, there is not sufficient evidence to attribute the activity or behavior of such people or groups to the Respondent pursuant to international law.

177. The Arbitral Tribunal agrees with the Respondent, and with the case law quoted by it, in that the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it. At any rate, the Arbitral Tribunal holds that there is not sufficient evidence supporting the allegation that the Mexican authorities, whether municipal, state, or federal, have not reacted reasonably, in accordance with the parameters inherent in a democratic state, to the direct action movements conducted by those who were against the Landfill. This conclusion is also applicable to the judicial system, in relation to the efforts made to take action against the community's opposing demonstrations or to the attempt to reverse administrative measures which were deemed inconsistent with the legal rules applicable to the Landfill, such as the withdrawal by the Hermosillo's Municipal authorities of the license to use the Landfill's site.

178. Promotora's behavior, or INE's behavior attributable to the Respondent, regarding the sale of the assets related to the Landfill, the commitments undertaken in connection with such sale or the grant of the Permit to operate of November 11, 1996, and preceding events, all took place prior to the entry into force of the Agreement. With respect to Promotora, such behavior has not been considered by the Arbitral Tribunal due to the reasons described in paragraph 92 of this award, and will not be analyzed, even if it were hypothetically attributable to the Respondent, to determine whether there has been a violation of Article 3(1) of the Agreement or not.

179. With regard to INE's behavior prior to the entry into force of the Agreement, described above, and the subsequent stages following such date, the Arbitral Tribunal does



not consider, even at the time of its consummation and turning point —the refusal to renew the Permit— that such behavior has no legal grounds under Mexican law or that such behavior is discriminatory, as required by Article 3(1) of the Agreement in order to constitute a violation. The Arbitral Tribunal has not found that INE’s denial to renew the Permit violated any Mexican laws or was issued beyond the Mexican legal framework. As provided below, the Arbitral Tribunal has not verified, either, the existence of discriminatory treatment detrimental to the Claimant in violation of the national and foreign treatment guarantees also set forth in the Agreement. Therefore, the Arbitral Tribunal considers that neither the Resolution nor the Respondent’s behavior leading to such Resolution amount to a violation of Article 3(1) of the Agreement.

180. According to Article 4(2) of the Agreement, each Contracting Party guarantees the foreign investor a treatment that should not be less favorable... “than that accorded under similar circumstances [...] to investments made in its territory by investors from a third State”. Pursuant to Article 4(5) of the Agreement, each Contracting Party, “In accordance with the restrictions and methods provided by the local laws [...] shall accord to the investments made by the other Contracting Party’s investors a treatment that should not be less favorable than the treatment afforded to its own investors...”. The Arbitral Tribunal observes, however, in its post-hearing brief, when referring to the alleged breach of the Agreement, that the Claimant omits any statement regarding the violation of the guarantees of non-discriminatory treatment (national or accorded to investors from a third State) provided in Articles 4(2) and (5) of the Agreement, which are not even mentioned, though the Claimant does sustain its allegations relative to the breach attributable to the Respondent of Articles 3 and 5 of the Agreement as alleged by the Claimant in the request for arbitration.<sup>218</sup>

181. In any case, the Arbitral Tribunal does not consider that the behavior attributable to the Respondent, to the extent such behavior commenced prior to the entry into force of the Agreement and was accomplished after such date, or occurred following the entry into force, such as, for instance in the latter case, the issuance of the Resolution, amounts to violations to the guarantee of national or foreign treatment set forth by the provisions of the Agreement referred to above. The Claimant has failed to furnish convincing or sufficient evidence to prove, at least *prima facie*, that the Claimant’s investment received, under similar circumstances, less favorable treatment than that afforded to nationals of the State receiving the investment or of a third State, or that said investment was subject to discriminatory treatment upon the basis of considerations relative to nationality or origin of the investment or the investor. The Arbitral Tribunal further considers that the alleged discriminatory treatment attributed by the Claimant to the Respondent on the grounds of the unlimited duration of operation permits or licenses granted to Residuos Industriales Multiquim S.A. de C.V. (RIMSA), which would be owned by a foreign investor,<sup>219</sup> or to prior operators or owners of the landfill, all of which were government entities of the state of Sonora,<sup>220</sup> occurred and were entirely isolated events taking place prior to the

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<sup>218</sup> Claimant’s post-hearing brief, pp. 104-126.

<sup>219</sup> Memorial, p. 124.

<sup>220</sup> Memorial, p. 26

Agreement's entry into force, and will not be considered by this Arbitral Tribunal as stated in paragraph 67 of this arbitration award.

182. With regard to other forms of discrimination apparently originated in the allegedly different treatment accorded by INE to RIMSA's and Claimant's investments, the Arbitral Tribunal holds that the Respondent has furnished satisfactory evidence —not rebutted by the Claimant on this point— of the fact that the circumstances under which RIMSA's investment was made and concerning such investment materially differed from the investment in the Landfill. Thus, it is not possible to establish standards which allow a comparison of the treatment accorded to the investment in RIMSA's landfill and the investment in the Landfill. Further, it is the opinion of this Arbitral Tribunal that the Respondent has not breached Article 2(1) of the Agreement with respect to the promotion and admission of foreign investments, and that no evidence of such violation has been submitted; it being also relevant to point out that the Claimant itself has stated that if such violation existed, it should be the subject matter of a direct claim between the Contracting Parties<sup>221</sup> of the Agreement. The Arbitral Tribunal also holds that the denial of the Permit's renewal does not amount to a violation of Article 3(2) of the Agreement, pursuant to which each Contracting Party "within the local legal framework" shall grant the necessary permits with regard to the investments from the other Party, as the Arbitral Tribunal considers that there is no evidence proving the fact that INE's denial of the Permit is contrary to Mexican laws.

#### **F. Compensation. Restitution in kind.**

183. The Claimant's claim for compensation or restitution in kind is based upon the provisions of Title VII(1) of the Appendix to the Agreement, which contemplates those two options. The Claimant requests restitution in kind —which the Claimant considers "absolutely impossible"— only secondarily, as the Claimant primarily seeks monetary damages.<sup>222</sup> The Arbitral Tribunal considers that monetary damages paid to the Claimant as compensation for the loss of the investment constitutes an adequate satisfaction of the Claimant's claim under the Agreement. Therefore, and taking into account that the Claimant primarily seeks monetary damages, the Arbitral Tribunal will not consider the admissibility or inadmissibility of the restitution in kind in this case.

184. The Claimant calculates the amount to be paid as monetary damages under the discounted cash flow calculation method by which the Claimant intends to determine the Landfill's market value. Upon the basis of the report issued by the expert witness appointed by the Claimant, the amount to be paid as damages as of the date of the expropriation —November 25, 1998—totals US\$ 52,000,000, plus interest. The Claimant further claims compensation for the damage allegedly caused to the Claimant's reputation, with arbitration costs to be borne by the Respondent.

185. The Respondent objects to the application of a discounted cash flow analysis, as the Respondent considers such calculation method to be highly speculative given the short term

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<sup>221</sup> Memorial, p. 93.

<sup>222</sup> Memorial, pp. 142 – 144.

during which the Landfill operated as an on going business (about two years and a half), thus preventing the application of sufficient historical data to prepare the reliable estimates required by such calculation methodology. The Respondent has proposed the calculation of damages based on the investment made, upon which the investment's market value would be determined. In any case, the Respondent's expert witness challenges the discounted cash flow calculation methodology—as applied by the Claimant's expert witness—with regard to various aspects, including the price, costs, and market condition estimates, the failure to compute certain costs, such as remediation and maintenance of closed cells, and the discount rate applied by the Claimant's expert witness. Also, the Respondent's expert witness offers its own analysis under the discounted cash flow methodology, which in an “optimistic” version as such expert witness puts it, would be calculated in the amount of US\$ 2,100,000 for the investment, and according to a “conservative” version such amount would total US\$ 1,800,000.

186. The Arbitral Tribunal has noted both the remarkable disparity between the estimates of the two expert witnesses upheld throughout the examination directed by the parties and the Arbitral Tribunal at the hearing held on May, 20-24, 2002, and also the considerable difference in the amount paid under the tender offer for the assets related to the Landfill—US\$ 4,028,788—<sup>223</sup> and the relief sought by the Claimant, amounting to US\$ 52,000,000, likely to be inconsistent with the legitimate and genuine estimates on return on the Claimant's investment at the time of making the investment. The non-relevance of the brief history of operation of the Landfill by Cytrar—a little more than two years—and the difficulties in obtaining objective data allowing for application of the discounted cash flow method on the basis of estimates for a protracted future, not less than 15 years, together with the fact that such future cash flow also depends upon investments to be made—building of seven additional cells—in the long term, lead the Arbitral Tribunal to disregard such methodology to determine the relief to be awarded to the Claimant.<sup>224</sup>

187. In Article 5.2, the Agreement provides that, in the event of expropriation, or any other similar measure or with similar effects:

Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the time when the expropriation took place, was decided, announced or made known to the public (...) valuation criteria shall be determined pursuant to the laws in force applicable in the territory of the Contracting Party receiving the investment.

Also, Article 10 of the Mexican Federal Law on Expropriation provides that the applicable compensation shall indemnify for the commercial value of the expropriated property, which in the case of real property shall not be less than the tax value. There has been no evidence or allegations as to the interpretation of this rule in light of Mexican laws.

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<sup>223</sup> Report by Fausto García y Asociados, p. 22

<sup>224</sup> Award of ICSID case No. ARB (AF)/97/1 *Metalclad Corporation v. United Mexican States*, 16 Mealey's International Arbitration Report, p. A-1 *et. seq.*; pp. A-14/A-15, 119-122 (2000). Award in case *Phelps Dodge Corp. and Overseas Private Investment Corp. v. The Islamic Republic of Iran*, 10 Iran-U.S. Claims Tribunal Reps., p. 121 *et. seq.*; 30, pp. 132-133 (1986-1); award of ICSID case No. ARB/98/4, *Wena Hotels v. Arab Republic of Egypt*, 41 I.L.M. 896 (2002), 122-125, pp. 918-919, award of December 8, 2000.

188. The Arbitral Tribunal considers that compensation to be awarded pursuant to such parameters—that is, the market value of the Landfill— shall be the total compensation for all the violations to the Agreement proved in this award, which, in relation to the Claimant, have the damaging effect of depriving the Claimant of its investment.

189. It is not in dispute that the assets forming the Landfill are owned by the “Tecmed Group”, which belongs to the Actividades, Construcciones y Servicios group and thus has the Claimant as its parent corporation, into which, under Spanish accounting standards, the accounts of Tecmed and Cytrar are consolidated.<sup>225</sup> According to Articles 1(1)(b) and (2)(e) of the Agreement, the Claimant—the foreign investor—is the owner of the foreign investment in Mexico through the Claimant’s subsidiaries. The Respondent has recognized that:

The TECMED group, through the Mexican company TECMED, TECNICAS MEDIOAMBIENTALES DE MEXICO, S.A. de C.V., presently has the following environmental facilities in Mexico (in addition to the landfill, CYTRAR and its administrative offices).....<sup>226</sup>

It is also undisputed, at least after Cytrar obtained the permit from INE to operate the Las Viboras Landfill, that the related assets indirectly held by the Claimant constitute a hazardous waste landfill,<sup>227</sup> i.e. an integrated unit comprising tangible and intangible assets, including the Permit and other permits or licenses to operate as a hazardous waste landfill. Such unit must be valued by this Arbitral Tribunal upon rendering its award. Therefore, the Arbitral Tribunal concludes that the deprivation of the financial and business use of the Landfill’s operation arising from the Respondent’s actions and in violation of the Agreement has caused damage to the Claimant and its investment in the Landfill. Therefore, the Claimant is entitled to receive compensation in accordance with the provisions of the Agreement and on the basis of the market value of the assets the Claimant has been deprived of.

190. The Arbitral Tribunal also considers that, although the Arbitral Tribunal may consider general equitable principles when setting the compensation owed to the Claimant, without thereby assuming the role of an arbitrator *ex aequo et bono*,<sup>228</sup> the burden to prove the investment’s market value alleged by the Claimant is on the Claimant. Such burden is transferred to the Respondent if the Claimant submits evidence that *prima facie* supports its allegation, and any difficulty in determining the compensation does not prevent the assessment of such compensation where the existence of damage is certain.<sup>229</sup>

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<sup>225</sup> “2000 Annual Report of Actividades de Construcción y Servicios”, document A7, Annex 8.1 “Consolidated Information”, pp. 131-132 ; 133.

<sup>226</sup> Respondent’s brief “Admissions and denials”, p. 4.

<sup>227</sup> Respondent’s brief “Admissions and denials”, p. 32.

<sup>228</sup> Award in the case *Kuwait and the American Independent Oil Company (Aminoil)*, 21 I.L.M., p. 976 *et seq.* (1982), 77-78 p.1016 ; specially No.78 : “It is well known that any estimate in purely monetary terms of amounts intended to express the value of an asset, of an undertaking, of a contract, or of services rendered, must take equitable principles into account”. To the same effect, award in the case *Himpurna California Energy Ltd. (Bermuda) v. PT (Persero) Perusahaan Listrik Negara (Indonesia)*, 14 Mealey’s International Arbitration Report, A-1 *et seq.* 441, p. 129 [A-44] (1999).

<sup>229</sup> ICSID case ARB/84/3, *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, 8 ICSID Law Review-Foreign Investment Law Journal, p. 389, 215 (1993).

191. The Parties have not raised any dispute as to the fact that this market value is defined as the fair value of the transaction on an arms' length basis, where both parties to the transaction have knowledge of the applicable circumstances.<sup>230</sup> The Respondent acknowledges that the price obtained in a public tender "...is an efficient manner to determine the price of the assets sold..."<sup>231</sup> The Claimant has not challenged this allegation. The Arbitral Tribunal finds that upon the 1996 sale the Landfill's market value was US\$ 4,028,788, and will take that figure as the starting point for a subsequent analysis. The Arbitral Tribunal also finds, on the basis of the evidence submitted, that the existence of a market supported by a sufficient number of similar transactions that may be used as a guide to determine the Landfill's market value as of November 25, 1998, has not been established.

192. In the task of establishing the market value as of such date —the moment when the expropriatory act occurred—, the Arbitral Tribunal will also take into account other factors in accordance with the practice of international arbitral tribunals in similar cases.

193. For such purposes and on the basis of Article 5(2) of the Agreement, although the Arbitral Tribunal will consider the existence of community pressure against the location of the Landfill at its current place and that such pressures and the location would have jeopardized the operations of the Landfill in the long run, the Arbitral Tribunal will not necessarily take into account the actions or determinations of the Mexican authorities that, echoing the community sentiment, in turn exerted pressure on Cytrar for it to relocate or that are part of the Respondent's actions considered to be in violation of the Agreement in this award or that contributed to the damage resulting from such violations,<sup>232</sup> and that may have an adverse effect on valuation of the compensation. Upon weighing such community pressure, the Arbitral Tribunal cannot ignore the relocation commitment assumed by Cytrar, supported by Tecmed, the performance of which would have mitigated or eliminated such pressure, and whose non-performance is not attributable to Cytrar or Tecmed, nor the responsibilities of the Municipality of Hermosillo and of INE, as the case may be, that were involved in the sale of the site to Cytrar or that authorized Cytrar to operate the site under the premise that its location was legitimate despite the fact that it did not comply with Mexican laws. Such legitimacy was terminated by the Resolution which, in practice, ignored such legitimacy in order to address social and political factors against such location.

194. The Arbitral Tribunal will also take into account the additional investments made as from the Landfill's acquisition until the date of the Resolution and will consider that Cytrar has contributed management and client development elements that caused, among other things, a 39% increase in the Landfill's operation by 1997, excluding the activities related

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<sup>230</sup> American Appraisal report, p.2.

<sup>231</sup> Respondent's closing statement, 167, p. 76. Declaration of expert witness Christianson, hearing held from May 20 to May 24, 2002; transcript for the session of May 22, p. 50. Expert witness report of Fausto García y Asociados, p. 23.

<sup>232</sup> *Philips Petroleum Co. Iran v Iran*, 21 Iran-U.S. Claims Tribunal Reports, p. 79 *et seq.*, specially 135, p. 133 (1989-1).

to Alco Pacifico,<sup>233</sup> and that also produced net income in the second year of operations, i.e. during a stage of entry into and consolidation in the market at the beginning of its operations. It cannot be denied that the investment in the Landfill was productive and added value to the former Landfill's operations as well as goodwill, nor can it be denied that the Claimant was deprived of its investment's profits, and value added and goodwill, or that the Claimant's losses also include lost profits. As acknowledged by the Respondent itself, this operation almost did not exist for a long time before Cytrar's acquisition of the Landfill and, in the short periods in which it did exist, such activities were reduced in scope from a financial and business standpoint.<sup>234</sup> It is logical to understand that, as activities increased due to Cytrar's operations, this increase must have required additional investments. Although upon assessing the Landfill's market value two of the nine cells of the Landfill were full, thus reducing the original landfill capacity from nine to seven cells, it must also be taken into account that the increased productivity of the Landfill was evidenced after Cytrar took over the Landfill's operation. Such increased productivity is necessarily based on Cytrar's managerial and organizational skills and on gaining new clients, to the extent that the Respondent is willing to acknowledge at least net income for one additional year for an amount of US\$ 314,545.<sup>235</sup> On the basis of these considerations, it is legitimate to conclude that the Landfill's market value as of November 25, 1998, could not be lower than the acquisition price paid by Cytrar.

195. On the basis of its own valuation, taking into account the Landfill's market value of US\$ 4,028,788 upon its acquisition and adding the investments made thereafter according to Cytrar's financial statements for 1996, 1997 and 1998, and the profits for two years of operation following the Resolution date, the Arbitral Tribunal finds that such market value as of November 25, 1998, was US\$ 5,553,017.12.<sup>236</sup> Although the Claimant's expert witness assessed the value of such additional investments at US\$ 1,951,473,<sup>237</sup> no documentary evidence has been filed to support such amount, and such evidence has not been alleged by the Claimant in its closing statement. The Respondent challenges such amount in its closing statement on the basis of accounting data by comparing the fiscal years mentioned above, and estimates such amount to be US\$ 439,000.<sup>238</sup> This amount has been accepted by the Arbitral Tribunal. Regarding the profits for the two additional years of operation, the Arbitral Tribunal has calculated such profits at the amount of US\$ 1,085,229.12. For this, the Arbitral Tribunal has considered that an informed buyer of the Landfill would have assumed that it had to be relocated due to the community pressure and that such relocation might take about two years. In such calculation, the Arbitral Tribunal has further considered that the projections clearly stated that Cytrar was increasing its

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<sup>233</sup> Report of Fausto García y Asociados, p. 26.

<sup>234</sup> Respondent's brief "Admissions and Denials", p. 12.

<sup>235</sup> Counter-memorial, 598, p. 171.

<sup>236</sup> The Arbitral Tribunal finds that the Claimant has made its compensation claim in US dollars (memorial, p. 146), and that such claim has not been challenged by the Respondent, who also uses such currency in its allegations to denominate the amounts to which it resorts to challenge the Claimant's claims. The expert witnesses for both parties also translate into such currency the figures they use for their analyses. Therefore, the Arbitral Tribunal makes its determination in US dollars.

<sup>237</sup> Hearing held from May 20 to May 24, 2003; transcript for the session of May 23, pp. 7 overleaf / 8.

<sup>238</sup> Respondent's closing statement added by expert witness Lars Christianson, taken into account by the Arbitral Tribunal as a part of such closing statement according to the Arbitral Tribunal's decision of August 12, 2002, p. 8.

revenues, the value of its clientele and goodwill as an on going business related to the Landfill exploitation, and the other considerations included in this Chapter F, particularly the circumstances explained in paragraphs 189-190 and 193-194, which, in the opinion of the Arbitral Tribunal, cannot be ignored upon establishing the economic compensation owed to the Claimant for the loss of the market value of its investment. The Arbitral Tribunal finds that it is not appropriate to deduct from such amount, which also reflects the principle that compensation of such loss must amount to an integral compensation for the damage suffered, including lost profits,<sup>239</sup> the cost of closing down the Landfill due to a decision attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement.

196. The Claimant requests that any compensation awarded to it accrue compound interest at a rate of 6%.<sup>240</sup> The Arbitral Tribunal has not found any specific allegation by the Respondent regarding this point. The application of compound interest has been accepted in a number of awards, and it has been stated that:

...compound (as opposed to simple) interest is at present deemed appropriate as the standard of international law in [...] expropriation cases.<sup>241</sup>

In connection with this case, in the opinion of the Arbitral Tribunal, application of compound interest is justified as part of the integral compensation owed to the Claimant as a result of the loss of its investment.

197. Therefore, the amount of US\$ 5,533,017.12 will accrue interest at an annual rate of 6%, compounded annually, commencing on November 25, 1998, until the effective and full payment by the Respondent of all amounts payable by the Respondent to the Claimant under this award.<sup>242</sup>

198. The Arbitral Tribunal finds no reason to award compensation for moral damage, as requested by the Claimant,<sup>243</sup> due to the absence of evidence proving that the actions attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement have also affected the Claimant's reputation and therefore caused the loss of business opportunities for the Claimant. In addition, the Arbitral Tribunal has not found that the adverse press coverage for Tecmed or Cytrar of the events regarding the Landfill,

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<sup>239</sup> P.C.I.J., *Chorzów Factory* case, (1938) P.C.I.J., Ser. A, 17, p. 29, 47.

<sup>240</sup> Memorial, p. 146.

<sup>241</sup> Award in ICSID case ARB/99/6 *Middle East Cement Shipping and Handling Co.S.A v Arab Republic of Egypt*, April 12, 2002, 174 , p. 42, <http://www.worldbank.org/icsid/cases/awards.htm>. See also: award of December 8, 2000, in ICSID case ARB/98/4, *Wena Hotels Ltd. v Arab Republic of Egypt*, 41 I.L.M. 896 (2002), specially 128-129, p. 919; award in ICSID case No. ARB/96/1 *Compañía del Desarrollo de Santa Elena S.A. v Republic of Costa Rica*, 15 ICSID Law Review-Foreign Investment Law Journal, p. 167; specially 96-106, p. 200-202 (2000); award in ICSID case no. ARB(AF)/97/1 *Metalclad Corporation v United Mexican States*, 16 Mealey's International Arbitration Report, A-1; specially 128, pp. 41-42 (A-16) (2000).

<sup>242</sup> Award in ICSID case No. ARB/84 /3 *Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt*, 8 Foreign Investment Law Journal-ICSID Law Review, p 328, specially 234-235, p. 393 (1993).

<sup>243</sup> Memorial, pp. 141-142.

was fostered by the Respondent or that it was the result of actions attributable to the Respondent.

199. Promptly after effective payment to the Claimant of all sums payable to it by the Respondent under this award, the Claimant shall take all the necessary steps to transfer, or cause to be transferred, to the Respondent, or to a nominee designated by the Respondent, the assets forming the Landfill.

200. Taking into account that the Claimant has been successful only with respect to some of its claims and that the challenges or defenses filed by the Respondent were also admitted partially, each Party will bear its own costs, expenses and legal counsel fees. The costs incurred by the Arbitral Tribunal and ICSID will be shared equally between the Claimant and the Respondent.

### **G. Decision**

201. Therefore, the Arbitral Tribunal finds as follows:

1. The Respondent has breached its obligations under the Agreement set forth in Articles 4(1) and 5(1).

2. The Respondent will pay the Claimant the amount of US\$ 5,533,017.12, plus a compound interest on such amount at an annual rate of 6%, commencing on November 25, 1998, until the effective and full payment by the Respondent of all amounts payable by the Respondent to the Claimant under this award.

3. Promptly after effective and full payment to the Claimant of all sums payable to it by the Respondent under this award, the Claimant shall take all the necessary steps to transfer, or cause to be transferred, to the Respondent, or to a nominee designated by the Respondent, the assets forming the Landfill.

4. Each Party will bear its own costs, expenses and legal counsel fees. The costs incurred by the Arbitral Tribunal and ICSID will be shared equally between the Claimant and the Respondent.

5. Any claim or petition filed in this arbitration and not admitted herein will be considered rejected.

Rendered in Washington, D.C.

Mr. Carlos Bernal Verea  
Arbitrator  
Date and place of  
execution:

Prof. José Carlos Fernández-  
Rozas  
Arbitrator  
Date and place of execution:



Dr. Horacio A. Grigera Naón  
Chairman of the Arbitral  
Tribunal  
Date and place of execution