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International Arbitration Case Law

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WASTE MANAGEMENT, INC., V. UNITED MEXICAN STATES (ICSID CASE NO. ARB(AF)/00/3) AWARD

Case Report by María Lucila Marchini**
Edited by Ignacio Torterola ***

An Award rendered on April 30, 2004, under Chapter Eleven of the North American Free Trade Agreement ("NAFTA"), and in accordance with ICSID Arbitration Additional Facility Rules.

Tribunal:	Professor James Crawford (President), Mr. Benjamin R. Civiletti, Mr. Eduardo Magallón Gómez
Claimant's counsel:	Mr. Kemp Sawyers, Mr. J. Patrick Berry, Ms. Clara Poffenberger, Ms. Guillermina Calles, Ms. Lila Pankey, Ms. Sharon Katz, BAKER BOTTS LLP / Mr. Bob Craig, ASSISTANT GENERAL COUNSEL (WASTE MANAGEMENT, INC.) / Mr. Ulrich Brunnhuber
Defendant's Counsel:	Mr. Hugo Perezcano Díaz, Mr. Salvador Behar Lavalle, Ms. Adriana González Arce Brilanti, Ms. Alejandra Galaxia Treviño Solís, MINISTRY OF ECONOMY (MEXICO) / Mr. J. Christopher Thomas, Mr. Cameron Mowatt, Mr. Carlos García, Mr. Rolando García, THOMAS & PARTNERS / Mr. Sanjay Mullick, Mr. Stephan E. Becker, SHAW PITTMAN

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1. Facts of the Case

Acaverde was a Mexican company created in 1994, which was wholly owned subsidiary of Waste Management Inc. ("Waste Management" or "Claimant"), a Delaware corporation with interest in municipal waste disposal services in the United States and elsewhere. In February 1995, Acaverde concluded a Concession Agreement with the Mexican City of Acapulco ("the City") in the State of Guerrero ("Guerrero"), for the provision of waste disposal services, for the term of 15 years from the date of commencement of services.

In particular, Acaverde undertook to provide on an exclusive basis certain municipal waste disposal and street cleaning services in a specified area of Acapulco. Residents or businesses located in that area must request and pay for the cleaning service. In addition, it agreed to build and operate a permanent solid waste landfill for the City as a whole. In turn, the City would not grant to any other company or person any right or concession inconsistent with Acaverde's rights under the Concession Agreement, and it undertook to enact ordinances and local statutes to comply with such commitment. Also, the City would provide a site for the landfill as a gratuitous loan for the term of the concession. Pending the construction of the permanent landfill, Acaverde would be given, free of charge, access to one of the existing sites.

Acaverde assumed to make an initial investment of up to US$12.8 million under the Concession Agreement, and would pay the City a bonus calculated on the basis of its success rate in obtaining payment from customers in the concession area. In return, the City would pay Acaverde a monthly fee for the services. For that purpose, the City would negotiate with a development bank established by the federal government of Mexico, Banco Nacional de Obras y Servicios Públicos, S.N.C. ("Banobras"), an irrevocable, contingent and revolving line of credit to guarantee "all payment obligations" for the term of the Concession Agreement. In June 1995, the Line of Credit Agreement was issued. Guerrero, the City and Banobras were parties to that agreement. Despite the reference in the Concession Agreement to "all payment obligations", the Line of Credit Agreement only covered "an amount equal to six monthly payments agreed to for the services rendered".

Disputes under the Concession Agreement were to be submitted to arbitration under the rules of Conciliation and Arbitration of the National Chamber of Commerce of Mexico City ("CANACO"). In turn, disputes under the Line of Credit Agreement were referred to the federal courts of Mexico.

In August 1995, Acaverde began providing services under the Agreement. However, difficulties were encountered almost immediately: there was a strong customer resistance to pay for waste disposal services, and problems arose in enforcing the exclusivity arrangements. In addition, Acaverde complained at the City's failure to provide premises for Acaverde´s operations or to enter into the gratuitous loan agreement for the new landfill. It was clear that the arrangement was not commercially viable, but Acaverde's financial difficulties were exacerbated in ensuring regular payments from the City under the Concession Agreement – of 26 invoices presented by Acaverde, the City paid only one in full and made partial payments with respect to two.

In June 1996, Banobras paid invoices for the months January-April 1996 under the Line of Credit Agreement, reducing the City's indebtedness. In July 1996, Acaverde requested Banobras to pay the invoice for May 1996, and it made a series of similar requests for subsequent months. Nevertheless, Banobras denied Acaverde's requests based on what it had been stated to be already paid was not been reimbursed by the City, and because of the probable modifications that the parties to the Concession Agreement were considering in response to the City's financial crisis. For its part, the City wrote to Banobras requesting not to make further payments, because it considered that Acaverde's service was incomplete.

In October 1997, Hurricane Paulina struck the Acapulco region, causing hundreds of deaths and enormous destruction. At the same time, Acaverde announced that from the middle of November, it would suspend the provision of services under the Agreement. Setasa, a Mexican company, assumed the tasks Acaverde has been performing.

Approximately 80% of the total amount invoiced went unpaid. Consequently, Acaverde brought two sets of proceedings: one before the Mexican federal courts against Banobras, which was dismissed; and an arbitration proceeding against the City, which was discontinued. In September, 1998, while the Mexican proceedings were still pending, Waste

Management commenced the first ICSID arbitration, which was dismissed due to the pending proceedings and because further proceedings were possible[1]. In September, 2000, when Acaverde's claims were dismissed and discontinued, Claimant re-filed the arbitration under ICSID bringing precisely the same claim as it had in the first ICSID arbitration: it alleged that Mexico was liable under Articles 1110 and 1105 of NAFTA for the actions of various Mexican state organs.

2. *Legal Issues Discussed in the Decision*

(a) The status of the Claimant as an investor (paras. 40, 76-85)

Mexico contended that Claimant did not have an investor status for the purposes of Chapter 11 of NAFTA on the grounds that it did not have a direct interest in the investment in Mexico, because Acaverde's direct shareholder was a company registered in the Cayman Island, not a NAFTA Party. Much on the contrary, the Tribunal decided that Claimant was entitled to claim under Chapter 11 of NAFTA because the requirements for commencing arbitration under its provisions were fulfilled.

At the time it was incorporated, Acaverde was owned, through a holding company called AcaVerde Holdings Ltd, by Sun Investment Co., a Cayman island company. AcaVerde Holdings Ltd, also a Cayman Island company, was purchased by Sanifill Inc., a Unites States company, at about the time the City approved the concession. Subsequently, Sanifill merged with USA Waste Services Inc., and the merged company later adopted the name Waste Management Inc.

It was important to note that Chapter 11 distinguishes between claims brought by an investor of another Party in its own right, and claims brought by an investor on behalf of a local enterprise. It addresses situations where the investor is simply an intermediary for interest substantially foreign, and there is no hint of any concern that investments are held through companies or enterprises of non-NAFTA States, if the beneficial ownership at relevant time is with a NAFTA investor.

In addition, the nationality of the investment (as opposed to that of the investor) was irrelevant. Thus, when Article 1105 specifies the treatment to be accorded to "investment of investors of another Party", does not mean

[1] *See* Waste Management, Inc. v. United Mexican States, ICSID Case No. ARB(AF)/98/2, Award,

that the investment itself have the nationality of that Party either at the time it was acquired or at the time the conduct complained of occurs. The same applies to Article 1110 dealing with expropriation.

"Where a treaty spells out in detail and with precision the requirements for maintaining a claim, there is no room for implying into the treaty additional requirements"[2]. No such restrictions appear in the text. It was not disputed that at the time the actions said to amount to a breach of NAFTA occurred, Acaverde was an enterprise owned or controlled indirectly by the Claimant, an investor of the United States. The nationality of any intermediate holding companies was irrelevant. Moreover, it was irrelevant whether Mexico was aware of the investor's identity or national character. Therefore, Claimant was entitled to claim under Chapter 11 of NAFTA.

(b) The claim for breach of NAFTA Article 1105 (paras. 76, 86-140)

Claimant argued that its investment was subject to arbitrary acts by the City, by Guerrero and Banobras, which were capricious, lacking of due process of law and which rendered the investment valueless. Furthermore, it contended that Acaverde was subjected to a denial of justice. Firstly, the Tribunal considered the scope and interpretation to be given to Article 1105 (1), which deals with "Minimum Standard of Treatment" (i), and secondly, each Claimant's allegations of breach (ii).

(i) The scope and interpretation of NAFTA Article 1105

Article 1105 (1) states that "each party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security". The Free Trade Commission ("FTC") issued an interpretation of Article 1105 (1): "1. [it] prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party. 2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens". 3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105 (1)".

[2] Award, ¶ 85.

The interpretation given by the FTC has been discussed in subsequent ICSID decisions, such as S.D. Myers[3], Mondev[4], ADF[5] and Loewen[6]. Despite certain differences of emphasis among them, a general standard for Article 1105 emerged: "the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial property (…) In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied upon by the Claimant"[7].

The standard is a flexible one, and must be adapted to the circumstances of each case. Turning to the case at hand, the Tribunal noted that an important part of the background to the case was the Mexican financial crisis started at the end of 1994, with a substantial devaluation of the currency and which continued for several years. The effects to the City were numerous: tourism declined, its financial obligations under the Concession Agreement were substantially increased, and the federal revenues it received were substantially reduced. It is in that context that the Tribunal analyzed the conduct of Banobras, Guerrero, and the City to consider whether Mexico was in breach of Article 1105 (1).

(ii) The allegations of breach of Article 1105 (1)

Concerning the State of Guerrero, it was clear that it was neither a party to the Agreement nor a guarantor, and the Tribunal had not been provided with any evidence that supports any specific charge against it in terms of Article 1105 (1). As regards the conduct of Banobras and the City itself, the Tribunal concluded that did not violate Article 1105 standard. The eventual guarantee of Banobras was a more limited one, so it did not appear that it had any obligation beyond such figure. Moreover, Banobras complied at least to some extent with the terms of the Line of Credit, so the claim that

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[3] *See* S.D. Myers, Inc. v. Government of Canada, Partial Award, November 13, 2000.

[4] *See* Mondev International Limited v. United Stated of America, Award, October 11, 2002, 6 ICSID Reports 192.

[5] *See* ADF Group Inc. v. United Stated of America, Award, January 9, 2003, 6 ICSID Reports 470.

[6] *See* The Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID Case No. ARB(AF)/98/3, Award, June 26, 2003.

[7] Award, ¶ 98.

Mexico was in breach of Article 1105 (1) by reason of the conduct of Banobras must be dismissed. The position with respect to the City was more complex. The Tribunal highlighted that "investment treaties are not insurance policies against bad business judgments"[8], so the question was whether losses were caused to Claimant by the City in circumstances to a breach of the minimum standard of treatment embodied in Article 1105 abovementioned. In the Tribunal's view, the evidence before it did not support the conclusion that the City acted in a wholly arbitrary way or in a way that was grossly unfair. It performed part of its contractual obligations, but the failure to comply with some of them was due to the financial crisis.

However, a question remained whether the Mexican courts adequately responded to the situation presented by the conduct of Mexican authorities, or constituted a denial of justice so as to entail a breach of Article 1105 (1). As regards the arbitration proceedings against the City, the Tribunal found that the decision of discontinuance made by Claimant was on financial grounds, and did not implicate Mexico in any internationally wrongful act. Concerning the proceedings in the Mexican federal court against Banobras under the Line of Credit, the Tribunal did not discern in the decisions of the federal courts any denial of justice as that concept has been explained by the NAFTA tribunals mentioned before. The Mexican court decisions were not arbitrary, unjust or idiosyncratic; there was no trace of discrimination on account of the foreign ownership of Acaverde, and no evident failure of due process.

In sum, the CANACO arbitration, which alone held the prospect of complete relief for Acaverde in respect of its claims against the City, was not pursued. As to the Banobras litigation, Acaverde did exhaust its remedies, but it was not a denial of justice for the federal courts to insist on prior action against the City. Therefore, this aspect of the claim under Article 1105 (1) failed.

(c) The claim for expropriation: NAFTA Article 1110 (paras. 76, 141-178)

Claimant's principal contention was that Acaverde's entire enterprise in Acapulco was expropriated by the City or at any rate by the combined

[8] *See* Maffezini v. Spain, ICSID Case No. ARB/97/7, Award, November 13, 2005, 5 ICSID Reports 419, 432, ¶ 64.

conduct of the City, Guerrero and Banobras, and that was a breach of Article 1110[9] of NAFTA.

To find whether there was a breach of Article 1110, the Tribunal firstly analyzed the standard provided in that provision. It noted that its paragraph (1) distinguishes between direct or indirect expropriation on the one hand, and measures tantamount to an expropriation on the other. An indirect expropriation is still a taking of property. But where a measure tantamount to an expropriation is alleged, there may have been no actual transfer, taking or loss of property by any person or entity, but rather an effect on property which makes formal distinctions of ownership irrelevant. This was essential in the case at hand.

It was evident that the phrase "take a measure tantamount to nationalization or expropriation of such an investment" contained in Article 1110 (1) was intended to add to the meaning of the prohibition the reference to indirect expropriation, giving it a broad meaning. However, the Tribunal considered that it did not need to reach final conclusions on the meaning of the phrase since each case has to be looked at it in light of the factual situation. The question was whether the combined conduct of Mexican public entities had an effect equivalent to the taking of the enterprise, in whole or substantial part.

In second place, the Tribunal turned to the impact of the Mexican measures on Acaverde as a whole. In the present case, there was not an expropriation of physical assets, nor was there any direct or indirect expropriation of the enterprise Acaverde as such. The reason Waste Management withdrew from Acapulco was because the operation was persistently uneconomic. Thus, the remained question was whether there was any conduct

[9] Article 1110: "Expropriation and Compensation. 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6. (…) 7. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, or to the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with Chapter Seventeen (Intellectual Property). 8. For purposes of this Article and for greater certainty, a non-discriminatory measure of general application shall not be considered a measure tantamount to an expropriation of a debt security or loan covered by this Chapter solely on the ground that the measure imposes costs on the debtor that cause it to default on the debt".

tantamount to an expropriation, which might trigger NAFTA Article 1110. The Tribunal did not regard the conduct of Mexico as tantamount to expropriation of the enterprise as such. Acaverde at all times had the control and use of its property: "an enterprise is not expropriated just because its debts are not paid or other contractual obligations toward it are breached"[10]. There was no outright repudiation of the transaction. It was not the function of Article 1110 to compensate for failed business ventures, absent arbitrary intervention by the State amounting to a virtual taking taking or sterilizing of the enterprise. Consequently, the Tribunal did not accept that there was an expropriation of Acaverde in this case, or any measure tantamount to the expropriation of Acaverde as an enterprise.

Lastly, the Tribunal examined whether the persistent refusal or inability of the City to pay sums due under the Concession Agreement involved an expropriation, or at least measures tantamount to an expropriation, of the sums due. It concluded that it is one thing to expropriate a right under a contract and another to fail to comply with the contract. Non-compliance by a government with a contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation. In the case at hand, Claimant did not lose its contractual rights, which it was free to pursue before the contractually chosen forum. It is necessary to show an effective repudiation of the right, underdressed by any remedies available to the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent. This had not been shown, and therefore did not pass the test for an expropriatory taking of contractual rights.

In conclusion, "it is not the function of the international law of expropriation as reflected in Article 1110 to eliminate the normal commercial risks or a foreign investor"[11], or obliged Mexico to compensate for the failure of a business plan. There was not an expropriation by Mexico of Waste Management's property, assets or investment, or a measure tantamount to such expropriation, according to Article 1110. Therefore, the case on Article 1110 must fail.

3. Decision

The Tribunal unanimously decided to dismiss Waste Management's claim in its entirety. It determined that the conduct of Mexico, which was the

[10] Award, ¶ 160.

[11] Award, ¶ 177.

subject of the claim, did not involve any breach of Article 1105 or 1110 of NAFTA. The Tribunal concluded that each party should bear its own legal costs and expenses, and that the costs and expenses of the Tribunal should be borne equally between them.