

Date of dispatch to the parties: July 14, 2006

INTERNATIONAL CENTRE FOR SETTLEMENT
OF INVESTMENT DISPUTES
WASHINGTON, D.C.

IN THE PROCEEDING BETWEEN

AZURIX CORP.
(CLAIMANT)

AND

THE ARGENTINE REPUBLIC
(RESPONDENT)

ICSID CASE No. ARB/01/12

AWARD

Members of the Tribunal

Dr. Andrés Rigo Sureda, President
The Honorable Marc Lalonde P.C., O.C., Q.C., Arbitrator
Dr. Daniel Hugo Martins, Arbitrator

Secretary of the Tribunal

Ms. Claudia Frutos-Peterson

Table of Contents

I.	INTRODUCTION.....	1
II.	PROCEDURAL BACKGROUND	2
III.	BACKGROUND TO THE DISPUTE	10
IV.	PRELIMINARY OBSERVATIONS.....	13
	1. Responsibility of the Respondent for Actions and Omissions of the Province	13
	(a) Positions of the Parties.....	13
	(b) Considerations of the Tribunal.....	14
	2. Scope of the Jurisdiction of the Tribunal	15
	3. The ENRON relationship.....	17
	4. Corruption.....	17
	5. Argentina's Economic Crisis.....	18
V.	APPLICABLE LAW	18
	1. Positions of the parties	18
	2. Considerations of the Tribunal	20
VI.	THE FACTS	21
	1. The Takeover of the Concession	21
	(a) Positions of the Parties.....	21
	(b) Considerations of the Tribunal.....	24
	2. Measures related to the tariff regime.....	24
	(a) Zoning Coefficients.....	25
	(i) Positions of the parties	25
	(ii) Considerations of the Tribunal	28
	(b) Construction Variations: Resolution 7/00	29
	(i) Factual background	29
	(ii) Considerations of the Tribunal	31
	(c) Valuations 2000.....	32
	(i) Positions of the Parties	32
	(ii) Considerations by the Tribunal	33
	(d) Retail Price Index (RPI) issue.....	34
	(i) Background	34

	(ii) Positions of the Parties.....	36
	(iii) Considerations of the Tribunal.....	37
3.	The Works in Circular 31(A)	39
	(a) Bahía Blanca: Algae Removal Works.....	39
	(i) Positions of the Parties.....	39
	(ii) Considerations of the Tribunal.....	45
	(b) Moctezuma	47
	(i) Positions of the Parties.....	47
	(ii) Considerations by the Tribunal.....	50
	(c) Polo Petroquímico (“Polo”)	50
	(i) Positions of the Parties.....	50
	(ii) Considerations of the Tribunal.....	52
	(d) Florencio Varela	52
	(i) Positions of the Parties.....	52
	(ii) Considerations of the Tribunal.....	54
4.	Rejection of Financing by the Overseas Private Investment Corporation (“OPIC”) ..	55
	(a) Positions of the Parties.....	55
	(b) Considerations of the Tribunal.....	57
5.	Memorandum of Understanding (MOU)	57
	(a) Positions of the Parties.....	57
	(b) Considerations of the Tribunal.....	60
6.	The Program for Optimizing and Expanding Service (POES).....	61
	(a) Positions of the Parties.....	61
	(b) Considerations of the Tribunal.....	66
7.	Circular 52(A) and Canon Recovery	66
	(a) Introduction.....	66
	(b) Positions of the Parties.....	67
	(c) Considerations of the Tribunal.....	75
	(i) Circular 52(A): The Canon as an Investment	77
	(ii) The Addition of Article 12.1.1.	78
	(iii) Rationale of the Concession	79
	(iv) Article 7.8.....	82
8.	Termination	86
	(a) Introduction.....	86
	(b) Positions of the Parties.....	86

(c)	Considerations of the Tribunal.....	89
9.	Conduct of the Province after Service Transfer	92
(a)	Positions of the Parties.....	92
(b)	Considerations of the Tribunal.....	96
VII.	BREACH OF THE BIT	96
1.	Expropriation without compensation	96
(a)	Positions of the Parties.....	96
(b)	Considerations of the Tribunal.....	108
(i)	Interpretation of the BIT	109
(ii)	Effect, Intent and Duration of Expropriation Measures	109
(iii)	Breach of Contract and Expropriation.....	112
(iv)	Legitimate Expectations	113
2.	Fair and Equitable Treatment.....	116
(a)	Positions of the Parties.....	116
(b)	Considerations of the Tribunal.....	129
3.	Failure to Observe Obligations.....	137
(a)	Positions of the Parties.....	137
(b)	Considerations of the Tribunal.....	138
4.	Arbitrary Measures	139
(a)	Positions of the Parties.....	139
(b)	Considerations of the Tribunal.....	141
5.	Full Protection and Security	142
(a)	Positions of the Parties.....	142
(b)	Considerations of the Tribunal.....	145
VIII.	COMPENSATION.....	147
1.	Positions of the Parties.....	147
2.	Considerations of the Tribunal	149
IX.	INTEREST	157
X.	COSTS.....	157
XI.	DECISION.....	158

AWARD

I. Introduction

1. The Claimant, Azurix Corp., is a corporation incorporated in the State of Delaware of the United States of America (hereinafter “Azurix” or “the Claimant”). It is represented in this proceeding by:

Mr. Doak Bishop
King & Spalding
1100 Louisiana, Suite 4000
Houston, TX 77002
United States of America

Mr. Guido Santiago Tawil
M&M Bomchil
Suipacha 268, Piso 12
C1008AAF Buenos Aires
Argentina

2. The Respondent is the Argentine Republic (hereinafter “Argentina” or “the Respondent”), represented in this proceeding by:

Mr. Osvaldo César Guglielmino
Procurador del Tesoro de la Nación
Procuración del Tesoro de la Nación Argentina
Posadas 1641
CP 1112 Buenos Aires
Argentina

II. Procedural background

3. On September 19, 2001, Azurix filed a request for arbitration against the Argentina Republic, with the International Centre for Settlement of Investment Disputes (hereinafter the "Centre"). Azurix claims that Argentina has violated obligations owed to Azurix under the 1991 Treaty Concerning the Reciprocal Encouragement and Protection of Investment between the Argentine Republic and the United States of America (hereinafter "the BIT"), international law and Argentine law in respect of Azurix's investment in a utility which distributes drinking water and treats and disposes of sewerage water in the Argentine Province of Buenos Aires. Azurix alleges such breaches were made by Argentina both directly through its own omissions and through the actions and omissions of its political subdivisions and instrumentalities.

4. On October 23, 2001, the Secretary-General of the Centre registered Azurix's request for arbitration, pursuant to Article 36(3) of the ICSID Convention on the Settlement of Investment Disputes between States and National of other States (hereinafter "the Convention").

5. On November 12, 2001, the parties agreed that the Arbitral Tribunal would consist of three arbitrators, one to be appointed by each party and the third presiding arbitrator to be appointed by the Chairman of the Administrative Council of the Centre. Accordingly, the Claimant appointed Professor Elihu Lauterpacht, C.B.E. Q.C., a British national, and the Respondent appointed Dr. Daniel H. Martins, an Uruguayan national. Dr. Andrés Rigo Sureda, a Spanish national, was appointed President after consultation with the parties.

6. The Tribunal was deemed to have been constituted on April 8, 2002 and the proceeding to have commenced. On the same date, the parties were notified that Ms. Claudia Frutos-Peterson, Counsel, ICSID, would serve as Secretary of the Arbitral Tribunal.

7. In accordance with Arbitration Rule 13, the Tribunal held its first session with the parties in Washington D.C. on May 16, 2002. Mr. R. Doak Bishop of King & Spalding represented the Claimant at the first session, and Mr. Hernán Cruchaga and Ms. Andrea G. Gualde of the Procuración del Tesoro de la Nación, Buenos Aires, acting

on instruction from the then Procurador del Tesoro de la Nación, Dr. Rubén Miguel Citara, represented the Respondent at the first session.

8. At the first session, the parties agreed that the Tribunal had been properly constituted and that they had no objection to any of the members of the Tribunal, and it was noted that the proceedings would be conducted under the ICSID Arbitration Rules in force since September 26, 1984 (hereinafter “the Arbitration Rules”). In respect of the pleadings to be filed by the parties, their number, sequence and timing, it was announced after consultation with the parties that the Claimant would file its Memorial within 150 days of the date of the first session, the Respondent would file its Counter-Memorial within 150 days of the date of receipt of the Memorial, the Claimant’s Reply would be filed within 60 days of the date of receipt of the Counter-Memorial, and the Respondent’s Rejoinder would be filed within a further 60 days of its receipt of the Reply. It was further noted by the Tribunal that, in accordance with the Arbitration Rules, the Respondent had the right to raise any objections it might have to jurisdiction no later than the expiration of the time limit fixed for filing its Counter-Memorial. If such objections to jurisdiction were made by the Respondent and rejected by the Tribunal, it was agreed that the above timetable would be resumed following the resumption of proceedings on the merits.

9. In accordance with the timetable decided during the first session, Azurix filed its Memorial on the merits on October 15, 2002, claiming that Argentina had breached the BIT by expropriating its investment by measures tantamount to expropriation without prompt, adequate and effective compensation (Article IV(1)), by failing to accord to it fair and equitable treatment, full protection and security, and treatment required by international law (Article II(2)(a)), by taking arbitrary measures that impaired Azurix’s use and enjoyment of its investment (Article II(2)(b)), by failing to observe obligations Argentina entered into with regard to Azurix’s investment (Article II(2)(c)), and by failing to provide transparency concerning the regulations, administrative practices and procedures and adjudicatory decisions that affect Azurix’s investment (Article II(7)). In addition, Azurix requested orders for the payment of compensation for all damages suffered and the adoption by Argentina of all necessary measures to avoid further damages to Azurix’s investment. Azurix expressly reserved its right to request a

decision on provisional measures under Article 47 of the ICSID Convention and Arbitration Rule 39.

10. On March 7, 2003, Argentina filed a Memorial on jurisdiction raising two objections to the Tribunal's jurisdiction. The first was that Azurix agreed to submit this dispute to the courts of the city of La Plata and waived any other jurisdiction and forum; the second was that Azurix had already made a forum selection under Article VII of the BIT by submitting the dispute to Argentine courts. On March 12, 2002 the Tribunal suspended the proceeding on the merits pursuant to Arbitration Rule 41(3), and set dates for filing pleadings on jurisdiction. Accordingly, Azurix filed its Counter-Memorial on jurisdiction on May 13, 2003.

11. Azurix filed a request for provisional measures on July 15, 2003 (dated July 14, 2003), subsequently supplemented by two letters dated July 21 and 28, 2003. The request sought a provisional measure recommending that Argentina refrain from incurring by itself or through any of its political subdivisions in any action or omission capable of aggravating or extending the dispute, taking into account especially the reorganization of Azurix's Argentine subsidiary, Azurix Buenos Aires S.A. (hereinafter "ABA"), or any other measure having the same effect.

12. At the request of the Tribunal, Argentina filed observations on Azurix's request for provisional measures on July 24, 2003, seeking dismissal of the request for provisional measures together with costs and requesting that the Tribunal request the Claimant to produce an original copy of the Decision of the Appeals Chamber of the Province of Buenos Aires.

13. The Tribunal, in a decision of August 6, 2003, rejected Azurix's request for provisional measures, considering that, in the circumstances of the case and at that stage of proceedings, it was not in a position to recommend the specific measure requested or to propose others with the same objective. The Tribunal did, however, invite the parties to abstain from adopting measures of any character which could aggravate or extend the controversy submitted to arbitration, and took note of statements made by Argentina affirming that the Province of Buenos Aires (hereinafter "the Province") recognizes that the receivables for services rendered by ABA before

March 7, 2002 belong to ABA, and that those collected or to be collected in the future have been or will be deposited in a special banking account, and that the situation described in Azurix's request would not affect the enforceability or execution of any award rendered on the merits. The Tribunal postponed its decision on costs in respect of the provisional measures request to a later stage of the proceedings and considered it unnecessary to request the Claimant to furnish the Tribunal with the Decision of the Appeals Chamber.

14. Argentina filed its Reply on jurisdiction on August 4, 2003

15. Azurix filed a Rejoinder on jurisdiction on August 29, 2003.

16. The hearing on jurisdiction took place in London on September 9 and 10, 2003. The parties were represented by Messrs. R. Doak Bishop, Guido Santiago Tawil, Ignacio Minorini Lima and Craig S. Miles, on behalf of the Claimant. Messrs. Carlos Ignacio Suárez Anzorena, and Jorge Barraguirre, and Ms. Beatriz Pallarés, from the Procuración del Tesoro de la Nación, and Mr. Osvaldo Siseles, from the Secretaría Legal y Administrativa del Ministerio de Economía y Producción, represented the Respondent. On December 8, 2003 the Tribunal issued its Decision on Jurisdiction, which is part of this Award, declaring that the dispute was within the jurisdiction of the Centre and the competence of the Tribunal.

17. During the hearing on jurisdiction, the Respondent had requested an extension of 90 days to file its Counter-Memorial on the merits should the Tribunal find that it had jurisdiction. On December 8, 2003, the Tribunal issued Procedural Order No. 1 establishing the schedule for the further procedures on the merits. According to that schedule, the Respondent was granted an extension of 50 days and its Counter-Memorial on the merits was due within 60 days from the date of that Procedural Order; the Claimant was to file its Reply within 60 days from its receipt of the Respondent's Counter-Memorial, and the Respondent was to file its Rejoinder within 60 days from its receipt of the Claimant's Reply.

18. On February 9, 2004, the Respondent filed its Counter-Memorial on the merits. In the Counter-Memorial, Argentina requested the Tribunal to order the Claimant to produce all reports, analysis and other documentation related to the Claimant's

participation in the privatization of the water supply and sewerage services of the Province and the Claimant's IPO. The Respondent also requested, if considered appropriate by the Tribunal, that the Tribunal ask the United States Congress to furnish the reports related to ENRON's scandal and its relationship to Azurix.

19. On February 20, 2004, it was agreed that the hearing on the merits would take place in Paris from October 4 to 8, 2004 and, if necessary, extend it to October 11-12.

20. On March 8, 2004, the Tribunal invited Azurix to comment on Argentina's evidence request in the Counter-Memorial. Azurix objected to the request on March 15, 2004 and requested the Tribunal that, in case it would agree to Argentina's request, Argentina be invited in turn to produce all documentation related to AGOSBA's services, their privatization, the original setting of the tariffs, all documents of the Privatization Commission, the ORAB, and the files related to ABA, AGOSBA and ABSA. The Respondent commented on Azurix's objection on March 29, 2004 and manifested its willingness to request the Province to produce evidence that the Tribunal considered relevant under Arbitration Rule 34.

21. On March 29, 2004, the parties agreed to extend by three weeks the schedule for the presentation of the Reply and the Rejoinder.

22. On April 19, 2004, the Tribunal issued Procedural Order No. 2 inviting the Respondent to request the Province to furnish the documentation filed with the Province for participating in the bidding process (Envelop No. 1 –the technical offer- and Envelop No. 2 –the economic offer) ("Envelops No. 1 and No. 2"), and postponed consideration of the production of the remainder of the evidence requested until the Tribunal had an opportunity to review the Reply, which was due by May 7, 2004.

23. The Respondent furnished the documentation requested under Procedural Order No. 2 on May 17, 2004. At the same time, the Respondent requested that the Tribunal do not distribute such documentation until Azurix had furnished its own copies of Envelops No. 1 and No. 2. At this point, the Respondent alleged certain irregularities in Circulars 51(b) and 52(a) and pointed out changes in the Concession Agreement which were not part of the draft agreement included in the bidding documents.

24. On May 24, 2004, the Tribunal issued Procedural Order No. 3 requesting Azurix to furnish the Tribunal its own copies of Envelops No. 1 and No. 2 and withheld the documentation received from the Respondent.

25. Azurix, instead of presenting its own copies of Envelops No. 1 and No. 2, sought copies directly from the Province allegedly for convenience's sake. On May 31, 2004, the Respondent objected that, by seeking the documents from the Province, Azurix had not complied with Procedural Order No. 3, withdrew its request related to the production of Envelops No. 1 and No. 2, informed the Tribunal on irregularities it had detected in Envelop No. 2 and requested that the Tribunal charge to the Claimant the costs related to this procedural incident.

26. On July 24, 2004, the Respondent requested an extension of 10 days to file its Rejoinder. The extension was granted on August 10, 2004.

27. On July 29, 2004, the Tribunal issued procedural Order No. 4 rejecting the request for production of evidence formulated in the communication of the Respondent of July 22, 2004 because of its general nature and failure to justify it.

28. On August 3, 2004, the Secretariat notified the parties that Professor Lauterpacht had resigned as an arbitrator for health reasons, and suspended the proceedings in accordance with Arbitration Rule 10(2). On the same date, the Secretariat notified the parties that the Tribunal had consented to Professor Lauterpacht's resignation in accordance with Arbitration Rule 8(2). On August 4, 2004, Mr. Marc Lalonde, a Canadian national, was appointed as an arbitrator by the Claimant in replacement of Professor Lauterpacht. On August 10, 2004, the Tribunal was reconstituted and the proceedings were resumed.

29. On August 16, 2004, the Tribunal issued Procedural Order No. 5 rejecting a further Respondent's request, dated August 2, 2004, for production of evidence because it considered that it was not adequately justified even if more precise than the request of July 22, 2004. On the same date, Argentina notified the appointment of Mr. Osvaldo César Guglielmino as the Procurador del Tesoro de la Nación Argentina.

30. On August 17, 2004, the Respondent filed its Rejoinder on the Merits.

31. On August 23, 2004, the Respondent requested the Tribunal to reconsider Procedural Order No. 5. The Claimant reiterated its objections to the Respondent's request on August 26, 2004. The Tribunal, after considering anew the Respondent's request and having then had the opportunity to review the Rejoinder, issued Procedural Order No. 6, requesting the Claimant to submit, not later than September 17, 2004, the study prepared by Hytsa Estudios y Proyectos, S.A. ("Hytsa") referred to in paragraph 35 of the Rejoinder, and the Respondent to submit by the same date the bid evaluation reports related to each stage of the bidding for the Concession.

32. As previously decided, the hearing on the merits was held, from October 4-13, 2004, at the World Bank's office in Paris, France. Present at the hearing were:

Members of the Tribunal

Dr. Andrés Rigo Sureda, President

The Hon. Marc Lalonde, P.C, O.C., Q.C., Arbitrator

Dr. Daniel H. Martins, Arbitrator

ICSID Secretariat

Ms. Claudia Frutos-Peterson, Secretary of the Tribunal

On behalf of the Claimant

Mr. R. Doak Bishop (King & Spalding, Houston, Texas)

Mr. John P. Crespo (King & Spalding, Houston, Texas)

Mr. Craig S. Miles (King & Spalding, Houston, Texas)

Ms. Zhennia Silverman (King & Spalding, Houston, Texas)

Ms. Carol Tamez (King & Spalding, Houston, Texas)

Mr. Guido Santiago Tawil (M & M Bomchil, Buenos Aires, Argentina)

Mr. Francisco Gutiérrez (M & M Bomchil, Buenos Aires, Argentina)

Mr. Federico Campolieti (M & M Bomchil, Buenos Aires, Argentina)

Also attending on behalf of the Claimant

Mr. Steve Dowd (Azurix Corp.)

Mr. Lou Stoler (Azurix Corp.)

On behalf of the Respondent

Mr. Osvaldo César Guglielmino (Procurador, Procuración del Tesoro de la Nación, Buenos Aires, Argentina)

Mr. Raúl Vinuesa (Procuración del Tesoro de la Nación, Buenos Aires, Argentina)

Mr. Gabriel Bottini (Procuración del Tesoro de la Nación, Buenos Aires, Argentina)

Mr. Juan José Galeano (Procuración del Tesoro de la Nación, Buenos Aires, Argentina)

Mr. Ignacio Pérez Cortés (Procuración del Tesoro de la Nación, Buenos Aires, Argentina)

Ms. María Soledad Vallejos Meana (Procuración del Tesoro de la Nación, Buenos Aires, Argentina)

Also attending on behalf of the Respondent

Ms. Guillermina Cinti (Provincia de Buenos Aires)

Mr. Roberto Salaberren (Provincia de Buenos Aires)

Mr. Juan Carlos Schefer (Provincia de Buenos Aires)

33. On November 29, 2004, the Respondent filed an application to disqualify the President of the Tribunal under Article 57 of the ICSID Convention. In accordance with Arbitration Rule 9(6), the proceedings were suspended. Pursuant to Article 58 of the Convention, the co-arbitrators issued a Decision dated February 25, 2005 on the Challenge to the President of the Tribunal declining the Respondent's disqualification proposal, which was notified to the parties on March 11, 2005.

34. On March 14, 2005, the proceedings were resumed in accordance with Arbitration Rule 9(6).

35. On March 15, 2005, the Centre transmitted to the Tribunal the parties' Post- Hearing Briefs of November 29, 2004.

36. The Tribunal met in Washington, DC from September 7 to 9, 2005 to discuss a draft of this award, and decided to request Azurix to explain, not later than September 28, 2005, certain discrepancies in the amounts in the financial statements of ABA for fiscal years 2000 and 2001. Azurix furnished its explanation on September 27, 2005 and the Tribunal invited the Respondent to comment on it by October 17, 2005. The Respondent sent comments on October 14, 2005.

37. On April 17, 2006, the Tribunal declared the proceedings closed pursuant to Arbitration Rule 38. By letter of June 13, 2006 the Tribunal extended by a further 30 days the period by which the award would be drawn up, in accordance with ICSID Arbitration Rule 46.

III. Background to the Dispute

38. In 1996 the Province started the privatization of the services of Administración General de Obras Sanitarias de la Provincia de Buenos Aires ("AGOSBA"), the Province owned and operated company which provided potable water and sewerage services in the Province. The Province passed Law 11.820 ("the Law") to create the regulatory framework for privatization of AGOSBA's services. The future operator of the water services would be granted a concession which would be overseen and regulated by a new regulatory authority established for the purpose - Organismo Regulador de Aguas Bonaerense ("ORAB"). The concessionaire was required to be a company incorporated in Argentina. The Province engaged Schroeders Argentina S.A. ("Schroeders") as adviser for the privatization of AGOSBA and requested Schroeders to distribute an information statement to potential investors. Schroeders sent the information statement to ENRON Corporation ("ENRON") inviting this company to participate in the bidding. ENRON requested from a consulting company, Hytsa Estudios y Proyectos S.A. ("Hytsa") a preliminary report on the information furnished by the Province in the Data Room on AGOSBA and its operations.

39. The privatization process was conducted by the Privatization Commission, which tendered the concession on the international market on the basis of the Law and of a set of contract documents prepared in accordance with the Law by ORAB, including the Bidding Terms and Conditions and a draft Concession Agreement.

40. A bid offer was made by two companies of the Azurix group of companies established for this specific purpose: Azurix AGOSBA S.R.L. ("AAS") and Operadora de Buenos Aires S.R.L. ("OBA"). AAS and OBA are indirect subsidiary companies of Azurix. AAS is registered in Argentina and is 0.1% owned by Azurix and 99.9% owned by Azurix Argentina Holdings Inc. (a company incorporated in Delaware), which in turn is 100% owned by Azurix. OBA, also registered in Argentina, is 100% owned by Azurix Agosba Holdings Limited which is registered in the Cayman Islands. Azurix owns 100% of the shares in Azurix Agosba Holdings Limited.

41. Having successfully won their bid, AAS and OBA incorporated Azurix Buenos Aires S.A. ("ABA") in Argentina to act as concessionaire. On June 30, 1999, ABA (also referred to as "the Concessionaire") made a "canon payment" of 438,555,554 Argentine pesos ("the Canon") to the Province. On payment of the canon, ABA, AGOSBA and the Province executed a concession agreement ("the Concession Agreement") which granted ABA a 30-year concession for the distribution of potable water, and the treatment and disposal of sewerage in the Province ("the Concession"). Handover of the service took place on July 1, 1999.

42. Azurix declared to know and accepted the bidding conditions and committed itself to undertake all measures necessary to ensure that OBA would fulfill the obligations set forth in the bidding conditions and the Concession Agreement as operator of the Concession during the first 12 years of operation. Similarly, Azurix accepted to be jointly responsible for the obligations of AAS and that during the first six years of the Concession there would be no change in the control of AAS.

43. The Claimant contends that its investment in Argentina has been expropriated by measures of the Respondent tantamount to expropriation and that the Respondent has, in addition, violated its obligations, under the BIT, of fair and equitable treatment, non-discrimination and full protection and security; that such measures are

actions or omissions of the Province or its instrumentalities that resulted in the non application of the tariff regime of the Concession for political reasons; that the Province did not complete certain works that were to remedy historical problems and were to be transferred to the Concessionaire upon completion; that the lack of support for the concession regime prevented ABA from obtaining financing for its Five Year Plan; that in 2001, the Province denied that the canon was recoverable through tariffs; and that “political concerns were always privileged over the financial integrity of the Concession”,¹ and “[w]ith no hope of recovering its investments in the politicized regulatory scheme, ABA gave notice of termination of the Concession and was forced to file for bankruptcy”.²

44. The Respondent has disputed the allegations of the Claimant. For the Respondent, the dispute is a contractual dispute and the difficulties encountered by the Concessionaire in the Province were of its own making. In particular, the Respondent has argued that the case presented by the Claimant is intimately linked to Enron’s business practices and its bankruptcy; that the price paid for the Concession was excessive and opportunistic and related to the forthcoming IPO of Azurix at the time Azurix bid for the Concession through AAS and OBA and that the Concessionaire did not comply with the Concession Agreement, in particular its investment obligations, and the actions of the Province, including the termination of the Concession Agreement by the Province, were justified.

45. Before proceeding to examine the facts and the parties’ allegations, the Tribunal will make the following preliminary observations concerning the responsibility of the Respondent for actions or omissions of the Province, the scope of the jurisdiction of the Tribunal, the Claimant’s ENRON relationship, allegations of corruption, Argentina’s economic crisis and the law applicable to the merits of the dispute.

¹ Memorial, p.7.

² Ibid.

IV. Preliminary Observations

1. Responsibility of the Respondent for Actions and Omissions of the Province

(a) Positions of the Parties

46. The Claimant alleges that Argentina is responsible for the actions of the Province under the BIT and customary international law. Indeed, the definition of investment covers investments made in the territories of the parties to the BIT, and the BIT in its preamble refers to the territory of each of the parties in reference to its reach. Furthermore, Article XIII makes the BIT explicitly applicable to the political subdivisions of the parties. The Claimant also refers to the responsibility of the State for acts of its organs under customary international law and cites, as best evidence, Articles 4 and 7 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts of the International Law Commission (“ILC”) (“Draft Articles”).

47. The Claimant also notes the decision on the merits in *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (“*Vivendi*”) where the tribunal stated that: “It is well established that actions of a political subdivision of [a] federal state, such as the Province of Tucumán in the federal state of the Argentine Republic, are attributable to the central government.”³ The Annulment Committee confirmed that statement: “in the case of a claim based on a treaty, international rules of attribution apply, with the result that the state of Argentina is internationally responsible for the acts of its provincial authorities.”⁴

48. The Respondent has not disputed that the BIT applies to the Province or the responsibility of the central State for acts of provincial authorities under customary international law. The Respondent has based its counter-argument on the fact that the Claimant’s allegations are in all instances based on breaches of obligations contractually assumed by the Province. Hence, according to the Respondent, the Tribunal does not need to reach the stage of whether the BIT imposes absolute

³ *Compañía de Aguas del Aconquija, S.A. & Vivendi Universal v. Argentine Republic*, (ICSID Case No. ARB/97/3), Award of Tribunal of November 21, 2000. para. 49.

⁴ *Compañía de Aguas del Aconquija, S.A. & Vivendi Universal v. Argentine Republic*, (ICSID Case No. ARB/97/3), Decisión on Annulment, July 3, 2002. para. 96

responsibility on the central government for actions of a political subdivision because the Claimant has failed to allege facts that are attributable to the Argentine Republic under the BIT.

49. The Respondent considers that the Claimant takes for granted the highly debatable proposition that contractual breaches result in a violation of the BIT. The Respondent then refers, among others, to statements in the Annulment Decision in *Vivendi II* to the effect that: “As to the relation between breach of contract and breach of treaty in the present case, it must be stressed that Articles 3 and 5 of the BIT do not relate directly to breach of a municipal contract. Rather they set an independent standard”, and “A state may breach a treaty without breaching a contract, and *vice versa*, and this is certainly true of these provisions of the BIT... It may be that “mere” breaches of contract, unaccompanied by bad faith or other aggravating circumstances, will rarely amount to a breach of the fair and equitable treatment standard ...” From these statements, the Respondent concludes that “a claimant in similar cases may not invoke as events or facts giving rise to international responsibility the same facts that constitute a breach of contract ... international rules are ‘independent rules’. Therefore, a State’s international responsibility may not be asserted by disguising mere contractual breaches.” The Respondent concludes by recalling that to address the conflicts of a contractual nature raised by the Claimant, both ABA and Azurix have waived their right to submit them to any other jurisdiction other than the administrative courts of the city of La Plata.⁵

(b) Considerations of the Tribunal

50. The responsibility of States for acts of its organs and political subdivisions is well accepted under international law. The Draft Articles, as pointed out by the Claimant, are the best evidence of such acceptance and as such have been often referred to by international arbitral tribunals in investor-State arbitration. Moreover, Article XIII of the BIT states clearly: “This Treaty shall apply to the political subdivisions of the Parties.” This is not in dispute between the parties. The issue is whether the acts upon which Azurix has based its claim can be attributed to the Respondent. The

⁵ Counter-Memorial, paras. 932-937.

Respondent contends that such attribution is not feasible because all the acts are contractual breaches by the Province. This is a different matter to which the Tribunal will now turn.

2. Scope of the Jurisdiction of the Tribunal

51. The Tribunal recalls that its decision on jurisdiction is based on the finding that the Claimant had shown a *prima facie* claim against the Respondent for breach of obligations owed by Argentina to the Claimant under the BIT. In that decision, the Tribunal noted that:

“The investment dispute which the Claimant has put before this Tribunal invokes obligations owed by the Respondent to Claimant under the BIT and it is based on a different cause of action from a claim under the Contract Documents. Even if the dispute as presented by the Claimant may involve the interpretation or analysis of facts related to performance under the Concession Agreement, the Tribunal considers that, to the extent that such issues are relevant to a breach of the obligations of the Respondent under the BIT, they cannot *per se* transform the dispute under the BIT into a contractual dispute”.⁶

52. The Tribunal also recalls that Azurix and the Respondent have no contractual relationship. The Concession Agreement is a contract between the Province and ABA, and Azurix made certain commitments and undertook certain guarantees to the Province at the time of the bidding for and signature of the Concession Agreement. None of the allegations made by the Claimant refer to breaches of the Province in relation to Azurix itself. The obligations undertaken by the Province in the Concession Agreement were undertaken in favor of ABA not Azurix. As the Respondent itself has asserted, Argentina is not party to the Concession Agreement, and ABA is not party to these proceedings. Therefore, the underlying premise of Article II(2c) of the BIT – that a party to the BIT has entered into an obligation with regard to an investment – is in-existent. Neither the Respondent nor the Province, as a political subdivision of the Respondent, has entered into a contractual relationship with Azurix itself.

⁶ Decision on Jurisdiction, para. 76.

53. The Tribunal, in evaluating the facts and the allegations of the parties, is mindful that its task is to determine whether the alleged actions or omissions of the Respondent and the Province, as its political subdivision, amount to a breach of the BIT itself. For this purpose, and since the allegations of the Claimant are based on disputes related to the Concession Agreement, the Tribunal will need to determine the extent to which the Province was acting in the exercise of its sovereign authority, as a political subdivision of the Respondent, or as a party to a contract. As stated by the tribunal in the case of *Consortium FRCC c. Royaume du Maroc*, a State may perform a contract badly, but this will not result in a breach of treaty provisions, “unless it be proved that the state or its emanation has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign.”⁷ It should be noted, however, that this was not just any contract as between two private parties. It was a Concession Agreement embodying the tariff regime of the Concession and the actions taken by the Province were taken in its capacity as a public authority and by issuing resolutions through its regulator and decrees, actions which can hardly be treated as those of “a mere party to the contract.”

54. As noted earlier, Argentina has questioned the ability of a claimant to invoke as events or facts giving rise to international responsibility the same facts that constitute a breach of contract. The Tribunal has no doubt that the same events may give rise to claims under a contract or a treaty, “even if these two claims would coincide they would remain analytically distinct, and necessarily require different enquiries.”⁸ To evoke the language of the Annulment Committee in *Vivendi II*, the Tribunal is faced with a claim that it is not “simply reducible to so many civil or administrative law claims concerning so many individual acts alleged to violate the Concession Contract or the administrative law of Argentina”, but with a claim that “these acts taken together, or some of them, amounted to a breach” of the BIT.⁹ This is the nature of the claim in

⁷ *Consortium FRCC v. Royaume du Maroc* (ICSID Case. No. ARB/00/6), Sentence arbitrale, para. 65. See also *Impregilo S.p.A. v. Islamic Republic of Pakistan* (ICSID Case No ARB/03/3), Decision on jurisdiction (*Impregilo*), para. 260.

⁸ *Ibid.*, para. 258.

⁹ Decision of Annulment Committee, para. 112.

respect of which the Tribunal held that it had jurisdiction and which the Tribunal is obliged to consider and decide.

3. The ENRON relationship

55. Argentina has placed substantial emphasis on the fact that Azurix was a subsidiary of ENRON and has alleged that Azurix followed the aggressive and dubious practices of ENRON in its bidding for and subsequent operation of the Concession. For purposes of the dispute before this Tribunal and based on the documentation submitted by the parties, the Tribunal considers that nothing has been proven that relates the case before this Tribunal to ENRON's case. The proven facts are that ENRON was invited by the Province to bid for the Concession and ENRON declined in 2001 to guarantee a loan of Banco de la Nación Argentina to ABA under the program of the National Sanitation Works Agency ("ENOHSA") financed by the Inter-American Development Bank ("IDB").

4. Corruption

56. In 2002, at the time Argentina was preparing the Rejoinder on jurisdiction, it realized that Section 12.1.1 of the Concession Agreement was added after the award of the Concession. ABA's exemption of fines during the first six months of the Concession for failure to meet the Concession's performance standards was also added after the award of the Concession. The Tribunal was informed by Argentina that an investigation of this matter had been initiated by the office of the Procurador del Tesoro. During the hearing on the merits, and as a reaction to insinuations of corruption during the examination by Argentina of a witness presented by Argentina, counsel for the Claimant asked the witness whether to his knowledge there had been any corruption in connection with the award of the Concession. The witness replied that he was not aware of any improper conduct, and the Procurador General present at the hearing confirmed that the investigation was continuing but that no evidence of improper conduct had surfaced. No further information has been transmitted to the Tribunal.

5. Argentina's Economic Crisis

57. Argentina has pleaded that the institutional, social and economic crisis that it endured in the period 1998-2002 was the worst in its history.¹⁰ On the other hand, the Claimant has alleged that the Respondent deliberately confuses the economic recession starting in 1998 with the economic and political crisis that began in 2001. According to the Claimant, the recession and economic crisis took place after termination of the Concession Agreement, are irrelevant for the purposes of this arbitration and cannot justify the Province's breaches of the Concession Agreement. The Claimant further observes that Argentina does not claim any justification based on the recession and only notes it as a background fact.¹¹ The Tribunal notes that the parties have not argued that the actions of the Province, ABA or Azurix had been influenced by the economic crisis. The crisis may provide context to the dispute, but none of the parties has pleaded that the economic crisis was the cause of the actions taken by the Province, ABA or Azurix.

V. Applicable law

1. Positions of the parties

58. The Claimant has argued that Article 42 of the Convention, in its first sentence, directs the Tribunal to look first to the rules of law agreed by the parties. Since the parties have not agreed to the governing law, the Tribunal should apply the BIT as *lex specialis* between the parties, and international law. The BIT expressly requires Argentina to comply with international law, and the BIT and international law have been incorporated by Argentina in its domestic law.¹²

59. The Claimant refers, among others, to Professor Weil's opinion that: "the existence of a Bilateral Investment Treaty raises the question of compliance with the rights and obligations contained therein to the level of a matter under international law, with respect not only to relations between the States party to the treaty *but also to relations between the host State and the investor.*" According to the Claimant, the BIT

¹⁰ Counter-Memorial, para. 851, pp.243-245.

¹¹ Reply, pp. 193-194.

¹² Memorial, p. 149.

requires “the Argentine Republic to afford U.S. investors like Azurix treatment no less favorable than that required by international law, both with respect to investment generally, and in particular with respect to expropriations or measures tantamount to expropriation of an investment.”

60. The Claimant also relies on the statement of the Annulment Committee in *Vivendi II* on the law applicable to the determination of whether a breach of the BIT has occurred, “In such a case, the inquiry which the ICSID tribunal is required to undertake is one governed by the ICSID Convention, by the BIT and by applicable international law. Such an inquiry is neither in principle determined, nor precluded, by any issue of municipal law, including any municipal law agreement of the parties.”¹³

61. The Claimant adds that international law also applies under the second sentence of Article 42(1) of the Convention. The Claimant relies here again on the authority of Professor Weil,

“no matter how domestic and international law are combined, under the second sentence of Article 42(1), international law always gains the upper hand and ultimately prevails. It prevails indirectly through the application of domestic law where the latter is deemed consistent with international law or incorporates it. It prevails directly where domestic law is deemed deficient or contrary to international law. Thus, under the second sentence of Article 42(1), international law has the last word in all circumstances: international law is fully applicable and to classify its role as ‘only’ ‘supplemental and corrective’ seems a distinction without a difference.”¹⁴

62. The Respondent draws a different conclusion from the fact that the parties have not agreed on the applicable law. In such a case, the Tribunal shall apply “the law of the Contracting State party to the dispute, including its rules on the conflicts of laws, and such rules of international law as may be applicable.” (Article 42(1) of the Convention). In accordance with this article, the dispute is basically governed by Argentine law, which is also applicable to contractual matters and provincial

¹³ Ibid., p. 151.

¹⁴ Ibid., 155-156.

administrative law underlying the claim. However, the Respondent admits that the BIT is “the point of reference for establishing the merits of the Argentine Republic’s obligations in connection with Azurix’s investment. Non-contractual international law is relevant to the extent that the Treaty refers to it, or to the extent relevant to interpretation of the contract, or to the extent included in Argentine law.”¹⁵

63. In its Reply, the Claimant concurs in that the BIT is the point of reference to judge the merits and reaffirms that the BIT is the *lex specialis* between the parties. The Claimant is unsure about the meaning of “non-contractual international law” and affirms that all relevant international law may be applicable. The Claimant adds that customary international law provides a floor or minimum standard of treatment for foreign investment while the terms of the BIT may provide a higher standard.¹⁶

64. In its Rejoinder, the Respondent reaffirms its considerations in the Counter-Memorial whereby, pursuant to Article 42 of the Convention, “the dispute is basically governed by Argentine law which is also applicable to contractual matters and by the provincial administrative law underlying Azurix’s claim.”¹⁷

2. Considerations of the Tribunal

65. The Tribunal notes first the agreement of the parties with the statement that the BIT is the point of reference for judging the merits of Azurix’s claim. The Tribunal further notes that, according to the Argentine Constitution, the Constitution and treaties entered into with other States are the supreme law of the nation, and treaties have primacy over domestic laws.¹⁸

66. Article 42(1) has been the subject of controversy on the respective roles of municipal law and international law. It is clear from the second sentence of Article 42(1) that both legal orders have a role to play, which role will depend on the nature of the dispute and may vary depending on which element of the dispute is considered. The Annulment Committee in *Wena v. Egypt* considered that “The law of the host State can indeed be applied in conjunction with international law if this is justified. So too

¹⁵ Counter-Memorial, p. 47.

¹⁶ Reply, paras. 18-20.

¹⁷ Rejoinder, para. 21.

¹⁸ Section 31 and Section 75(22).

international law can be applied by itself if the appropriate rule is found in this other ambit.”¹⁹

67. Azurix’s claim has been advanced under the BIT and, as stated by the Annulment Committee in *Vivendi II*, the Tribunal’s inquiry is governed by the ICSID Convention, by the BIT and by applicable international law. While the Tribunal’s inquiry will be guided by this statement, this does not mean that the law of Argentina should be disregarded. On the contrary, the law of Argentina should be helpful in the carrying out of the Tribunal’s inquiry into the alleged breaches of the Concession Agreement to which Argentina’s law applies, but it is only an element of the inquiry because of the treaty nature of the claims under consideration.

68. Before the Tribunal considers the meaning of each of the standards allegedly breached by the Respondent, and because this discussion is closely related to the conflicting views of the parties on the facts of the dispute and their implications, the Tribunal will now consider at length the facts and then each of the standards of treatment of the BIT supposedly breached by the Respondent. In considering the allegations of the parties under each of the factual situations, the Tribunal will assess to which extent the established facts evidence actions on the part of the Province in the exercise of its public authority or as a party to a contract. The Tribunal will follow the order in which the facts have been presented in the memorials taking into account the witness statements, the documentation submitted, expert opinions and the written and oral arguments made by the parties.

VI. The Facts

1. The Takeover of the Concession

(a) Positions of the Parties

69. The Claimant has alleged that on the day of the transfer of the Concession, July 1, 1999, no representatives of the Province or AGOSBA were present to ensure an orderly and safe transfer. According to the Claimant, critical documents were burnt in the facility located at the Plaza San Martín, and in nearly all branches

¹⁹ *Wena Hotels Limited v. Arab Republic of Egypt*, (ICSID Case No. ARB/98/4). *Ad hoc* Committee Decision on Application for Annulment, dated February 5, 2002, 41 ILM (2002) p. 941.

tools and equipment to operate the Concession were missing. The Claimant alleges also to have found certain anomalies in the customer database, – i.e. the archives of large account customers were missing and so were the methodology for calculating VAT amounts, interest calculation, whether or not a property was a vacant lot, the due date of installments, etc. According to the Claimant, ABA communicated the specific deficiencies of the database to the MOSP and ORAB in October 1999 after it received an inadequate response from AGOSBA, and did not receive an “effective response” from either.²⁰

70. The Respondent has pointed out that Claimant alleged no difficulties at the takeover of the Concession in the request for arbitration, in the grounds for the termination of the Concession Agreement adduced by the Claimant or in the discussions on the Memorandum of Understanding (MOU). According to the Respondent, the execution of the Concession Agreement took place in the presence of all the relevant provincial authorities, the Concession area is very large and it was not possible for officials to be present physically at all locations, and the Bidding Conditions provided a remedy in Article 15.1.3 for such a situation. ABA never notified the Province of any conflict or negligence by the Province in connection with the takeover.

71. The Respondent affirms that all necessary information was made available to the bidders as part of the privatization related documentation and drawings and maps were made available to ABA on July 2, 1999 and that, in accordance with Section 2.4 of the Terms of Reference, Azurix acknowledged full access to all information and waived any claim to insufficient or non-delivery of information. The Respondent also points out that no claim was ever made in connection with defective equipment or tools and considers that the allegations of the Claimant in respect of the database are inadmissible. The Respondent refers in this respect to a communication of ABA to AGOSBA in terms that show deference and gratitude rather than offense for lack of cooperation. According to the Respondent, the database may have contained

²⁰ Memorial, pp. 25-29.

errors and defects but they were known to all bidders. The Respondent concludes by affirming that the takeover took place in a “context of mutual cooperation.”²¹

72. In its Reply, the Claimant alleges that the Respondent relies on formalisms. It disputes the meaning given by the Respondent to Article 15.1.1, since this section could only be invoked if the ‘legal’ transfer was not made. Equally, the Claimant considers misplaced the reference to Section 2.4, since this Section presumes good faith in the Province’s discharge of its duties and cannot be invoked when insufficient information was not received because of obstruction and sabotage by provincial employees.²² The Claimant contests the affirmation that no complaints were ever made. In fact, numerous complaints were filed with the Privatization Commission, the ORAB, the Provincial Governor and Argentine federal officials.²³

73. The Claimant admits in its Reply that 12,700 maps were received on July 2, 1999, but that they were in total disarray and ABA had to engage the services of Halcrow to digitalize and organize the documentation. The maps were old, outdated and failed to describe the current state of the Concession. In contrast, ABA’s employees were approached by former AGOSBA staff to offer them digitalized updated maps of the Concession, that, according to them, could substantially reduce the number of network expansions required under the Concession Agreement.²⁴

74. The Respondent in the Rejoinder reaffirms its understanding of Article 15.1.3 of the Bidding Conditions and disputes that it only applies to the “legal” transfer. The takeover was a defined term in the Concession Agreement: “The act whereby the Concessionaire assumes the provision of service according to Chapter 15.”²⁵ The Respondent confirms that all documentation, including blueprints, maps and the users’ database, was provided to the Concessionaire. ABA had the obligation under the Concession Agreement to digitalize the maps, and, if the Concessionaire employed Halcrow for this purpose, it was to fulfill an obligation not because the Province did not

²¹ Counter-Memorial, paras. 167-194.

²² Reply, paras. 76-77.

²³ Ibid., para. 68.

²⁴ Ibid., paras. 70-72.

²⁵ Rejoinder, paras. 148-152.

comply with providing the pertinent information.²⁶ The Respondent finds that none of the evidence provided by the Claimant shows that ABA voiced any complaints during the six-month period following the takeover. ABA did not even mention it at the time of submitting its First Five-Year Plan proposal.²⁷

75. The Respondent concludes by alleging that the evidence shows that the conflict identified as “takeover” was created by Azurix for these proceedings and that ABA and Azurix raised concerns about facts related to the takeover before provincial and federal authorities when their officers were warned about possible international arbitration proceedings.²⁸

(b) Considerations of the Tribunal

76. The Tribunal considers that the Claimant has failed to prove that the irregularities that may have occurred had the serious consequences that the Claimant has alleged and that can be attributable to the Province. The item with most serious implications would seem to be the destruction and removal of documentation, in particular of Concession’s maps. As admitted in the Reply, these maps were supplied by AGOSBA to ABA and ABA had the obligation to digitalize them. It would appear that the maps that the former employees had digitalized were more current than those furnished to ABA by the Province but no evidence has been furnished to the Tribunal showing that the alleged up to date maps offered by former employees of AGOSBA had been updated while in the service of AGOSBA and removed before the handover of the Concession, or that they were ever in the possession or control of the Province.

2. Measures related to the tariff regime

77. The measures under this heading include the elimination of zoning coefficients, the valuation applicable to non-metered customers whose property had undergone construction changes, the so-called Valuations 2000, and the RPI. The Tribunal will consider them in that order.

²⁶ Ibid., para. 170.

²⁷ Ibid., para. 185.

²⁸ Ibid., para. 186.

(a) Zoning Coefficients

(i) Positions of the parties

78. On April 9, 1999, the Privatization Commission issued Information Communiqué No.12 on zoning coefficients. This communiqué attached a list of coefficients that “will apply for the correction of fiscal valuation of property and allow for determining the billing ranges as per Sanitary Rates in each district to which AGOSBA provides services according to provisions of Act 10.474 Section 7”. The communiqué added: “Please note that the tariff scheme that shall apply to the Concession shall be the one contained in Annex Ñ, which does not contemplate any zoning coefficients.”

79. The Privatization Commission was asked the following question on Communiqué No. 12:

“Question No. 160: Annex Ñ Concession Contract. The information communiqué No. 12 leaves evidence that the tariff system, which will rule the concession, will be the one included in Annex Ñ, which does not contemplate zoning coefficients. Is it correct to assume that the new billing could surpass the one determined in the last billing previous to the taking over due to the fact that it was affected by such adjustment?”

80. On April 23, 1999, the Privatization Commission replied:

“It is clarified that as regards the tariff system, it is governed by what is established in Annex Ñ of the Concession Agreement and the tariffs set not only for metered system but also for the non-metered system in Section 4 of the aforesaid Annex should be especially taken into account.”

81. The Claimant concludes from this exchange that it was reaffirmed that Annex Ñ would govern the application of the non-metered tariff regime and that water bills would be increased for those persons who previously benefited from zoning coefficients.²⁹

82. According to Circular 59(A) of June 25, 1999, AGOSBA issued the first billing cycle after the transfer of the Concession so that the new Concessionaire would

²⁹ Memorial, p. 33.

have sufficient time to prepare. When ABA sent the bills for its first billing cycle (the second billing cycle after the transfer) without applying the zoning coefficients, consumers reacted badly to the resulting price increase. This event happened during the presidential campaign in which the governor of the Province, Mr. Duhalde, was running for president of the country.

83. On August 4, 1999, the ORAB issued Resolution 1/99. According to this resolution, ABA was precluded from billing amounts in excess of those amounts billed by AGOSBA for non-metered service prior to the granting of the Concession, and it ordered ABA to credit those amounts that exceeded AGOSBA's final billing for non-metered service during the month of August. ORAB based Resolution 1/99 on Article 4a-1 of Title II of Annex Ñ which states: "The tariff that results due to the application of the scale shall not exceed the one determined by the final billing prior to the Taking of Possession, for the same real estate, i.e., provided no building developments have been recorded."

84. ABA appealed administratively Resolution 1/99. ABA argued that Resolution 1/99 equated the terms tariff and bill, that a bill increase is not necessarily a tariff increase, that it did not change the tariff; and that it had simply eliminated the zone coefficient and, while the bills were higher, the tariff remain unchanged. The ORAB rejected the appeal by Resolution 2/00 of January 19/00 and dismissed ABA's interpretation of Annex Ñ as inconsistent with the regulatory framework promulgated by the Law.

85. The Claimant alleges that the action taken by the ORAB was politically motivated under pressure of the Government of the Province which was concerned that higher water bills would damage the chances of Mr. Duhalde in the presidential race. According to the Claimant, the press reported statements by the Minister of Public Works (MOSP) to the effect that the bills issued by ABA were incorrect and that consumers should not pay them until the issue was clarified (testimony of Mr. Castillo quoted in the Memorial p. 33). The Claimant further alleges that the Minister of MOSP

“wanted to ease and postpone the solution in any way” till after the presidential election.³⁰

86. The Claimant maintains that the action taken by ABA was correct and permitted under the Concession Agreement. The Claimant bases its position on the interpretation provided by Circular 27(A) and on the different meanings of the terms bill and tariff. Tariff is “a public document that includes a description of the company services, rates and charges, as well as the governing rules, regulation and practice in relation to those services”.³¹ It is inappropriate to use tariff as a synonym of rates or prices, “the tariff is nothing else that a list of prices or rates”.³² According to the Claimant, the ORAB contravened the Law by not providing a well-founded decision in dismissing the appeal of ABA as required by Chapter III, article 13-II of the Law.

87. The Respondent argues that the position of the Claimant has no basis on the Contract or on the Communiqué or the Circular. The Respondent first recalls that the non-metered system was a temporary system that should have been replaced 100% by a metered system by year five of the Concession, and that the Communiqué is not part of the contractual documentation of the Concession. In rejecting the understanding by the Claimant of the Communiqué and the Circular, the Respondent explains that, according to article 4 of Annex Ñ, the Concessionaire needed to follow two criteria for billing purposes: first, the bill should be the result of multiplying the presumed consumption by the price per cubic meter established on the basis of the valuation of the building concerned, and second, the resulting bill should not exceed that of the last bill prior to the takeover of the Concession. Thus, if the bill resulting from applying the values in the table included in article 4 exceeded the bill before the takeover, then the consumer should be charged only what had been charged then. The exceptions were only for new customers that, by definition, would not have received a bill prior to the Concession takeover, and in the case of construction variations which would affect the fiscal valuation of the building.

³⁰ Testimony of Mr. Guaragna quoted in the Memorial, p. 34.

³¹ L. Goodman, *The Process of Ratemaking*, Virginia: Public Utilities Reports, Inc. (1999) p. 45 quoted in the Memorial, p. 37.

³² Villegas Basavilbaso, *Derecho Administrativo*, vol. 3, p. 178, quoted by M. Marienhoff in *Tratado de Derecho Administrativo*, 1981, vol. II p. 133 (Exhibit 33 to the Memorial).

88. The Respondent expresses its inability to understand how the Claimant can rely on the distinction between tariffs and rates to justify its position. The Respondent agrees with the definition of tariffs and rates provided by the Claimant and affirms that the Province never maintained that these concepts were the same or were used indistinctly.³³ The Respondent cannot follow how a bill for a building for a non-metered service may be increased without at the same time increasing the tariffs.³⁴

89. The Respondent considers that it was always clear that Annex Ñ did not contemplate zoning coefficients and the clarification in Communiqué No.12 would have been unnecessary. This does not mean that bills for the first month of the Concession could be increased; the function of article 4 (a-1) was to avoid this effect.³⁵ Equally irrelevant, for purposes of the Claimant's interpretation, is Circular 27(A). This circular replied to the question by simply referring to the provisions of Annex Ñ, in particular what is provided in article 4.³⁶ According to the Respondent, once the appeal of Resolution 1/99 was rejected, the decision of the ORAB became administratively firm and unassailable under the administrative law of the Province.³⁷

(ii) Considerations of the Tribunal

90. Both parties agree that zoning coefficients are not included in Annex Ñ. They also agree on the meaning of the terms tariff, bills and rates. Communiqué No.12 was issued by the Privatization Commission at its own initiative, so it may have considered it necessary to point out that Annex Ñ did not include zoning coefficients. When applied to a bill, coefficients had the effect of reducing it. Hence the follow up question to the Privatization Commission - question No. 160 - specifically asking whether "Is it correct to assume that the new billing could surpass the one determined in the last billing previous to the taking over due to the fact that it was affected by such adjustment?" The Commission replied – item No. 20 of Circular 27(A) - by referring generally to the tariff regime in Annex Ñ and stating that "the tariffs set not only for the

³³ Counter-Memorial, para. 277.

³⁴ Ibid., para. 280.

³⁵ Ibid., para. 293.

³⁶ Ibid., para 297-298.

³⁷ Ibid., paras. 301-303.

metered system but also for the non-metered system in Section 4 of the aforesaid Annex should be especially taken into account”.

91. This statement evaded the answer to the question asked and left ample room for misunderstanding. The interpretation of paragraph 4(a) by the Claimant is based on the difference between tariffs and bills which is reflected in the terminology of the Concession Agreement. In the key subparagraph of article 4, we read: “the resulting tariff from the application of said scale shall not exceed that determined in the last billing...” The paragraph clearly refers to tariffs and billing as two different matters, what should not be exceeded is the tariff applied in the last billing, not the billing itself. This being the case, the reading by the Claimant of the Concession Agreement and of the information provided by the Privatization Commission would seem reasonable. Indeed, if there is a subsidy resulting from the application of a zoning coefficient and such subsidy ceases to be applicable, the bill will necessarily be higher without any increase in the underlying tariff. To interpret the Contract otherwise, it is to admit that the Information Communiqué No. 12 was openly misleading and Circular 27(a), at best, evasive.

92. To conclude, the ORAB provided an interpretation of the Concession Agreement not in accordance with the concepts of tariff, rates and bills underlying it and with the information provided the bidders at the time they prepared the tenders. The decision of ORAB seems to reflect a concern with the political consequences of the elimination of the coefficients rather than with keeping to the terms of the Concession Agreement.

(b) Construction Variations: Resolution 7/00

(i) Factual background

93. The Concession Agreement permitted the Concessionaire to re-categorize non-metered customers whose fiscal valuation had changed because of construction improvements. On February 17, 1999, March 8, 1999 and March 24, 1999, the Claimant requested the Privatization Commission for the updated records of property valuations of the *Dirección Provincial de Catastro Territorial* (DPCT). On May 5, 1999, the Commission issued Circular 44(A) stating that the records had not been updated since

1994 except for individual updates “which occurred on a daily basis by customers visiting local branch offices.”³⁸ Allegedly the Claimant continued to press for the records³⁹ and on June 23, 1999, the Commission issued Circular 58(A) with a CD containing the valuations of the DPCT.

94. Based on this information, ABA identified about 60,000 non-metered customers whose properties reflected a valuation increase. In January 2000, ABA informed the ORAB that it would re-categorize these customers into a higher tariff scale. On February 8, 2000, the ORAB issued Resolution 7/00 ordering ABA to abstain from re-categorizing these customers until the ORAB would have verified the valuation changes with DPTC. After three weeks, ABA appealed Resolution 7/00.

95. On March 17, 2000, the ORAB, by Resolution 15/00, authorized retroactive increases for construction variations of lands that were paying for the water service as uncultivated land and appeared as built lots in the CD attached to Circular 58(A). In these cases, it was evident that the different valuation was due to construction.

96. On June 26, 2000, the ORAB issued Resolution 54/00 rejecting the appeal of ABA. Resolution 54/00 recalled that, in the presentation made by ABA, it was not evident that the changes in fiscal valuation were due to construction variations and, therefore, the ORAB considered it necessary to conduct a study to determine the rationale of the variations. Resolution 54/00 affirmed that Resolution 7/00 only requested the Concessionaire to abstain from re-categorizing the properties and did not alter the procedure established in the Concession Agreement for the application of the valuations furnished by the Cadastre.⁴⁰

97. The study conducted by the ORAB revealed that 76% of the variations presented by the Concessionaire were due to construction on the properties concerned.⁴¹ On November 22, 2001, after ABA had terminated the Concession, the ORAB issued Resolution 62/01 authorizing the re-categorization of those properties subject to the approval of a business plan to mitigate the impact on users. ABA

³⁸ Memorial, p. 42.

³⁹ Idem.

⁴⁰ Counter-Memorial, paras. 321-325.

⁴¹ Ibid., para. 328.

presented the business plan on December 11, 2001. The ORAB requested further information on the plan on December 28, 2001. ABA responded on January 29, 2002. According to the Respondent, the relationship of ABA with the Province and the ORAB and the delivery of the service had deteriorated to such an extent that the ORAB requested the MOSP Undersecretary to include this matter among those to discuss between the Province and ABA.⁴² Thereafter, the MOSP Undersecretary advised ABA by letter not to proceed with the re-categorization. According to Azurix and based on press reports, the re-categorization took place once the Concession was transferred to Aguas Bonaerenses.

98. The facts as described have not been contested by the parties.

(ii) Considerations of the Tribunal

99. Resolution 7/00 did not refer to the reasons why the ORAB considered it necessary to verify the variations with DPCT. The Resolution ordered ABA to refrain from re-categorization until the ORAB had determined whether the variations were actually construction variations. The ORAB acted on the basis of an internal report of February 8, 2003 that alerted it to the fact that the CD attached to Circular 58(A) did not distinguish between variations in fiscal valuations for construction or other reasons. This simple factual information was not referred to in Resolution 7/00.

100. Construction variations had been the subject of several questions during the bidding process so a clear understanding of what the term meant seems to have been important from the bidders' point of view. According to Annex Ñ, the real estate fiscal valuations to be applied were those furnished by the DPTC. When the information was furnished to the bidders with Circular 58(A), this Circular did not refer to variations in fiscal value. When ABA identified the variations, it had no way to know whether they were caused by construction activity or other reasons. When the ORAB became aware of the issue, it would have seemed appropriate to base its reasoning on this fact, rather than to simply refer to the need to verify the valuation changes, which was understood as a delay tactic by the Concessionaire. The reason for the verification became only apparent when Resolution 15/00 was issued and the appeal was rejected.

⁴² Ibid., para. 332.

101. The ORAB proceeded to identify the previously uncultivated lots with relative speed as compared with the time that it took to verify the other valuation changes. Resolution 15/00 was issued within 5 weeks of Resolution 7/00. On the other hand, Resolution 62/01 was issued more than 21 months after Resolution 7/00. Even if the tariff increases could be applied retroactively and the number of variations to be verified was large, this seems to have been an unduly protracted process. The delay also meant that the application of the new level of tariff would result in larger amounts to be paid retroactively with the consequent negative perception from the consumers' point of view. When the ORAB authorized the re-categorization, a plan to mitigate the impact was required from ABA and, even when such plan had been approved by the provincial authorities, the re-categorization by ABA was not authorized by MOSP.

102. To conclude, the bidders were not provided with accurate information on the variations, and the Province seems to have engaged in a protracted dilatory process; first in identifying the construction variations and then in delaying the re-categorization. As in the case of the zone coefficients, the concern was on the political effect rather than with applying the terms of the Concession Agreement.

(c) Valuations 2000

103. The Concession Agreement specified that the 1958 valuations methodology or its equivalent be used to determine the appropriate tariff schedules for non-metered customers. The 1958 valuation was discontinued by the DPCT in early 2000 by law 12.397 of the Province.

(i) Positions of the Parties

104. The Claimant argues that the change in property valuation methodology caused a fundamental problem for ABA as it became impossible to apply accurately Valuations 2000 to the existing non-metered tariff scale.⁴³ The new methodology prevented the application of the tariff regime to new real estate created and to updated valuations for existing real estate that had experienced construction variances.⁴⁴ Since the Province did not provide an equivalent methodology, as required by the Concession

⁴³ Memorial, p. 50.

⁴⁴ Ibid. p. 51.

Agreement, ABA proceeded to prepare an equivalent methodology and presented it to the ORAB on November 22, 2000. According to the Claimant, the ORAB avoided responding on the equivalent methodology proposal notwithstanding persistent communications of ABA, and no determination was ever made by the ORAB.⁴⁵

105. The Respondent argues that it was not the role of ABA to prepare equivalent valuations and that the Concession Agreement was clear that the equivalent valuations had to be determined by the DPCT. Furthermore, the change to Valuations 2000 would have a minimum impact on the Concessionaire since it would only affect construction variations in existing properties and new properties in the Concession area. In any case, the Concession Agreement provided the way to calculate the applicable tariffs when there was inadequate real estate valuation. According to the Respondent, the methodology proposed by ABA was a disguised effort to increase tariffs, a fact that is denied by the Claimant.

106. The Respondent points out that ABA in fact made a proposal to value *ex officio* properties which had no valuation on February 29, 2000. The DPCT informed ABA that it could not decide on this matter because the system in effect did not permit the establishment of a valuation mechanism such as proposed by ABA. However, the ORAB, by Resolution 45/00 of June 13, 2000, permitted ABA and AGBA to carry out *ex officio* valuations as proposed by ABA.⁴⁶

(ii) Considerations by the Tribunal

107. The Province proceeded to change the valuation system in the first quarter of 2000, shortly after the Concession was awarded. The bidders were not informed of the upcoming change. When the change occurred no alternative methodology was provided. The complaint of Azurix seems to be more on the lack of a meaningful response by the Province than anything else. Even the arrangement proposed by ABA in February 2000 was put forward at its own initiative, although it was the Province's responsibility to provide alternative methodologies as explained by the Respondent. Irrespective of the merits of ABA's proposal and whether it meant a raise

⁴⁵ Reply, paras. 173-190.

⁴⁶ Counter-Memorial, paras. 345-371.

on applicable tariffs to the properties affected by the valuations, this tariff conflict could have been avoided by simply instructing the Concessionaire on what to do at the time the new law was issued and as part of its implementation. It seems that the administration of the Province was not very pro-active in search of solutions to a problem that the Province itself had created.

(d) Retail Price Index (RPI) issue

(i) Background

108. The Concession Agreement provides for extraordinary revisions of the tariffs on account of, *inter alia*, variations in cost indices. According to Article 12.3.5.1, the concept of such revisions is as follows: “These revisions shall be carried out where the Concessionaire or the Regulatory Entity alleges an increment or fall in the Concession cost indexes when its absolute value exceeds three per cent (3%), in accordance with the provisions set out in clause 12.3.5.2.” Article 12.3.5.2 sets forth the formula for the calculation of the percentage cost index variation. For this purpose, the formula uses as a basis 50% of the change in the Consumer Price Index of the United States and 50% of the change in the Producer Price Index, Industrial Commodities, also of the United States.

109. ABA requested the commencement of the procedures for the tariff review foreseen in Article 12.3.5.3 of the Concession Agreement on December 20, 2000 based on a 6.659% increase in the RPI. On January 3, 2001, the ORAB regulatory department noted in a letter to the Board of the ORAB that ABA had met the formal regulatory requirements of said article and was authorized to seek an RPI review.⁴⁷ On January 30, 2001, Mr. Pievani, the head of the economic regulation area of the ORAB, sent a further report to the ORAB president confirming the 6.659% RPI increase but considering the request inadmissible based on consequences related to the provision of the service and to the users, in particular, he referred to the Bahía Blanca incident, which is considered later in this award. On February 8, 2001, the President of the ORAB notified the MOSP Undersecretary of ABA’s request and recommended the denial of the tariff review. On February 27, 2001, the MOSP instructed the ORAB to solicit from ABA

⁴⁷ Exhibit 70 to the Memorial.

a detailed cost study justifying the impact of the variance of prices on ABA's cost structure, to conduct its own cost study and to condition the review and ultimate submission of the request to the Executive Branch on ABA's presentation of the cost study. On March 9, 2001, the ORAB notified ABA of the need to present a cost study.

110. ABA responded to the cost study request in a note to the ORAB, dated March 18, 2001, requesting ORAB to clarify the procedural or contractual framework on which ORAB based its request.⁴⁸ The ORAB reiterated the request for a cost study within five days on April 5, 2001. On April 16, 2001, ABA responded by explaining "the economic and financial principles behind the RPI adjustment as an integral element of price cap regulation and price controls, and the importance of the regulator's objectivity to insure the transparency of the regulatory process".⁴⁹ On May 14, 2001, ABA sent the ORAB a more comprehensive analysis of the economic and financial principles underlying inflationary adjustments and a discussion of the automatic and objective nature of the inflationary review process.⁵⁰

111. On May 30, 2001, the ORAB sent a letter to the MOSP Undersecretary informing him of ABA's concerns with the handling of the RPI request by the Province and requesting the advice of the provincial Organismos de Asesoramiento y Control (Asesoría General de Gobierno, Contaduría General and Fiscalía de Estado). After these organs had expressed their opinion, the ORAB issued, on October 24, 2001 (after ABA had terminated the Concession Agreement) Resolution 53/01 whereby it summoned ABA "to furnish the ORAB with a study on costs that warrant the incidence of such indexes on tariffs in order to verify the admissibility of an extraordinary tariff revision" within ten days under the penalty of the tariff revision request be disallowed. Since ABA did not provide the cost study requested, the ORAB issued Resolution 23/02 on March 26, 2002 (after the Province had taken over the Concession) dismissing the request.

⁴⁸ Memorial, p. 61.

⁴⁹ Ibid., p. 62.

⁵⁰ Ibid., p. 63.

(ii) Positions of the Parties

112. The controversy on the RPI is related to the extent that the review had an automatic character under the Concession Agreement. The Claimant argues that such review was automatic once the correctness of the elements underlying the percentage calculation had been verified, that this was an essential element of price-cap regulation and that there was no need to present a cost study. Such study was required only for the extraordinary tariff review foreseen elsewhere in the Concession Agreement. The Claimant notes that it was notified of the need of a cost study nearly three months after it filed its RPI request when in accordance to the contract the review of ORAB was to be completed within 30 days, and that the cost study was mandated by the MOSP Undersecretary but it did not figure in the ORAB's early evaluation of the review, nor in the separate report of Mr. Pievani. The Claimant alleges that the protracted process outlined by the Regulatory Group in the ORAB and the addition of a cost study were politically motivated and that there is no basis for them in the Concession Agreement. Furthermore, the public hearings do not have the role in the case of the RPI review attributed to them by the Respondent. Their objective is to provide transparency in the process of tariff reviews. According to the Claimant, the last paragraph of Article 12.3.5.3 proves that, once the revision is considered pertinent, the percentage of variation in the RPI had to be applied to the tariffs established in US dollars.

113. The Respondent has alleged that the procedure for the extraordinary tariffs reviews was common to all such reviews, and that there was no automatic raise of tariffs simply by the fact that a review had been triggered by a certain level of inflation. The steps required to be undertaken for such review were followed by the ORAB without the cooperation due by ABA to the regulatory organ of the Province and without any political motivation on the part of the Province which at all times followed the provisions of the Law and the Concession Agreement. The function of the public hearing goes beyond that attributed to it by the Claimant and it is the same for all tariff reviews. The ultimate decision to approve a tariff review request was the function of the provincial Governor.

(iii) Considerations of the Tribunal

114. As in the other controversies under the generic heading of tariff conflicts, the issues are based to a large extent on the interpretation of the Concession Agreement, in particular, Article 12. This Article has the following structure: General Principles (12.3.1), Procedure (12.3.2), Automatically Unacceptable Assumptions for Increases in the Tariffs and Prices (12.3.3), Ordinary Five-Year Reviews (12.3.4), Extraordinary Reviews based on Variations in the Indices of Costs (12.3.5), and General Extraordinary Reviews (12.3.6).

115. One of the general principles applicable to all revisions (“modificaciones”) is that revisions of the tariffs and prices can compensate only the costs arising from the delivery of the Service provided that there is compliance with the terms of the Agreement. The procedure to be followed is common for all revisions and includes, *inter alia*, the requirements that the revisions be based “on prior analyses and technical, economic, financial and legal reports, and on proof of the facts and actions that justify the revision”, and that there be an evaluation of the consequences that may result from the revision in respect of the delivery of the service and of the users. In addition, the proposed revisions shall be debated in a public hearing before the executive approves or rejects proposed revisions.

116. In the specific context of the revisions for reason of variations in the cost indices, Article 12.3.5.3 entitled “Verification of Revision Admissibility” provides that, once it is established that a variation is above the percentage set forth in Article 12.3.5.1, the procedure moves on to “the verification stage” where the ORAB is required to verify the existence of the elements that justify the revision in accordance with the general principles of Article 12.3.1 and the provisions of Article 12.3.5. Once the verification is completed, the ORAB shall determine whether the revision is justified and the modification to be introduced to the existing tariffs and prices. If the ORAB finds the revision justified, then a public hearing on the proposed revision should take place. The conclusions of the ORAB and the minutes of the hearing are sent to the executive which decides whether to agree to the revision or reject it.

117. It is evident from a reading of the contractual provisions that the Concession Agreement applies the same procedure to all reviews, therefore, a review for variations in cost indices is not more or less automatic than an ordinary five-year review. The elements that trigger the review are objective and whether a review should or should not take place could be seen as automatic once the correctness of the calculations have been verified, but this is the first step in the process. The ORAB then had to decide on the appropriateness of any revisions taking into account the general principles in Article 12.3.1, one of which is that modifications may only compensate for actual costs in the delivery of the service, and the consequences that the modification may have for service delivery and the users. The fact that the revision would be the subject of a public hearing and that the executive may or may not approve it show that a cost indices variation revision was not assured, under the terms of the Concession Agreement, to produce the result of simply transferring the variation in the costs indices to the tariffs and prices.

118. The parties have also argued whether the cost study requested from ABA by the ORAB was appropriate. The Claimant has placed special emphasis on the political motivation of the request since it was not in the original assessment of the ORAB. Given that under the terms of the Concession Agreement the ORAB was obliged to evaluate whether the modification based on variation in the cost indices was justified in terms of the general principle that modifications should reflect the costs of the service, the request would seem to be legitimate.

119. In interpreting the Concession Agreement and as affirmed by the parties and required by the Agreement itself, it is necessary to proceed with a harmonious reading of all the relevant provisions. While the last paragraph of Article 12 would seem to indicate that once the review is considered justified then the price index increase shall be applied to the tariffs retroactively as calculated, this provision cannot be read in such a manner as to contradict the general principle established in Article 12.3.1. The Tribunal is not convinced that the position taken by the Province would have changed the economic equilibrium of the Concession, as Azurix has claimed, as long as the principle to reflect actual cost variations due to inflation had been respected. In any case, this point is speculative since the review was never completed.

3. The Works in Circular 31(A)

120. The Privatization Commission issued Circular 31(A) on April 23, 1999 on the subject of works under execution. This circular lists works in progress for purposes of Article 15.3.1 of the Concession Agreement and explains that, once the works would have been completed, they would be transferred without charge to the Concessionaire. Each work is listed with the location, a brief description, the amount budgeted and the percentage of completion. It is disputed whether the works were ever completed. ABA either refused to accept them because it considered them defective, or accepted them provisionally, according to ABA, in order to prevent a collapse of the water supply system. We will consider each of these works in the sequence presented by the Claimant in its Memorial and the allegations made by the parties in their respect.

(a) Bahía Blanca: Algae Removal Works

121. The so-called “Algae removal works at the Paso de las Piedras Dam” in Circular 31(A) consisted of the construction of a micro-filtering plant, refurbishment of certain key aspects of the Patagonia WTP filters, the repair of the system that evenly distributes the incoming water between the two filtration modules at the Patagonia WTP (“the Equipartition system”), the modification of certain elements of the direct filtration system at the Patagonia WTP (“Direct Filtration”), and the construction of a chlorine dioxide dosing facility (“Chlorine Dioxide Dosing System”). The Province retained the responsibility for the operation of the Reservoir and supplying raw water to the Patagonia WTP.

(i) Positions of the Parties

122. In the Memorial, the Claimant alleges that the Algae Removal Works had serious defects in their design and construction. The Claimant gives as examples that the Micro-Filtration Plant as designed permitted raw untreated water to by-pass microfiltration, the Direct Filtration system was only partially completed and the items installed were never connected, the Equipartition System was only partially completed and did not allow even distribution of water to the filter modules, the Patagonia Filters were not completed, and the Chlorine Dioxide Dosing system was defective in its design and construction and posed operational safety hazards.

123. On August 24, 1999, explains the Claimant, ABA provided the ORAB with a list of necessary short-term corrective measures to be completed prior to ABA taking possession of the Algae Removal Works, including that the water level at the Reservoir was unusually low, the new Micro-Filtering Plant was overloaded, the sand filters at the Patagonia WTP were old and overloaded, and the repairs to the Equipartition system failed to evenly distribute water. ABA also proposed the creation of a technical committee for the operation of the dam and reservoir to define contingency plans for drought periods and determine minimum quality standards to be met by the raw water supplied by the Province.⁵¹

124. The Claimant alleges that the failure to complete the Algae Removal Works caused an extraordinary algae bloom in the reservoir on April 10-11, 2000 resulting in the water appearing cloudy and hazy and with earth-musty taste and odor. According to the Claimant, the complaints of the consumers were picked up by the press and politicians and it became a major media and political event. The Claimant contends that none of the factors that caused the algae bloom were subject to ABA's control nor could the algae bloom have been foreseen based on the information supplied by the Province. This notwithstanding, observes the Claimant, provincial officials issued statements that caused panic in the population and did not conform with the analyses of the provincial Central Laboratory of the Ministry of Health which had determined that, "although the Bahía Blanca network water is not drinkable from a physical/chemical standpoint, no microbial contamination that could cause infectious diseases was detected."⁵²

125. The Claimant points out that, as reported in the press, the Governor invited the citizens not to pay the bills, and that the ORAB ordered ABA to discount the invoices from April 12 until the ORAB deemed the drinking water to meet quality standards. The Claimant alleges that the ORAB took this action bowing to political pressure even if the president of the ORAB had indicated to the press that there were no grounds for a penalty because the quality parameters were in accordance with the

⁵¹ Memorial, pp. 71-73.

⁵² Ibid., Exhibit 104.

standards defined in the bidding terms and conditions.⁵³ On April 28, 2000, the ORAB, by Resolution 24/00, prevented ABA from invoicing any amounts until the service was normalized. The prohibition was lifted by Resolution 33/00, dated May 8, 2000. On May 18, 2000, at the request of MOSP, the Provincial Domestic Trade Bureau forbade ABA from invoicing and collecting for services until water quality was deemed acceptable to users.

126. The Claimant notes that this action was taken under the Consumer Defense Act which applies to situations not covered by a specific regulatory framework, and disputes the authority of the Provincial Domestic Trade Bureau to issue this measure because the ORAB had exclusive jurisdiction on billing matters. The Claimant also notes that the press reported that the governor was studying the means to remove the ORAB officials responsible for the decision to allow ABA to receive payments when the service was not in good condition and that a lawsuit was filed against these officials.⁵⁴ Under such pressure, ABA agreed with the ORAB to extend the service discount from May 5 to May 31, 2000 but stating that it did not accept responsibility for the water problems and reserved the right to seek reimbursement for its damages from the Province. On June 2000, the ORAB issued Resolution 43/00 ordering a 100% discount on invoices for services provided in Bahía Blanca and Punta Alta from April 12 through May 31, 2000.⁵⁵

127. The Committee of Control for Privatized Public Services and Companies, and the Consumer and User Defense Committee of the Provincial Legislature held hearings on the algae incident. According to the Claimant, ABA, MOSP and the ORAB were summoned to appear before said committees. MOSP and the ORAB arranged for a separate meeting closed to the public. In that meeting, the MOSP Minister stated:

“We are aware that, in association with the ORAB, we have forced certain decisions that are of a political nature, particularly by requesting the ORAB to apply a resolution whereby the Concessionaire is to receive no payment for each day in which water supply quality is not as agreed; by doing so, we breached the

⁵³ Ibid., p. 82.

⁵⁴ Ibid., Exhibit 127.

⁵⁵ Ibid., p. 83.

concession agreement, and this was a political decision. We took a step further beyond the general meaning of the agreement itself.”⁵⁶

According to the Claimant, the MOSP Minister also recognized that the problems that occurred had plid causes and the Mayor of Bahía Blanca attributed them to the lack of investments for many years.⁵⁷

128. In the Counter-Memorial, the Respondent recalls that, according to Circular 31(A), 98% of the works had been completed. This percentage reflected the fact that the Micro-Screening Plant of the Paso de las Piedras dam had been refurbished and started up by June 23, 1998, and on December 9, 1998 eight additional filters were released for use.⁵⁸ The Respondent points out that Azurix was aware of the condition of the works at the time it submitted the bid for the Concession and ABA had taken over the operation of the service, including algae treatment.⁵⁹

129. The Respondent explains that, under the Concession Agreement, the Concessionaire was responsible for carrying out all tasks to guarantee efficient provision to users, the protection of public health and the rational use of resources, and it was specifically responsible for the quality of unfiltered water and the quality and quantity of drinking water. The Respondent further notes that the Concessionaire was also responsible for the quality of unfiltered and drinking water taken from the Paso de las Piedras dam. The Respondent affirms, based on Article 1 of Exhibit O to the Concession Agreement, that “even when the Province was in charge of the operation and maintenance of the Dique Paso de las Piedras dam, the latter was explicitly exempted from any responsibility regarding the ‘quality and quantity of water delivered’ to the Concessionaire.”⁶⁰

130. The Respondent affirms that ABA infringed the biological parameters for drinking water required in the Concession Agreement. The Respondent points out that the audit report ordered by the ORAB stated that all water coming from superficial sources is susceptible of being treated for human consumption and what varies is the

⁵⁶ Ibid., p. 84, quote from the parliamentary record.

⁵⁷ Ibid., p.85.

⁵⁸ Counter-Memorial, paras. 605-606.

⁵⁹ Ibid., para. 607 and ff.

⁶⁰ Ibid., para. 624.

intensity of the required treatment. The same report considered that the Concessionaire managed the crisis in an improvised and imprudent manner and the measures adopted by ABA were not technically suitable to remedy the problem and, hence, the ORAB imposed a fine for not non-compliance with its obligations under the Concession Agreement.⁶¹

131. The Respondent further notes that a crisis in the drinking water supply is a serious and alarming event for the community and, if the image of ABA deteriorated in the eyes of the users, it was because of the negligent manner in which ABA addressed the problem.⁶²

132. In its Reply, Azurix alleges that the Province did not disclose to the bidders information in its possession related to the reservoir situation and points out that Argentina fails to recognize that the April 2000 algae bloom was an extraordinary occurrence that ABA could not predict or avoid on the basis of the information or assets under its management.⁶³

133. Azurix contests Argentina's assertion that since the beginning ABA was in charge of algae treatment operations. Azurix recalls that the Algae Removal Works were the exclusive responsibility of the Province, and the works that concerned the Patagonia plant were never completed. Furthermore, ABA could not avoid operating this plant in its existing condition because of its critical importance. Azurix also explains in this context that it needed the ORAB's prior permission for any operation to be carried out in connection with the Algae Removal Works and to access the Micro Filtration Plant facilities. The Claimant notes that this plant was never transferred to ABA and ABA was involved in its operation during the algae crisis in order to take emergency measures.⁶⁴

134. The Claimant disputes the interpretation of the Concession Agreement by the Province and argues that Article 3.6.1 only applied to raw water sources under ABA's management and considers it nonsensical the extension of ABA's obligation to sources exclusively controlled and operated by the Province. In fact, according to the

⁶¹ Ibid., para. 643 and ff.

⁶² Ibid., paras. 650-651.

⁶³ Reply, para. 318 and ff.

⁶⁴ Ibid., para. 326 and ff.

Claimant, none of the action that could have prevented the algae incident was under ABA's control: the Province had exclusive control of the dam and reservoir, could control agricultural run-off into the reservoir, fail to complete the Algae Removal Works and lowered the water level of the reservoir favoring algae blooms.⁶⁵

135. The Claimant explains that the fine imposed by the ORAB on account of the algae incident was imposed after the service had been transferred to the Province more than two years after the algae bloom event and four days before the deadline for filing petitions in ABA's bankruptcy proceedings. The Claimant also points out that the fine was in excess of the amounts permitted under the Concession Agreement. Azurix contests the grounds on which the fine was imposed. Azurix argues that the guidelines values in Table IV of Annex C to the Concession Agreement are only reference values in line with the World Health Organization (WHO)'s recommendations and that the Respondent turns them in strict limits.⁶⁶

136. The Claimant affirms that ABA took all measures required to remedy or mitigate the effects of the situation caused by the Province and that at no time was there any risk to public health, and observes that the Respondent relies exclusively on the audit report prepared by the ORAB to argue that ABA was negligent in dealing with the crisis. Azurix further observes that such report is not reliable given the lack of independence of the ORAB from the Province's political will.⁶⁷

137. The Claimant contests the Respondent's assertion that ABA voluntarily gave a discount to customers and affirms that ABA was forced by the ORAB to apply such discount to the water bills.⁶⁸ Furthermore, it is unacceptable to Azurix that public statements by officials with a view "to inciting fear, uncertainty and even violence against ABA" be described by the Respondent as "the free exercise of a democratic society's rights."⁶⁹

138. In the Rejoinder, Argentina reiterates in substance its previous arguments, mainly, that at the time of the bidding for the Concession the Algae Removal Works

⁶⁵ Ibid., para. 335.

⁶⁶ Ibid., para. 339 and ff.

⁶⁷ Ibid., para. 344-345.

⁶⁸ Ibid., paras. 346-347.

⁶⁹ Ibid., para. 352.

were 98% completed, that Azurix and ABA were aware of the condition of the works and submitted themselves to Section 2.4 of the Bidding Conditions,⁷⁰ that Azurix inspected the works before submitting its offer, that since the beginning of the Concession ABA was in practice responsible for the operation of the Service and the treatment of the algae, that the Concessionaire was responsible for the quantity and quality of raw water from the Paso de las Piedras dam even if the operation and maintenance was under the charge of the Province, that Table IV of Exhibit C to the Concession Agreement required that the drinking water had no phytoplankton and zooplankton, and that failure to meet these biological parameters meant that the ORAB was required to impose a fine.⁷¹

139. The Respondent alleges that the community unrest was not due to intervention of provincial officials, as claimed by Azurix, on the contrary, these officials were responding to the population concern over the foul smelling and tasting water. The Respondent argues that Azurix has admitted as much by recounting how the problem with the water smell and taste had “gradually attracted the attention of politicians and journalists and became an issue widely covered by the media.”⁷²

(ii) Considerations of the Tribunal

140. The allegations of the parties relate to their understanding of the Concession Agreement, the causes of the algae incident and the reaction of the provincial authorities.

141. It is a matter of dispute between the parties whether the Concessionaire was responsible for the quantity and quality of the water from a source not under its management. The dispute relates to whether Article 3.6.1 of the Concession Agreement applies to the raw water supplied from the Paso de las Piedras reservoir. The Tribunal notes that this Article does not differentiate between sources of raw water and Annex O specifically exempts the Province from responsibility from the quantity and quality of water supplied from said reservoir.

⁷⁰ This section provides, *inter alia*, that bidders by the fact of submitting a bid recognize that they had sufficient access to information to prepare it correctly and that the bid was based exclusively on their own investigation and evaluation.

⁷¹ Rejoinder, para. 630 and ff.

⁷² *Ibid.*, para. 636 and ff. Quote from p. 79 of the Memorial.

142. It is also disputed between the parties whether the Concessionaire breached the biological parameters set forth in Annex C to the Concession Agreement. The Tribunal has difficulty with the Claimant's understanding of the wording of Annex C and the concordant provisions in the Concession Agreement. Article 3.6.2 is very clear in requiring that the Concessionaire meet the parameters established in Annex C and in specifying that in all cases the failure to meet the technical parameters shall be considered a potential risk for the public health.

143. However, the Concession Agreement was based on certain factual assumptions that did not turn out to be correct. It is not contested that the Algae Removal Works were not completed notwithstanding that at the time of bidding for the Concession they were represented to be 98% complete and expected to be completed by April 1999, at least two months before the beginning of the Concession and a full year before the extraordinary algae bloom occurred. The reservoir was kept by the Province only 25% full to permit completion of the works. In turn the low water level contributed to the extraordinary nature of the algae bloom. The works undertaken by the Province had the objective to obtain treated water at the outlet of the Patagonia plant with "levels of the chlorophyll photosynthetic pigment below 1mg/m³, irrespective of the species or number of cells, pH, etc. present in the water." This objective was not achieved. The filters installed at the micro-filtering plant were inadequate for filtering algae, a fact on which the ORAB and the consultants of Azurix agreed. The Bahía Blanca Drinking Water Supply Monitoring Report prepared by the ORAB noted that it had not found domestic or international precedents where these micro-filtering systems were used for the primary elimination of this type of plankton organisms.⁷³ Similarly, the report prepared by the consulting firm JVP employed by ABA concluded that the direct filtration system at Paso de las Piedras was not fit for the treatment of water because of the high concentration of algae/chlorophyll reaching the Patagonia plant due to the properties of the water from the reservoir and the removal capacity of the micro-screens system.⁷⁴ Since August 1999, ABA had repeatedly advised the ORAB, to no avail, of the measures necessary for ABA to take possession of the Algae Removal Works. For

⁷³ Halcrow Report, p. 32. Exhibit 90 to the Memorial.

⁷⁴ Ibid., p.33.

instance, in a letter to the ORAB dated August 24, 1999 (less than two months into the Concession and eight months before the April 2000 incidents) ABA alerted the ORAB that there was an increase in “the algae problem” due to the unusual low level in the reservoir.⁷⁵ In the same vein, ECODYMA, the contractor engaged by AGOSBA to carry out the Algae Removal Works, wrote to the General Administrator of Sanitary Works of the Province on July 19, 1999 to bring to her attention that the quality of the water of the reservoir did not meet the standards used as a base for its bid because of the high level of turbidity of the water and the algae bloom in large number and variety.⁷⁶

144. Given this factual situation, the reaction of the provincial authorities shows a total disregard for their own contribution to the algae crisis and a readiness to blame the Concessionaire for situations that were caused by years of disinvestment and to use the incident politically, as admitted by the MOSP Minister in hearings held by commissions of the provincial parliament on the algae incident. It equally shows the willingness of high placed provincial officials, including the Governor, to interfere in the operation of the Concession for political gain whether by forcing ABA not to bill the customers or threatening the staff of the ORAB for lifting the billing interdiction. These actions by the Province are clearly actions taken in use of its public authority and go beyond the contractual rights as a party to the Concession Agreement. The Tribunal understands that governments have to be vigilant and protect the public health of their citizens but the statements and actions of the provincial authorities contributed to the crisis rather than assisted in solving it.

(b) *Moctezuma*

(i) *Positions of the Parties*

145. As explained by the Claimant in its Memorial, the works as described in Circular 31(A) included two elements: “Drilling Construction Works” and “Construction of Aqueduct and Injection Pipelines”. These works were only 10% and 25% completed according to Circular 31(A). The drilling component consisted of drilling 16 wells capable of extracting 300 m³ per hour. Under the drilling contract, AGOSBA had the

⁷⁵ Exhibit 94 to the Memorial.

⁷⁶ Exhibit 95 to the Memorial.

right to reject the work performed if the water flow was lower than 50% of the required capacity or the water did not meet sanitary requirements. The aqueduct was intended to transport water from Moctezuma to the cistern in Carlos Casares for delivery to this town and the town of Pehuajó. These works were to be completed in 18 months, by June or early July 2000.

146. According to the Claimant, on March 14, 2000, AGOSBA informed the ORAB that there would be a two-month delay and the works would be completed by September 2000. The dateline was postponed further and the Claimant finds it disconcerting that the ORAB, instead of pressing the Province to fulfill its obligations, informed ABA that “Azurix [sic] cannot assert completion of works as the grounds of non-compliance of the parameters for water quality in such localities.”⁷⁷ The completion occurred nearly 18 months after the original completion date and after ABA had terminated the Concession. The Claimant explains that ABA was willing to accept the works provisionally subject to a technical and functional evaluation and that the evaluation performed on January 3, 2002 showed that the works were unsuitable for the purpose and were not accepted by ABA. In particular, the wells could supply only a third to half the agreed water flow.⁷⁸

147. In the Counter-Memorial, Argentina describes a different situation. It refers to the study submitted by ABA to the ORAB in May 2000 where it acknowledges that the wells have been drilled and 13 km. of aqueduct completed. In the same study, ABA recommended to cut the extraction of water by 50% to preserve the geological reserves. The works were completed and ABA was notified on October 2, 2001. ABA accepted the works provisionally on October 10 because it had terminated the Concession on October 5. The civil works were completed by end of August but the electricity connection could not be installed because of flooding in the area. The External Audit of September 2001 presented by ABA to the ORAB states that access to some drillings was not gained because they were in a flooded area. The works were not essential to meet service quality targets because of the 3-year exemption in Annex F of

⁷⁷ Ibid., pp. 89-90.

⁷⁸ Ibid., pp. 90-91.

the Concession related to physical and chemical parameters of water quality. ABA was never penalized nor has Azurix claimed any damages on this account.

148. In its Reply, Azurix points out that Argentina has failed to mention that the wells were expected to solve quantity of water issues and not only quality, and that the quality of the water did not comply with the parameters originally provided in the work specifications.⁷⁹ The fact that there was no deadline in Circular 31(A) does not mean that this Circular can be considered in isolation of the contracts and specifications for the works in question. The flooding only took place after April 15, 2001, more than eight months after the expiration of the deadline and after the works had been suspended because of lack of payment to the contractor.⁸⁰ Azurix maintains that ABA did not even accept the works provisionally but “subject to the conditions mentioned in Note GRP 1882/01, particularly its completion in accordance with the specifications and the contract signed for their execution...”⁸¹ As already pointed out, the ORAB warned ABA that non-completion of the works in Moteczuma could not be used as excuses for non-compliance with water quality parameters. The ORAB also determined that there was decreased pressure in the cities of Pehuajó and Carlos Casares and ordered ABA to solve this issue. ABA had to drill five new wells, implement a pumping scheme to optimize drinking water distribution in Pehuajó, and started the construction of an arsenic treatment plant because the Moctezuma wells failed to meet the standard required in relation to arsenic levels.⁸² According to the Claimant, the worst part was the damage to the image of ABA among the customers since the works had been presented by the Province as the solution to the water problems of the previous 40 years and created high expectations among the authorities and local people.

149. Argentina in its Rejoinder claims that the temporary acceptance of the works on October 10, 2001 was linked to the unilateral termination of the Concession 5 days earlier and that the additional works and studies claimed to have been necessary because of the deficient Moctezuma works were already included in the Five-Year Plan presented by ABA to the ORAB in November 1999. No fine was ever imposed on ABA

⁷⁹ Reply, para. 355.

⁸⁰ Ibid., paras. 365-366.

⁸¹ Ibid., para. 368.

⁸² Ibid., p. 120 footnotes 382 and 383.

related to the alleged consequences of the Moctezuma works on ABA's delivery of services. The only fines were related to the interruption of service because of breakage of the Nueve de Julio aqueduct on May 2 and June 29, 2000 because of improper operating procedures. The breakage happened before the original delivery dates.⁸³

(ii) Considerations by the Tribunal

150. It is accepted by the parties that the works were late. It is clear from the evidence presented that the works stopped first because the contractor was not paid by the Province and later because of flooding. It is also clear that the quantity of the water that could be extracted from the wells was below expectations. For the Tribunal this is a simple contractual matter not involving the exercise of the provincial public authority.

(c) Polo Petroquímico ("Polo")

(i) Positions of the Parties

151. AGOSBA had entered into an agreement with Profértil and the Province for the supply of industrial water for a fertilizer plant under construction. The water supply contract was assigned to ABA as part of its takeover of the Concession. To meet the water requirements, the Province had started construction of an aqueduct which was listed as 95% complete in Circular 31(A). Azurix claims that the Province failed to deliver the aqueduct. In a letter of August 25, 1999 to ABA and AGOSBA, Profértil noted the defects "in the construction and design of the Industrial Aqueduct and the inferior quality of the equipment and materials used". In January 2000, ABA informed Profértil that the aqueduct did not meet the requirements to provide the service and it would not be possible to supply Profértil with the quantity and quality of water agreed by the Province. Azurix received the Industrial Aqueduct in March 2000 provisionally and subject to "final acceptance upon the satisfactory result of routine technical evaluation and the Province assuming full responsibility for any service failures not caused by ABA".⁸⁴ On August 2000, the Province, Profértil, PBB and Polisur (other industries in the Polo) signed a letter of intent to construct a new pipeline. Azurix considers this fact as an admission that the existing aqueduct was "not fit for its intended purpose". Azurix

⁸³ Rejoinder, para. 661.

⁸⁴ Memorial, p. 92.

lists a series of steps that it took to minimize the deficiencies of the aqueduct, including the building of a by-pass between the aqueduct and an existing water pipeline, and supplying the companies in the Polo with industrial water while bearing the cost of the raw water paid to the Province.⁸⁵

152. Argentina points out that pursuant to Article 15.4.1 of the Concession Agreement, the contracts signed by OSBA listed in Annex N would be transferred to the Concessionaire. Circular 39(B), item 2, Annex O, established guidelines for the supply of industrial water to the companies in the Polo. The guidelines established the price to be paid to the Province and the responsibility of the Province for the amount of water delivered. The quality of the water should be that of water in its natural state at the Paso de las Piedras dam treated at the micro-screening plant.⁸⁶ The President of the ORAB informed ABA about the transfer of the aqueduct on March 28, 2000. In the “Inventory of Fixed Assets” of ABA, the aqueduct was listed as an asset assigned to the Concession with April 15, 2000 as “Date of Origin” and in excellent condition.⁸⁷ Argentina argues that ABA tried to generate conflicts with Profértil because it did not consider the contract advantageous, and with the Province to renegotiate the Concession.⁸⁸

153. Azurix in its Reply reaffirms that the poor condition of the work prevented adequate service provision to the industries in the Polo. In addition, the deficient operation of the dam affected the quality of the water to such an extent that ABA could not “invoice the industrial water it delivered in order not to become committed to an operation that it could not guarantee through the Province’s facilities”.⁸⁹ Furthermore, the commercial negotiations that ABA may have held with the industries of the Polo are alien to the issues raised by Azurix. There is no doubt that the deficiencies experienced by the aqueduct created a negative image of ABA in the eyes of the industries located in the Polo.⁹⁰

⁸⁵ Ibid., pp. 93-94.

⁸⁶ Counter-Memorial, para. 196.

⁸⁷ Ibid., para. 698.

⁸⁸ Ibid., paras. 699-704.

⁸⁹ Reply, para. 384.

⁹⁰ Ibid., para. 388.

154. In the Rejoinder, Argentina reaffirms its previous arguments on the assignment of the contract and ABA's acceptance of the aqueduct. If ABA had made investments to ensure the continuity of service, it is because ABA considered it necessary to comply with its obligations. They are not the Province's or Argentina's responsibility.

(ii) Considerations of the Tribunal

155. The Tribunal considers that the fact that the Province agreed to build a new aqueduct proves that the one delivered to the Concessionaire was inadequate. The tests conducted by ABA, which have not been disputed by Argentina, provide also evidence of the low level of pressure acceptance by the water pipeline. The letter of August 1999 from Profertil to AGOSBA and ABA speaks by itself and its content has not been refuted by Argentina. However, this is a matter of a contractual nature that does not go beyond the relationship between the parties to the Concession Agreement acting as such.

(d) Florencio Varela

(i) Positions of the Parties

156. This component of work in progress for which AGOSBA took responsibility consisted of drilling four wells. According to the drilling contract, the wells were to be completed in 180 days from the date of the contract, December 30, 1998. Circular 31(A) stated that the wells were 70% completed, which Azurix disputes. Azurix alleges that the Province failed to deliver the wells and hence it was impossible to keep up with the summer water demands and such failure caused service interruptions. On December 27, 1999, the ORAB ordered ABA "to conform the service to the established service levels within 24 hours". To comply, ABA "took control of the Florencio Varela Extraction Wells on a provisional basis in order to begin providing water service to the local citizens".⁹¹ On December 28, 1999, ABA explained to the ORAB that the Province's failure to complete the wells made it impossible for ABA to comply with its obligations to provide water service. ABA's first Annual Report noted that the drilling ended before

⁹¹ Memorial, p. 96.

reaching the aquifer “to avoid more complicated works, which rendered said works useless”.⁹²

157. According to Argentina, the wells were “practically completed” at the end of July 1999 and the final measurement was carried out. ABA’s Service Report states that the wells were available for service. The wells were included in the inventory of assets on June 15, 1999. The wells needed to be supplemented with the pertinent interconnection pipes. Their installation was the responsibility of the Concessionaire. ABA’s Annual Progress Report on the POES and Service levels for the year July 1999-June 2000 includes at least three of the wells in the actual service provision. In any case, ABA did not suffer any damages nor did the ORAB impose any penalties.⁹³

158. In its Reply, Azurix finds that Argentina has failed to address the evidence presented in the Memorial. Azurix notes that it took five months for the ORAB to authorize ABA to assume operation of the Florencio Varela wells, to conduct tests, to adapt them and to complete them in order to address the summer increased demands.⁹⁴ Azurix contests the significance of the quoted reports and the measurement statement. According to Azurix, the purpose of the Service Report was “to evaluate the condition of the water system ‘*at the time of ABA’s take over of the Concession*’”.⁹⁵ The Report noted that the four wells were not in operation and the equipment was missing. The date of origin in the Fixed Assets Inventory does not have the relevance that Argentina attributes to it. Date of origin is merely a technical term that does not explain why the ORAB did not authorize ABA to take material possession till December 27, 1999. Prior delivery of the wells was essential for the installation of the water pipes. Once ABA obtained the authorization, it immediately proceeded to complete them at its own expense and connect them to the network. Only three wells were put in operation, the fourth could not be used due to construction problems, was abandoned and new drillings had to be made at ABA’s own expense.⁹⁶

⁹² Ibid., p. 97.

⁹³ Counter-Memorial, paras.706-717.

⁹⁴ Reply, para. 390.

⁹⁵ Ibid., para. 393. Emphasis in the original.

⁹⁶ Ibid., paras. 394-395 and footnote 429.

159. In the Rejoinder Argentina contends that the completion of the works during the first month of the Concession was duly proved by Argentina. Argentina points out that Azurix quoted only partially from the Service Report which stated that “only the ducted well was available. The equipment is missing. The equipment is stored at the ‘Centro’ operating location”.⁹⁷ Contrary to Azurix’s allegations, it was not necessary to equip the wells to interconnect them. In any case, no fine was imposed since no fines could be imposed during the first six months of the Concession.⁹⁸

(ii) Considerations of the Tribunal

160. From the parties allegations it emerges that Argentina does not contest that ABA was authorized to use the wells on December 27. The inventory of fixed assets showing the wells as an asset added on June 15, 1999 indicates that assets were added before work was completed or were in service. On June 15, the Concession Agreement had not been signed yet and there is no dispute that, on that date, the works were not completed. Argentina claims the works were completed in July and ABA claims never to have accepted them. There is no dispute that only three out of the four original wells went into service and that they produced low water flow. The certificate of measurement of July 20, 1999 simply recorded the fact that the final measurement took place and it is signed by OSBA and the Contractor. Hazen & Sawyer (“H&S”) stated that: “The concessionaire had to unilaterally take over the unfinished wells from AGOSBA and to put them into production before they were formally transferred as stipulated in ABA’s concession contract”.⁹⁹ There seems to be a difference of view between simply executing the works and accepting them as works satisfactorily completed under the terms of the civil works contract concerned. ABA considered works completed when accepted in terms of the specifications in the contract, while the Province seems to have been concerned with the physical completion of the works even if they did not meet the contract specifications. The Tribunal concludes from these considerations that that this is a matter in which the Province did not exercise its public authority and acted as any other contractual party.

⁹⁷ Rejoinder, para. 679.

⁹⁸ Ibid., para. 686.

⁹⁹ Exhibit 163 to the Memorial, pp. 2-11.

4. Rejection of Financing by the Overseas Private Investment Corporation (“OPIC”)

(a) *Positions of the Parties*

161. Azurix submits that, in the privatization of public water systems, the private investor usually needs to compensate for under-investment in the infrastructure during the previous State-run operation.¹⁰⁰ ABA estimated that it would need \$311 million to comply with the POES goals. ABA contacted OPIC and the Inter-American Development Bank (“IDB”) to obtain \$100 and \$150 million loans, respectively, in the fall of 1999. In April 2000, both institutions expressed interest in providing financing and in May 2000 Azurix submitted formal applications.¹⁰¹ These institutions engaged H&S to perform a comprehensive due diligence investigation of the Concession and H&S staff visited Argentina in August 2000. During a second visit in October 2000, H&S focused primarily on ascertaining “how the Provincial authorities viewed the ongoing development of the Concession and what role the Province would play in promoting investment security and stability over the course of the Concession”.¹⁰² On September 21, 2001, OPIC rejected formally the application. The letter described the issues identified by their due diligence that required “clear and definitive resolution to ensure the concession’s long-term viability and render it an acceptable credit capable of borrowing funds.”

162. The issues identified by H&S were uncertainty on tariffs, substantial scope of the capital plan required to meet the service goals compared to the level of cash ABA is expecting to generate from forecasted revenues based on tariffs in place, lack of clear definition of roles or responsibilities and unclear commitment of the Province to the Concession given unmet obligations.¹⁰³ The letter concluded:

“We understand that since our meeting in Argentina during November 2000, ABA has continued discussions with ORAB and Buenos Aires Provincial government and no significant progress has been made regarding the core issues related to

¹⁰⁰ Memorial, p. 98.

¹⁰¹ *Ibid.*, p. 101.

¹⁰² *Ibid.*, p. 103

¹⁰³ *Ibid.*, pp. 107-108 and Exhibit 173.

tariff setting and the capital expenditures program. From a creditworthiness perspective, this failure to reach an agreement regarding modifications to the concession to restore a sustainable situation for ABA precludes us from moving forward with potential financing.”

163. According to Azurix, the denial of financing by OPIC made it impossible to obtain long-term financing from other sources. It meant that Azurix would have to fund ABA’s operational expenses itself.¹⁰⁴

164. In the Counter-Memorial, Argentina alleges that Azurix was always short of funding. Argentina points out that Azurix prepared an IPO to obtain funds that it could not obtain otherwise but that the IPO funds benefited ENRON instead. Furthermore, the World Bank denied funding to Azurix in Ghana because of its totally non-transparent policy. In any case, Azurix was responsible for obtaining funding, and it was its decision where to find it whether using its own capital or becoming indebted to multilateral institutions or other entities.¹⁰⁵

165. Azurix contests the assertions of Argentina on financing, the link of OPIC financing to the denial of a World Bank loan to Ghana and the lack of resources. Azurix draws attention to the fact that the denial of financing in Ghana took place in March 2000 while OPIC and the IDB expressed interest in providing financing in April and June 2000. The H&S report in January 2001 did not mention the issue and the letter of OPIC sent on September 21, 2001 neither.¹⁰⁶

166. Argentina points out in its Rejoinder that the conflicts that eventually led OPIC to deny funding were generated by Azurix itself. The notification of Azurix on January 5, 2001 of a dispute under the BIT would have affected the denial of funding by OPIC. Argentina adds another instance of funding denial not mentioned by Azurix. ABA requested a US\$50 million loan from ENOHSA under an IDB-financed program. The loan was denied because the lender requested the guarantee of ENRON or a suitable bank guarantee, which ABA could not provide. ABA was notified on September 21, 2001, the same date as OPIC’s letter, and no reference was made to any conduct or

¹⁰⁴ Memorial, p. 109.

¹⁰⁵ Counter-Memorial, pp. 162-167.

¹⁰⁶ Reply, para. 284.

omissions by the Province or the Regulatory Agency but to lack of plans, excessive budgets, lack of environmental impact assessments, etc.

(b) Considerations of the Tribunal

167. The rejection of the loan by OPIC was very clear and specific in its reasons. The World Bank was not mentioned nor ENRON. The Tribunal has no reason to second guess the management of OPIC in its reasoning for rejecting the request. As regards the ENOHSA loan, ENRON was not prepared to guarantee the loan as required by Banco de la Nación Argentina, the administrator of the program. By September 21, 2001, ABA had already requested the Province to cure its noncompliance with the Concession Agreement. Evidently, each institution had a different choice of reasons for denying funding. For the Tribunal, the significance of the reasons given by OPIC and the due diligence analysis on which they are based stems from the fact that OPIC is unrelated to any of the parties involved and the consultants hired to do the due diligence had no allegiance to any of the parties to this proceeding. The H&S report shows that the lack of funding for ABA could not be attributed to the relationship of Azurix with ENRON or to whichever denial of funding by the World Bank. H&S's assessment noted the politicization of the Concession, the lack of commitment of the provincial authorities to the Concession, and the impact of those two factors on its viability. However, these were not the only reasons adduced by OPIC to reject Azurix's financing request. OPIC's letter also referred to "the substantial scope of the capital plan required to meet the service goals of the concession in terms of both aggressive timing and cost, as compared to the level of cash ABA is expecting to generate from forecasted revenues based on tariffs currently in effect."¹⁰⁷ In other words, the current tariff level was insufficient to sustain the scope of the capital plan.

5. Memorandum of Understanding (MOU)

(a) Positions of the Parties

168. On January 5, 2001, the Claimant notified Argentina of the existence of a dispute under the BIT. According to the Claimant, at that point the Province renewed its

¹⁰⁷ Exhibit 173 to the Memorial.

discussions with ABA to remedy the breaches of the Concession Agreement, and on February 15, 2001 the MOSP and ABA signed a Memorandum of Understanding (MOU). The Claimant alleges that:

“the MOU implicitly recognized that the guarantees given by the Privatization Commission (including Circular 52(A) were essential to the attraction of qualified investors. Moreover, it implicitly recognized that the Province, as the granting authority, had the ability to revisit the purpose and goals of the Concession Agreement to optimize intended social purposes. Finally, and importantly, it recognized implicitly that the economic equilibrium of the contract was broken. These principles were incorporated into the MOU under the mutual understanding by ABA and the Province that the economic equilibrium of the Concession needed to be restored.”¹⁰⁸

169. To implement the goals of the MOU a committee was established (“the MOU Committee”). This committee had to produce an interim report of the negotiations within 30 days and a resolution of the issues outlined in 60 days. During the discussions, the MOSP Undersecretary took the view that the Canon was subject to business risk and he proposed an amortization scheme as a percentage over sales and the remaining unamortized value to be recovered through the re-bidding of subdivided areas of the Concession. According to the Claimant, throughout the discussions “the approach of the MOSP was centered on questioning the privatization process and discarding key assurances that had been provided to ABA”, and the affirmation that the Concession was based on the risk principle.¹⁰⁹ The Claimant alleges that by the end of the negotiating period “the repeated promises that the Province made to cure the outstanding breaches related to the application of the tariff regime remained unfulfilled” and the Province opted for deferring ABA’s rights under the Concession. Thus as told by Mr. Clark, a member of the MOU Committee representing ABA, in his witness statement:

¹⁰⁸ Memorial, pp.120-121.

¹⁰⁹ Ibid., pp. 123 and 125.

“As a condition to the signing of MOU II, the Province asked Azurix to withdraw its arbitral claim with ICSID and to release the Province from any claims... when ABA stressed the urgent need to increase cash flow, the Province responded that ABA should address this at the first tariff review at the end of the five-year period ... ABA was not in a position to wait until the end of the five-year period, and needed immediate solutions to the threat of its financial collapse.”¹¹⁰

170. The Claimant summarizes the MOU process results by affirming that by September 2001 the promises made by the Province to resolve the tariff issues were conditioned to withdrawal of the arbitration claim and the renunciation to recover the Canon, “In essence, after nearly a year of pursuing the rectification of Provincial breaches through the MOU efforts, nothing had changed to make the Concession economically viable. The breaches of the Concession Agreement, which affected the viability of Azurix’s investment, were still uncured.”¹¹¹ According to the Claimant, this situation prompted ABA to consider the termination of the Concession Agreement due to the Province’s continuous breaches.

171. From the Respondent’s point of view, the MOU was simply an agreement to create a committee to look into possible negotiating procedures.¹¹² It was “a negotiating process in which the parties, regardless of the rights to which they are legally entitled or for which they may have a rightful claim, try to reach a sustainable understanding for the Concession Contract within the framework of Law No. 11.820 and the rules and regulations applicable to the service.”¹¹³

172. The Respondent alleges that no agreement was reached in the context of the MOU negotiations because ABA adopted an unyielding position to be released of its obligations and transfer entrepreneurial risk to the Province. As a result, no proposals were ever submitted to the MOSP as it had been foreseen in Article 2 of the MOU, and

¹¹⁰ Ibid., quote in pp. 126-127.

¹¹¹ Ibid., p. 127.

¹¹² Counter-Memorial, para. 494.

¹¹³ Ibid., para. 495.

the quality and expansion targets in the Concession Agreement and in the approved First Five-Year Plan were never modified.¹¹⁴

(b) Considerations of the Tribunal

173. The MOU was part of a process to revisit certain aspects of the Concession. Its purpose and function was to conduct “the joint analysis of the issues” listed in Section 2 of the MOU. All items listed are couched in terms of work to be done – studies, discussions, preparation of a “regulatory model” - except for the second item – POES goals (Section 2.2) – which in part is drafted as a decision to establish, right there and then, a “priority works” plan to be performed during the current year because “the current critical service condition cannot be resolved by goals based contracts.” (2.2, first paragraph) A detailed plan of works and actions for 2001 was attached as an exhibit to the MOU.

174. The second paragraph of Section 2.2 recognizes the need to revise the goals of the POES in view of Resolution 179/00 of the MOSP and Resolution 59/00 of the ORAB which established sanitary vulnerability, risk and access criteria. The third paragraph of this section entrusts the ORAB with the control and regulation of the service “by following up on the Priority Works Plan.”

175. The MOU was signed by the Minister of Public Works and Services and the General Manager of the Concessionaire in the presence of the Secretary General of FENTOS and the Secretary General of SOSBA and city mayors, all of whom acknowledged the contents by subscribing the exhibit on works and actions for 2001. The signature took place also in presence of members of the provincial Senate and House of Representatives.

176. While the Respondent has played down the importance and significance of the MOU, it seems that it reflected a moment in which the parties were prepared to give serious consideration to the problems that had surfaced during the first year of the Concession. The level of the positions held by the persons who signed it and the context of the signature ceremony show the importance that the parties attached to the

¹¹⁴ Ibid., paras. 497-498.

MOU. In particular this is significant for the decision to establish the Priority Works Plan and have it subscribed by the city mayors. At least in this respect, the MOU was more than a simple agreement to establish a committee as has been submitted by the Respondent. The Tribunal will now consider the implications of the MOU for purposes of assessing the performance of the Concessionaire against the POES in 2001.

6. The Program for Optimizing and Expanding Service (POES)

(a) *Positions of the Parties*

177. The Respondent points out in its Counter-Memorial that the Claimant had failed to comply with the POES, the core of the Concession. It argues that as part of the POES, the Concessionaire presented a Five-Year Plan proposal with serious shortcomings because from the very beginning it knew that it would not fulfill its obligations. As early as June 2000, ABA tried to reformulate the POES so as not to comply with the Five-Year Plan. The POES obligations were enforceable from the beginning and the MOU did not exempt ABA from complying with them. ABA did not meet the POES goals and investment commitments to such an extent that it prompted the Province to impose fines and terminate the Concession Agreement by fault of the Concessionaire.

178. In response, the Claimant alleges that the Province failed to provide accurate information to the Concessionaire necessary to define the POES goals and delayed approval of these goals for so long that they were no longer relevant. According to the Claimant, the POES goals were superseded by the MOU which recognized that “the economic equilibrium of the concession had been materially altered, and the parties agreed to a finite Priority Work Plan to replace the POES.”¹¹⁵ Furthermore, the compliance with the POES was subject to certain pre-conditions, such as the proper application of the tariff regime and the cooperation of the Province and the ORAB with the Concessionaire.

179. The Claimant alleges that the provincial authorities failed to provide the Concessionaire with complete and accurate information for purposes of the definition,

¹¹⁵ Reply, para. 402.

presentation and subsequent performance of the First Five-Year Plan. The documents promised in Circular 66(A) were not delivered to the extent promised and ABA had to request information on, among others, updated network plans, business documentation, computer center documentation, billing unit records and documents, information and documents related to personnel, debits and credits and technical operating documentation. The documentation requested was never delivered to ABA notwithstanding that it existed: "It was held by former AGOSBA officials – closely connected to the Union - who sought to require ABA to enter into commercial arrangements to acquire the same information that should have been delivered by the Province at the takeover."¹¹⁶

180. The Claimant maintains that it presented the Five-Year Plan diligently given the circumstances and that delays in its approval occurred by factors not mentioned by the Respondent such as the request, on February 23, 2000, three months after filing the Five-Year Plan, for information that was in fact in the hands of former officers of AGOSBA to pressure ABA into arrangements with them, or the introduction of the sanitary risk concept that the Province requested that be included by Resolution No. 59/00 of July 21, 2000. According to the Claimant, the introduction of this concept meant that the Concessionaire was instructed to prioritize investment based on new criteria –accessibility, risks and sanitary vulnerability- and “with no consideration to the relevant compensation required to preserve the economic balance of the concession.”¹¹⁷ The Five-Year Plan was not approved until February 21, 2001 by Resolution 11/01.

181. The First Annual POES Progress Report was approved by the ORAB by Resolution 16/02 on February 19, 2002, 18 months after the submission of the Report. According to the Claimant, “these delays jeopardized the Concessionaire’s performance and evidenced the ORAB’s arbitrary conduct. Furthermore, the lack of certainty and the impossibility to foresee the plan that would be approved by the ORAB or the criteria that

¹¹⁶ Ibid., para. 428.

¹¹⁷ Ibid., para. 445.

would be used to measure compliance with the goals placed ABA in an uncertain situation, which affected its operations.”¹¹⁸

182. The Claimant disagrees with Argentina’s argument that the Priority Work Plan included in the MOU was independent from the POES. For the Claimant, this would mean that ABA would have undertaken new investment obligations in addition to those in the POES notwithstanding that the MOU recognized the economic imbalance of the Concession; it was clear that the MOU suspended the goals for the second year of the Concession.¹¹⁹

183. According to the Claimant, the Province, not ABA, sought to modify the POES because of a political shift in how the new provincial government viewed the Concession Agreement. Minister Sícara had expressed the intent in February 2001 to change the model from one based on objectives to a model based on investments and a return to a cross-subsidy scheme implementing a social tariff for low income users.¹²⁰

184. The Claimant disagrees with the description of POES non-compliance provided by the Respondent. According to the Claimant, the Respondent carries the evaluation without taking into account the non-application of the tariff regime and the agreement on a Priority Work Plan in the MOU. According to the Claimant, the ORAB could never have evaluated compliance with the POES because it had failed to define the methodology to assess the goals of the POES. The Claimant points out that the evaluation is based on investment amounts rather than goals as required in the Concession Agreement, that the analysis of the expansion goals disregards the setbacks concerning determination of serviced populations, excludes the connections installed within the serviced areas, and that includes, as alleged breaches, goals to be reached in a three or five-year term.¹²¹

185. The Claimant also alleges discriminatory treatment to the extent that public – ABSA - and private companies – AGBA - were exempted from POES compliance. According to the Claimant, this exemption was due to the

¹¹⁸ Ibid., para. 463.

¹¹⁹ Ibid., para. 474.

¹²⁰ Ibid., para. 469.

¹²¹ Ibid., paras. 480 and 482.

unreasonableness of the POES goals when the Province refused for political reasons to apply the tariff regime. The Claimant points out that, in the case of AGBA, the goals for year 2001 were suspended even though the economic crisis did not start until the end of 2001.¹²²

186. The Respondent affirms that the MOU did not operate to amend the Concession Agreement or the targets under the POES, “it was merely an attempt by the parties to create a committee to consider the issues and submit a proposal designed to overcome certain difficulties, which was never put together”.¹²³ The POES was enforceable from the beginning of the Concession. The quantitative and qualitative targets were established in the Concession Agreement and the Five-Year Plans were merely designed to provide additional details, adjustments or updates.¹²⁴ The POES and the Five-Year Plans were specific contractual obligations to be discharged in accordance with the terms of the Concession Agreement and were not merely guidelines towards the targets as argued by the Claimant.¹²⁵ Compliance with the POES was an exclusive obligation of the Concessionaire and the Province did not hinder or affect negatively compliance of ABA with the POES.

187. The Respondent also contests that the Province discriminated in favor of other companies. AGBA, a private company, had complied with the applicable POES notwithstanding that it had higher targets during the first year of its concession and had only requested, on July 20, 2001, a temporary postponement of the POES deadline for the second year in view of the extraordinary economic crisis of the country. The postponement was not related to the rate system as asserted by the Claimant.¹²⁶

188. As regards ABSA, the Respondent justifies the exemption from the service expansion obligations because it was owned by the Province, the temporary nature of the service transfer, the fact that the Concession had been abandoned, and the deep crisis prevailing at the time.¹²⁷

¹²² Ibid., para. 407.

¹²³ Rejoinder, para. 327.

¹²⁴ Ibid., para. 336.

¹²⁵ Ibid., paras. 339-340.

¹²⁶ Ibid., paras. 350-375.

¹²⁷ Ibid., para. 382.

189. The Respondent contests that the Province had any responsibility for the delayed approval of the First Five-Year Plan. It had provided ABA all the necessary information and the delay was the result of the many requests for postponing the submission deadline. The original deadline of three months from the date of takeover of the Concession was first postponed by two months, and then it was extended by an additional 45 days. As this was not yet enough, two further postponements were granted by ORAB. All together these postponements delayed presentation of the draft Five-Year Plan by nearly nine months. It was submitted on June 12, 2000.

190. According to the Respondent, it was always ABA that attempted to change the POES. When ABA was supposed to submit the Five-Year Plan, in fact it submitted an Emergency Investment Plan and sketched the structure of a plan for the five years, there was a second draft Five-Year Plan, an appeal for reversal of Resolution 10/00, a Supplementary Report to the Five-Year Plan, and a letter to ORAB of July 17, 2001.

191. The Respondent considers that the notions of vulnerability, accessibility and sanitation risk did not modify substantially the POES. Inclusion of these notions was to direct the targets already established to areas that were more intensely exposed to sanitation risks.¹²⁸

192. The Respondent argues that the MOU was only the first step in a process of renegotiation that was never completed because of ABA's desire to walk away from its obligations and transfer all business risks to the Province. The Priority Work Plan never became effective and it could not have amended the Concession Agreement or changed the targets established in the POES for the second year of the Concession.¹²⁹

193. The Respondent affirms that the obligations under the POES were not conditional upon the definition of evaluation criteria regarding performance under the POES, and the achievement of the targets regarding the expansion of drinking water and sewerage works did not call for any regulatory criterion beyond the terms of the Concession Agreement.¹³⁰ ABA did not comply with the minimum requirements for region and county during the first two years, the annual renovation and reconditioning of

¹²⁸ Ibid., para. 406.

¹²⁹ Ibid., paras. 409-410.

¹³⁰ Ibid., paras. 415 and 418.

pipes' target, and the target of maintenance or reconditioning of effluent primary and secondary treatment plants. ABA failed to make sufficient progress in the micro-measurement by year two of the Concession to such an extent as to make it unlikely that the 40% target prescribed in the Concession Agreement could be reached by year five. ABA equally failed to complete the infrastructure works contemplated in Exhibit I to the approved Five-Year Plan. In the second year, ABA prepared the second progress annual report for the POES based exclusively on the Priority Works Plan attached to the MOU and hence failed to reach the targets established in Exhibit F of the Concession Agreement.¹³¹

(b) Considerations of the Tribunal

194. The Priority Works Program was not additional to the POES. It is doubtful that, in its financial condition, ABA would have undertaken new obligations in addition to the POES. The sanitary risk was a new element which would have an effect on the POES and was introduced by the Respondent. It is evident that the MOU was an attempt to solve the problems that had developed and the attempt failed. The POES was never amended and the parties to the Concession Agreement continued to be bound by its original terms, including the tariff regime. However, the failure by the Province to honor the tariff regime contributed significantly to Azurix's inability to implement the POES as planned.

7. Circular 52(A) and Canon Recovery

(a) Introduction

195. The issue of Canon recovery and the meaning of Circular 52 (A) first emerged during the discussions in 2001 in the context of the MOU as we have already seen. On July 18, 2001, ABA sent a communication to the Province requesting that the Province cure the breaches of the Concession and warning that, if these were not cured, ABA would terminate the Concession. The Province replied on August 29, 2001 denying any wrongdoing and, in particular, denying "ABA's right to recover its investment (including the initial Canon), as expressly stated in Circular 52(A) and Article

¹³¹ Ibid., paras. 423-449.

12.1.1 of the Concession”.¹³² The controversy is linked to the level of risk assumed by the Concessionaire and the principles inspiring the Concession.

(b) Positions of the Parties

196. Azurix claims that the Province issued Circular 52(A) in an attempt to attract the highest bids from prospective investors. Azurix maintains that Circular 52(A) assured bidders that the Canon would be considered an investment fully amortizable through tariffs.¹³³ In this respect, Azurix refers to LECG’s expert report: in which it is stated:

“Although the Province did not issue ex-ante details on regulatory methodology and accounting principles for the tariff reviews, it issued Circular 52(A). In this Circular, the Province indicates very clearly that the initial payment will be treated as an investment. As such, bidders, including Azurix Corp. must have properly assumed that, in the context of a price-cap regime, the canon would be included in the asset base for tariff review purposes, after accounting for its amortization.

This expectation was based on international and Argentine regulatory experience.”¹³⁴

197. Argentina contests the interpretation given by Azurix to Circular 52(A). In its Counter-Memorial, Argentina explains that the fee paid for the Concession is the price to run a monopoly. Argentina considers that this issue was not “a real conflict between ABA and the Province as Law No. 11,820 and the Contract would have never allowed such transfer. The issue was introduced within the framework of negotiations with the Province, in a desperate attempt by Azurix to alter the obligations assumed and the Contract”.¹³⁵ Argentina draws attention to Article 12.3.1 of the Concession which provides that the tariffs shall be in force during the term of the Concession and their review may only occur based on events after the takeover of the Concession (Article 12.3.4, 5 and 6 of the Contract and Section 23-II of the Law).

¹³² Counter-Memorial, para. 130.

¹³³ Memorial, p. 178.

¹³⁴ Ibid., p.125.

¹³⁵ Counter-Memorial, para. 854.

198. Argentina refers to the expert report of Mr. Chama, one of Argentina's experts, who explains that the bidding process for the Concession sought to select "the economic player that is willing to pay the highest price, usually called 'fee', for the right to exercise the monopoly; and the selection consists simply of determining who is willing to pay the highest price as from a certain rate level, with a rate adjustment system primarily based on service conditions established in the bidding documents and in the regulatory framework governing the service."¹³⁶

199. According to Argentina, the offer of Azurix was opportunistic in the sense that the purpose was the immediate renegotiation of the Concession Agreement to recover the profits renounced in the competitive bidding process. Mr. Chama states that "it could never be argued that the concession fee can be defined as a component of the cost of service and become a factor determining the rates or prices of the service itself".¹³⁷ Argentina wonders what would be the point of competing in a bidding process if the concession fee would be subsequently transferred to users.¹³⁸ Argentina further argues that the transfer of the concession fee to the tariffs would result in "the absurdity of having different tariffs in different areas depending on the concession fee offered by the winning bidder."¹³⁹

200. Argentina points out that, in the letter of August 29, 2001, the Minister of Public Works of the Province stated that Azurix's representative, after several months of negotiations, requested "an additional condition: to study the mechanisms to adjust the Tariff Regime, aiming at recouping the concession fee paid for taking over the Concession."¹⁴⁰ The Minister adds: "under the Bidding Conditions, payment of the concession fee corresponded to the price that you bid for the concession, assuming the risk that you may not recoup it, considering that if the [C]oncession guaranteed the reimbursement of the price paid plus a rate of return thereon, the business started by

¹³⁶ Ibid., para. 861.

¹³⁷ Ibid., para. 864.

¹³⁸ Ibid., para. 867.

¹³⁹ Ibid., para. 868.

¹⁴⁰ Ibid., para. 875.

Azurix would not be a risky one, as it is stated in Article 12.3.1 of the Concession Contract.”¹⁴¹

201. As part of Argentina’s arguments on this issue, Argentina brings to the attention of the Tribunal certain alleged irregularities regarding Circulars 51(B) and 52(A) and Section 12.1.1 of the Contract. According to Argentina, these two circulars were the last circulars issued by the Privatization Committee before bidders presented their economic offer.¹⁴² Circular 51(B) reduced the volume of water that the Concessionaire was to deliver annually free of charge established only the week before, on May 5. The reduction for ABA exceeded 57%. In contrast, the water volumes fell only by 1.48% in Region B, the only Region not awarded to ABA.¹⁴³

202. As regards Article 12.1.1 of the Contract, Argentina draws the attention of the Tribunal to the statement of Azurix in the Memorial whereby the Province, in need of money to balance the budget in 1999, wanted to maximize the Canon and “To this end, it issued Circular 52(A), saying that the Canon would be recognized as an amortizable investment, and thus, included in the tariff rate base. The Province confirmed this by adding Article 12.1.1 to the Contract.”¹⁴⁴ Argentina observes that this section of Article 12 was not in the model contract which was part of the bidding documents and did not establish that the concession fee could be transferred through tariffs. The original Article 12 simply stated a general principle to be taken into account in the determination of the tariff regime. Azurix’s interpretation would make this section contrary to law. The Concession Agreement could not be substantially altered after the bidding process. Amendments to the Concession Agreement were done through letters of amendment, no such letter was used in this case and it might have also been absent in another change also introduced after the award of the contract, i.e. the introduction of a 6-month period of grace for penalties on account of any infringements.¹⁴⁵

203. Argentina alleges that the Tribunal took Article 12.1.1 of the Concession Agreement into account as a decisive factor in its decision on jurisdiction in disregard of

¹⁴¹ Ibid.

¹⁴² Ibid., para.878

¹⁴³ Ibid., paras. 878-881.

¹⁴⁴ Ibid., para. 882. Emphasis added by the Respondent.

¹⁴⁵ Ibid., paras. 898-899.

the possible irregularities that affect this section which “could have led the tribunal to error.”¹⁴⁶ Argentina informs that its courts will solve the issues dealing with the inclusion of Article 12.1.1 and considers that, “In any case, the impact on the progress of Azurix’s claim before this Tribunal is evident, as well as the fact that the Tribunal is not competent to decide on the facts described.”¹⁴⁷

204. Azurix contests that the Canon is only an access fee for the Concession. Circular 52(A) explained that the Canon constitutes an investment to be amortized. According to Azurix, utility investors understand that, when access to other markets is prohibited, canon payments are considered investments to be recovered through regulated tariffs. This is standard regulatory practice in Argentina and the Province. Azurix refers to an internal MOSP report on the MOU process in which Mr. Sícario states: “the proposed scheme accounts for the fact that there is a canon to be amortized by the expiration of the Concession term”.¹⁴⁸ This is in contrast with the statements made by him before the Tribunal as a witness. According to Azurix, the Province simply lacked the political will to allow its recovery in accordance with representations made by the Privatization Commission, the Concession Agreement and Circular 52(A).¹⁴⁹

205. Azurix dismisses the concept of “unbounded risk” claimed by Argentina. According to Azurix and relying on LECG rebuttal: “The ‘unbounded risk’ concept introduced by Mr. Chama, is deadly off the mark. Were concessions based on the ‘unbounded risk’ concept, no private investor will ever pay anything for the concession.”¹⁵⁰

206. Azurix also dismisses the unconstitutionality alleged by Argentina if similarly situated customers would pay different prices for public services. This is actually a fact in the Province and Argentina.¹⁵¹

207. Azurix also rebuts the notion that Circular 52(A) is only an accounting clarification and points out that Argentina fails to explain how this clarification was to be

¹⁴⁶ Ibid., para. 900.

¹⁴⁷ Ibid., para. 902.

¹⁴⁸ Reply, 251.

¹⁴⁹ Ibid., para. 252.

¹⁵⁰ Ibid., para. 255.

¹⁵¹ Ibid., paras. 256-257.

applied or its practical meaning. Furthermore, argues Azurix, Argentina's allegations in respect of the Canon are not consistent with the facts and recognized utility practice. Azurix points out that in the case of another Argentine public utility, Transener, specific provisions like Article 7.8 and Circular 52(A) were not deemed necessary to include the Canon in the tariff rate base.¹⁵²

208. Azurix affirms that it was the behavior of the Province that was opportunistic. The additional capital contributions made by Azurix and exceeding US\$106 million do not indicate behavior of an opportunistic investor seeking additional advantages through a post-bid negotiation. Azurix observes that if the Province, advised by Mr. Chama himself during the bidding process judged Azurix's bid opportunistic or reckless could have rejected the bid and did nothing of the sort.¹⁵³ On this point, Azurix concludes that, 'in light of the guarantees offered by the Regulatory Framework, the Concession Agreement and Circular 52(A), the Province should have recognized the implications of accepting Azurix bid. If the Province chose to ignore long-term effects for the benefit of short-term political interests, then it did so under the legal obligation to honor commitments made.'¹⁵⁴

209. Azurix also contests the supposed irregularities of Circular 52(A) and Article 12.1.1. As Argentina itself admits, this Article merely reiterates what is already contemplated in the Regulatory Framework and the Concession Agreement: "It is Azurix's view that Article 12.1.1 is consistent with Article 28-II(d) of Law 11.820, Article 7.8 of the Concession Agreement and Circular 52(A). They all fit together into a harmonious and systematic whole. Therefore any suggestions that this introduction substantially changed the scope of the Concession Agreement is wrong. It merely clarified it."¹⁵⁵ According to Azurix, by its actions, the Province repudiated Circular 52(A).

¹⁵² Ibid., paras. 258-263.

¹⁵³ Ibid., paras. 266-267.

¹⁵⁴ Ibid., para. 268.

¹⁵⁵ Ibid., para. 272.

210. In the Rejoinder, Argentina refers to statements made by a World Bank expert, Mr. Guasch, to support the allegation of opportunistic behavior of Azurix. According to Mr. Guasch,

“...operators should be held accountable to their bids, and if petitions for renegotiation are turned down, operators ought to feel free to abandon the projects, if they choose to do so (with the corresponding penalties). The appropriate behavior for the government is to uphold the sanctity of the bid and not concede to opportunistic request for renegotiation and, in such cases, allow concessions to fail. Such outcomes would reduce the incidence of renegotiation. That is a key issue in private concessions of infrastructure services –yet one that is often resolved in favor of operators. Thus aggressive bidding and the high incidence of renegotiation should not be surprising.”¹⁵⁶

211. And again more specifically on the issue of valuation of concession assets:

“What clearly should not be used for the value of the concession in the capital base –from which the operator is allowed to earn a fair rate of return- is the value paid at the bidding stage, regardless of depreciation method. Doing that would take away the efficiency-competitive angle of the auction, by allowing a rate of return on whatever price was paid for the concession.”¹⁵⁷

212. Argentina considers reasonable that the bidders take into account the return on the investment in order to calculate the concession fee, but it is illogical and unreasonable that the fee be passed through to rates. While every bidder may expect to make reasonable profits above the concession fee, this is not an acquired right.¹⁵⁸

213. Argentina denies Azurix’s allegation that in the natural gas and electricity sectors the amounts paid as concession fees had been taken into account to determine applicable rates.¹⁵⁹ Furthermore, Argentina considers that the concession fees in these sectors may reflect accurately the value of assets transferred because there are no

¹⁵⁶ Rejoinder, p. 1.

¹⁵⁷ Ibid., para. 868.

¹⁵⁸ Ibid., paras. 870-871.

¹⁵⁹ Ibid., paras. 877-878.

cross-subsidies or an obligation to expand the grid.¹⁶⁰ Then Argentina refers to the specific example of Transener, an electricity distribution company. In the context of a five-year rate review, Transener argued that the price paid for the concession should be used to determine the asset value for rate-setting purposes. The regulatory agency for the power sector did not accept the argument. In fact, NERA, an expert consulting company in the instant case, advised the regulator that, if the price paid at the time of the privatization:

“constituted the basis of the calculation, then, any amount paid should be recovered through rates (circularity of rates)” and, “if the rates can be calculated on the basis of the value of the company at the time of privatization or, if the rate of return of the company is guaranteed on the bid price, there is nothing to prevent an economic agent from offering a large amount if the implicit regulatory rate of return is higher than its own weighted capital cost.”¹⁶¹

214. Argentina refers also to NERA’s advice to defend the concepts of regulatory and accounting amortization advanced in the Counter-Memorial. According to NERA:

“Regulatory amortization is the annual percentage of the asset base that is deducted from the regulatory book value in accordance with the standards established by the regulator. Accounting amortization is the percentage of the asset base that may be written off the accounting books every year in accordance with the standards set by the tax authority and the professional council of economic sciences. These are two different concepts. While regulatory amortization serves the purpose of setting rates, accounting amortization is used to calculate taxes and determine the accounting book value.”¹⁶²

According to Argentina, ENRE, the regulator, took into account these observations.

¹⁶⁰ Ibid., para. 881.

¹⁶¹ Ibid., paras. 889-890.

¹⁶² Ibid., para. 261.

215. Argentina considers Article 7.8 of the Contract to be very clear. It consists of three elements: the amortization of assets in service acquired or built by the Concessionaire and the improvements made thereon by the Concessionaire.¹⁶³ As regards Article 1.8, Argentina considers that this Article is also clear in showing that the concession fee was not an investment but the price paid to be awarded an area. Argentina refers to Mr. Chama's expert advice and affirms that, for the Concessionaire to earn a reasonable return, Azurix's assessment underlying its Offer would have to have been reasonable and the fee compatible with the financial equilibrium of the Concession. The Concession fee presupposed an appropriate economic offer, otherwise the Concessionaire would offset its deficits derived from ordinary business risks, a compensation expressly prohibited in the Concession Agreement.¹⁶⁴

216. Argentina points out that, as there was no rule permitting it, there was no submission by ABA to the ORAB requesting the transfer of the concession fee paid onto rates or the increase in rates to cover a part of the concession fee. Argentina alleges that the dispute only arose at the end of the negotiations with the Province in search of an overhaul of the rate system or an excuse to provide grounds for termination.¹⁶⁵ The circulars issued by the Privatization Commission could only introduce clarifications of or amendments to the Terms of Reference provided they were not substantial in nature. If Circular 52(A) would be interpreted as Azurix suggests, it would have introduced a substantial amendment to the rate system contemplated in the Contract. Professor Comadira in his expert opinion states that, in that case, "it would be unreasonable and incompatible with the rest of the provisions of the terms of reference."¹⁶⁶ According to the same expert, the rate system could only be modified after the third year of the Concession (Article 30-II(c)), the rates¹⁶⁷ and prices should have been effective during the term of the Concession (Article 12.3.1), and the values and prices could only be modified by virtue of the procedures and for the reasons disclosed in Article 12.3.2. Therefore, ABA's interpretation of Circular 52(A), "apart from being inconsistent with

¹⁶³ Ibid., para. 911.

¹⁶⁴ Ibid., para. 917.

¹⁶⁵ Ibid., para. 921.

¹⁶⁶ Expert Opinion of Professor Comadira (Comadira), p. 41, quoted in the Rejoinder, para. 928.

¹⁶⁷ It should be pointed out that Article 12.3.1 does not refer to "rates" but to "tariff values."

the harmonic and systematic interpretation of all the clauses of the Terms of Reference, which it may only clarify but never modify substantially under penalty of becoming an absolute nullity, disregards clear legal regulations applicable to the Concession Contract.”¹⁶⁸ Professor Comadira even affirms that:

“A modification of the contracting conditions as the one provided for in the Circular under analysis should have necessarily meant a new call for bids to enable the possible participation of any potential bidders that would have been self excluded under the original conditions. Since that was not the case, the equality guarantee has been clearly violated, thus corrupting the whole procedure.”¹⁶⁹

217. In addition, Professor Comadira explains that the addition of Article 12.1.1 and its interpretation by Azurix would mean that the essential principle of equality in a bidding process would have been violated, this being “a fundamental principle of the general law and administrative law.” He concludes by inviting the Tribunal to rule this article as manifestly void of absolute and incurable nullity in response to “an ethical or juristic requirement.”¹⁷⁰

218. According to Argentina, the studies leading to the presentation of the offer could not have taken into “account an interpretation that would have distorted the rate system contemplated in the contract, on the grounds of a nonexistent provision.” Azurix could not have entertained any expectations in this respect.¹⁷¹

(c) *Considerations of the Tribunal*

219. It will be useful to quote first in full the relevant legislative and contractual provisions:

¹⁶⁸ Comadira, p. 40, quoted in the Rejoinder, para. 930.

¹⁶⁹ Ibid., p. 37, quoted in the Rejoinder, para. 933.

¹⁷⁰ Ibid. p. 44, quoted in the Rejoinder, para. 940.

¹⁷¹ Rejoinder, paras. 942-943.

Article 28 of the Law:

“Prices and tariffs will tend to reflect the economic cost of providing potable water and sewer services, including the Concessionaire’s margin of profit for and the resulting basic infrastructure costs of the POES.”

Concession Agreement:

Article 12.1.1:

“Determination of the tariff level required under Article 28-II of Law No. 11.820, shall be based on the general principle under which tariff values shall cover the operating, maintenance and amortization costs of the services and allow for a reasonable rate of return on the amounts invested by Concessionaire within an efficient operation and management environment, as well as full achievement of the agreed-upon service expansion and quality goals.”

Article 7.8:

“The Service-related assets acquired or built by the Concessionaire and belonging to it as well as all improvements made thereon shall be capitalized by accounting procedures and shall be depreciated integrally over the term of the Concession or over their Useful Lives, whichever term is shorter; the provisions of the fourth paragraph hereof notwithstanding.

The investments the Concessionaire makes in the assets received by/from the Province upon Take Over shall be considered as acquisition and/or maintenance costs of the Concession in accordance with provisions of clause 1.8 and shall be amortized over the term of the Concession.”

Article 1.8:

“The grant of the Concession shall be in consideration of payment of an initial canon equal to ... by the Concessionaire. Said amount has been paid up by the Concessionaire to the Province upon the signing of the Agreement, and it is equivalent to the amount offered by the Awardee [sic] under the Bidding Process, to be credited as the price for the Concession Area. However, the Concessionaire does hereby undertake to make all necessary investments to

execute the POES and to secure the correct provision of Service under the Agreement, the description of which is detailed in Annex F hereto, the tariffs increments being subject to the guidelines stated in Annex Ñ being subject to compliance with said obligations.”

Circular 52(A):

“It is clarified that the initial royalty which is referred to in Section 1.8 of the Concession Contract constitutes an amortizable investment during the concession period (article 7.8 correlative and concordant of the Concession Contract).”

220. The Tribunal will turn first to the relationship of Circular 52(A) to Article 1.8, second to the meaning of the additional provision 12.1.1 of the Concession Agreement, third to the rationale of the Concession, and fourth to asset depreciation in the asset regime of the Concession Agreement (Article 7.8).

(i) Circular 52(A): The Canon as an Investment

221. The parties have discussed the meaning of the term “canon” and whether the Canon is an investment. Article 1.8 of the Contract refers to the Canon as “the consideration” for the granting of the Concession and, in the next sentence, as “the price for the Concession Area.” The following sentence deals with the undertaking related to the POES investments. It starts with the word “however” as a counterpoint to the consideration paid by the Canon, as if to emphasize that the payment of the Canon were not the only contribution to be made by the Concessionaire. This reading of Article 1.8 is reinforced if compared with the terms of Article 28 of the Law. Article 28 sets forth the general principle that: “the prices and tariff will tend to reflect the economic cost of the provision of the services of water supply and sewer services”, and continues by saying: “including a profit margin and the cost arising from the POES related to basic infrastructure.” The economic cost of a service would include, by definition, all costs related to the provision of the service. The specific reference to investments arising out of the POES would seem to be a clarification rather than an exclusion of other investment costs. In case there was any doubt about its meaning at the time of the bidding for the Concession, the Privatization Commission issued Circular 52(A) which

clearly states that “the initial canon...constitutes an investment.” The Tribunal has no reason to doubt the interpretation given by the Privatization Commission. It had the power to issue clarifications of the Bidding Terms and Conditions and all bidders would have been aware of the clarification when they submitted the bid as in the case of any other circular issued by the Privatization Commission. Argentina had argued that Circular 52(A) was issued close to the deadline for the submission of bids and was the last circular issued by the Commission. The evidence provided to the Tribunal shows that Circular 52(A) was not the last circular to be issued by the Commission and that other significant circulars were issued after the date of Circular 52(A). The issue is not so much whether the Canon is an investment but whether being an investment makes it a recoverable investment beyond the given tariff at the time of bidding and as adjusted through the extraordinary reviews.

(ii) The Addition of Article 12.1.1.

222. In arguing that Article 12.1.1 of the Concession Agreement is not extraneous to the Concession regime, the Claimant states that: “it is Azurix’s view that Article 12.1.1 is consistent with Article 28-II(d) of Law 11.820, Article 7.8 of the Concession Agreement and Circular 52(A). They all fit together into a harmonious and systematic whole. Therefore, suggestions that this introduction substantially changed the scope of the Concession Agreement are wrong. It merely clarified it.”¹⁷² In support of this statement, the Claimant refers to the expert opinion of Professor Fernández who affirms:

“Section 12.1.1 of the Contract is not a word-by-word reproduction of the section with the same number of the sample agreement attached to the Bidding Terms and Conditions; however, under no means does it imply a modification to the agreed-upon terms since it merely incorporates into the contract the provisions of Section 28(ii) of Law 11.820 and the statement made at the time by means of Circular 52(A), acknowledging that the Canon was an ‘investment to be amortized throughout the term of the concession.’”¹⁷³

¹⁷² Reply, para. 272.

¹⁷³ Legal Opinion of Professor Fernández, para. 56, Reply, Annex 1, para. 271.

223. In the Counter-Memorial, Argentina considered that Article 12.1.1 established a general principle already taken into account in Annex Ñ of the Concession Agreement in order to determine the tariff regime. The resulting rate for the duration of the Concession was “fair and reasonable and allowed a reasonable return.”¹⁷⁴ For Argentina, it was impossible to build Azurix’s interpretation into the terms of Circular 52(A) and Article 12.1.1 of the Concession Agreement without amending substantially the terms of the agreement against the provisions of the Law, which did not permit the passing through of the Canon to the rates.

224. In the Rejoinder, Argentina argued differently and, instead of admitting that Article 12.1.1 established a general principle, it stated that the insertion of Article 12.1.1 is not being supported by any legal provision and that this article could not have been part of the considerations present when Azurix submitted its bid for the Concession.¹⁷⁵

225. Article 12.1.1 provides that the tariff level required under article 28-II shall be based on the general principle that the tariff values cover the operation, maintenance and amortization costs of the service and permit a reasonable return on the investments of the Concessionaire in the context of an efficient administration and operation and exact fulfillment of the agreed quality and expansion objectives of service. While article 12.1.1 refers to article 28-II of the Law, it introduces a notion, “return on assets”, not present in this article 28, and, conversely, there is no reference to the “profit margin” of Article 28-II in Article 12.1.1. Taking a long term view of the Concession, profit margins and rates of return may come to the same result, but they are different concepts and the concession regime does not contemplate a regime based on rates of return as explained by the Claimant’s own experts and to which we will now turn.

(iii) Rationale of the Concession

226. At the time of bidding, the bidders knew the tariff level and that this level could not be changed except as provided in the model contract. These provisions are usual in concession tariff regimes known as price cap regulatory regimes. Both parties

¹⁷⁴ Reply, para. 887.

¹⁷⁵ Ibid., para. 941.

agree that the tariff regime under the Concession Agreement followed the price cap model.¹⁷⁶ However, the parties' experts draw different implications for purposes of determining whether the Canon was part of the tariff review. The expert report of LECG submitted by the Claimant explains this regime and affirms that:

"The strong incentives for greater efficiency are probably the major innovation of the price cap regulatory regimes, and reflect an essential benefit of the system. A second benefit...is the reduction in regulatory costs as compared to the **traditional rate of return regulation**, which required continuous supervision of investments and costs, thus increasing regulatory costs."¹⁷⁷

227. This report quotes from a World Bank study:

"For a concessionaire that has paid a transfer to government to operate a business at a predetermined set of prices, these issues [asset valuation and depreciation] could be important. Regulatory disputes could emerge relating to what the concessionaire actually bought with that transfer – **a stream of future earnings or a return on the preexisting and future asset base?** Issues relating to the depreciation profile of both old and new assets therefore assume particular importance and should be signaled by the government during the bidding process.

[...] If the criterion is the largest lump sum offered to run a franchise, however, the outgoing concessionaire could receive the highest bid, **since this bid reflects the value of the assets as they currently exist**. However, this value is based on the future stream of earnings, which is determined by the price set by the regulator throughout the new franchise. If the regulator unreasonably ratchets down prices for the period of the new concession, this effectively expropriates the value of the assets built in the previous concession. Generally, therefore, **new**

¹⁷⁶ Argentina explains in its Counter-Memorial that there are different ways to regulate utilities, "One is to adjust tariffs based on the actual costs of the service provider and the other way is to fix in advance a fair and reasonable tariff capable of covering the costs of an efficient operator and yielding a reasonable profit. In the latter case, to earn a reasonable profit, the service provider must be efficient." (para. 959). According to Argentina, the privatizations during the nineties followed generally the second model (Counter-Memorial, para. 960).

¹⁷⁷ Exhibit 19A to Memorial, p. 32. Emphasis added by the Tribunal.

investment by the concessionaire needs to be transparently treated by the regulator at each review, as part of the process of rolling forward the asset base and charging depreciation on it.”¹⁷⁸

228. Somehow contradictorily, the LECG report argues for linking the Canon to the tariff review in a price cap regime when the quoted literature explains that in lump sum situations the value of the assets has been calculated by the bidder on the basis of the stream of estimated earnings within the *set level of tariffs* and the periodic adjustments permitted by the Concession Agreement.

229. LECG analyzes what would be the evolution of tariffs if the Canon were not included in the tariff base,

“At the first ordinary rate review the regulator, following standard regulatory practice as well as the regulatory framework and the Concession Contract, would consider the expected investment and operating costs, add the amortization of capital additions for the previous four years, and derive a tariff rate that would provide a normal rate of return only on the additions to the capital following the privatization. The result would be a price that would fall substantially below the long run marginal cost of the system. This is because such rates would remunerate only the capital added since privatization but not the capital already in place when the company started operations. Since, to be able to provide the service efficiently and effectively, both kinds of assets (i.e., that in place prior to privatization and the additional post-privatization) are needed, rates have to remunerate both of them.”¹⁷⁹

230. LECG concludes,

“Adding the canon to the tariff base provides the right incentives for both consumption and investment. Consumers will be facing the long run cost of providing the system and investors will have incentives to invest.”¹⁸⁰

¹⁷⁸ Ibid., pp. 59-60. Emphasis added by the Tribunal.

¹⁷⁹ LECG “An Economic Assessment of Argentina’s Counter-Memorial and of Mr. Chama’s Report”, Exhibit 4 to the Reply, p. 29.

¹⁸⁰ Ibid., p. 30.

231. In its reasoning, LECG ignores the current tariff level at the time that the Concession was granted. That tariff level was already in effect and future adjustments were meant precisely to remunerate the capital added since privatization. LECG's argument assumes that the current tariff would not be taken into account in the calculation of the adjustment, while the Concession Agreement considers it the base from which to start the review. The existing tariff provides the remuneration for the capital invested in the Concession *ab initio*.

232. Paradoxically, LECG itself seems to agree with this conclusion. When discussing the issue of the elimination of monopolistic rents through a competitive bidding process, the report adds a footnote stating that:

“Observe that although the investor bids the expected net present value of future cash flows, the investor makes money on the investment. Indeed, when discounting future cash flows, the investor uses a discount rate. This discount rate is the rate of return the investor gets on the initial investment (the canon) over the life of the concession.”¹⁸¹

233. The Tribunal will now analyze asset depreciation in the asset regime of the Concession Agreement.

(iv) Article 7.8

234. Article 7.8 on depreciation (“amortización”) is part of Article VII of the Concession Agreement on “Assets” (“Régimen de Bienes”). The first paragraph of this article provides for the capitalization and depreciation of assets over the term of the Concession or their useful lives whichever is shorter, with an exception which we do not need to refer to for purposes of this analysis. The assets to be capitalized and depreciated are those assets, and improvements on them, which are service-related, have been acquired or built by the Concessionaire and belong to the Concessionaire. They need to meet these three conditions. The term “belonging” is a translation of “que sean de su titularidad.” They need to be assets to which the Concessionaire has legal title. Article 7.2 on “Title” distinguishes between the possession of assets received by

¹⁸¹ Ibid., p. 31, footnote 53.

the Concessionaire from the Province and assets and movable assets and real property acquired or constructed during the term of the Concession which shall be owned by the Concessionaire. Title to these assets shall be recorded in the Real Property Registry and in the respective registries of movable assets. This is not the case of assets received from the Province.

235. The distinction becomes clearer when Article 7.2 and 7.8 are read together with Article 7.6 on disposition of assets. In the case of disposition of assets “owned by the Province ... the Concessionaire shall act as the Province’s agent.” This distinction then carries over to the second paragraph of Article 7.8 which establishes that, “The investments made by the Concessionaire in the assets received by [sic] [“de” in Spanish, “from” would be the correct translation] the Province upon Take Over shall be considered as acquisition of and/or upkeep costs of the Concession in accordance with provisions of clause 1.8 and shall be depreciated over the term of the Concession.” This paragraph limits the definition of investments to those made in the properties received from the Province without including the properties themselves.

236. The distinction between assets received and those acquired or improvements on the assets received carries over to the requirement for approval of acquisition and disposal of assets and how administrative silence to a request for acquisition or disposal of assets needs to be interpreted. In the case of movable assets owned by the Province, and those owned, whether movable or not, by the Claimant, silence to a request for their disposal shall be understood as approval (Article 7.6.2). On the other hand, silence by the ORAB in the case of non-movable assets registered in the name of the Province shall be understood as rejection of the request (Article 7.6.1).

237. The distinction is particularly relevant when it comes to the termination of the Concession. In the case of termination due to acts of God or *force majeure* (Article 14.2.1), the Province is required to pay the non-amortized value of investments and Service-related assets acquired or built by the Concessionaire in accordance with Article 7.8. Under the terms of this article, the assets received from the Province are not acquired assets. The Concessionaire did not become the owner of the assets transferred by the Province, nor did it ever have registered title to them.

238. The Claimant has argued that the existing assets at the time of the transfer and those acquired later form a unit. The argument is based on Articles 42-II and 43-II of the Law. Article 42-II provides that: “The assets that are covered by this article and which must be included in the Concession Contract are the assets the Concessionaire receives by virtue of the Contract. Also included are assets that the Concessionaire acquires or builds in order to fulfill its obligations under the Concession Contract.” Article 43-II reads as follows: “Assets that are transferred to the Concessionaire are part of a group known as the appropriated unit [‘unidad de afectación’ in Spanish].”

239. The Tribunal considers that the indivisibility of the unit has to be considered in the light of the other provisions on assets in the Concession Agreement and it cannot override the distinctions made between them regarding the ownership of assets, and their administration and disposal.

240. The Tribunal concludes after this analysis of the relevant provisions of the Law and the Concession Agreement that a harmonious interpretation of these provisions does not permit to consider the Canon as if it would be an investment not included in the existing tariff at the time of the transfer. The Tribunal has no doubt that the Canon is an investment, but, for purposes of tariff setting and amortization, the investor, in preparing the bid for the Concession, had to make a calculation of the value of the earnings stream of the Concession, and the price paid for the Concession was the result of this calculation. It is interesting to note, in that regard, that the Claimant seems to be the only bidder to have interpreted Circular 52(A) as it did, the other bidders presenting canons with values at least ten times lower than that submitted by the Claimant.

241. While the principle of amortization may have applied to the initial Canon as a matter of principle, whether it was amortized or not during the duration of the Concession would depend on whether the Concessionaire had estimated correctly the worth of the future earnings of the Concession based on the initial tariff and the discount rate to be applied to this estimate of future earnings. The discount rate used by the Claimant in the preparation of the bid was the rate of return on the Canon as an

“investment”. This seems to be inherent to a price cap concession regime and the terms of the Concession Agreement.

242. To conclude the consideration of the issue of Canon recovery, the Tribunal refers to the statement made by Argentina that the Tribunal may have erred by disregarding the irregularities of Article 12.1.1 in affirming its jurisdiction. According to Argentina, the Tribunal took this Article as a decisive factor in its decision. The Respondent refers specifically to paragraph 62 of the decision on jurisdiction, which reads as follows:

“The Tribunal finds difficulty in following the Respondent’s reasoning on the basis of the definition of investment in Article 1.1(a) of the BIT. First, a concession contract, such as that entered by ABA with the Province, qualifies as an investment for purposes of the BIT given the wide meaning conferred upon this term in the BIT that includes “any right conferred by law or contract.” The Concession Agreement itself refers repeatedly to investments. For instance, in the context of the determination of the tariff level, the Concession Agreement refers to “a reasonable return on the amounts *invested* by the Concessionaire,” [Article 12.1.1] and “the Concessionaire does hereby undertake to make all necessary *investments* to execute... [Article 7.8]”

243. In that paragraph, the Tribunal refers to Article 12.1.1 as an example of references to investments for purposes of the definition of this term under the BIT. The reasoning of the Tribunal would be the same without this example, which is not the only example in the paragraph. The other example, Article 7.8, has not been questioned by the Respondent. It should be apparent from the preceding discussion that what is an investment under the BIT and what is a recoverable investment under the Concession Agreement are different matters, and that whether an investment is or is not recoverable may be irrelevant for purposes of it being considered an investment under the BIT.

8. Termination

(a) Introduction

244. As has already been noted, ABA requested the Province to cure its breaches of the Concession Agreement on July 18, 2001. The Province replied on August 29, 2001 denying any wrongdoing; in particular, the letter denied the right of the Concessionaire to recover its investment, including the initial Canon. On October 5, 2001, ABA terminated the Concession Agreement. On November 1, 2001, the Province issued an Executive Order rejecting the termination of the Concession Agreement and ordering ABA to cease and desist from claiming that it had terminated the Concession Agreement, and to refrain from engaging in conduct that would disturb the provision of the service.

245. ABA filed for bankruptcy reorganization proceedings on February 26, 2002. On March 7, 2002, the Province deemed that ABA had abandoned the service. On March 12, 2002, the Province terminated the Concession Agreement alleging ABA's fault: non-fulfillment of service expansion and quality goals, fines imposed on ABA, difficulties of ABA in obtaining chemical supplies in February 2002 and paying for electric power, Enron's bankruptcy and service abandonment. On March 15, 2002, ABA delivered the service to the Province.

(b) Positions of the Parties

246. The Claimant has asserted that Article 48-II of the Law expressly delegated the definition of the right to terminate the Concession to the Concession Agreement, and that Article 14.1.4 of the Concession Agreement did not require the intervention of any authority to be terminated. On the other hand, Article 14.4.4 provides for court intervention for purposes of the reception of the service. Thus, concludes the Claimant, when the Province had considered it necessary to include reference to court intervention, it did so.¹⁸²

247. The Claimant also addresses the need for the competent authorities to intervene in case of termination of a concession required by Article 49-II of the Law.

¹⁸² Reply, para. 520.

According to the Claimant, this Article has to be construed appropriately and can “only be interpreted as appointing the competent governmental authorities for the purposes of declaring termination of the Concession Agreement upon the occurrence of events allowing the grantor its right of termination [...] It cannot be construed as a reference to termination when it is not declared by ‘an authority’”.¹⁸³

248. The Claimant also draws the attention of the Tribunal to the different treatment of termination on account of the grantor’s fault in the case of the Concession Agreement as compared to other concession agreements previously entered into by the Province and in which intervention of the courts is required to declare the agreement terminated in the event of resistance on the part of the Province. The Claimant draws the conclusion that these previous agreements were taken into account by provincial officials in drafting the Concession Agreement and departed from them, *inter alia*, in respect of the Concessionaire’s right to terminate the Concession Agreement.¹⁸⁴

249. The Claimant maintains that the many serious breaches of the Concession Agreement caused an irreversible imbalance of the economics of the Concession and that, in these circumstances, the demand by the Government that ABA continue to provide the service and complying with the expansion goals constituted overt and unwarranted abuse of its rights.¹⁸⁵ On the basis of Professor Fernández’s legal opinion, the Claimant affirms that, if it were not possible for the Concessionaire to terminate the Concession Agreement unilaterally without further intervention of the Province the contractual provision would lack any practical application; because the final settlement of this matter would be entirely left to the discretion of the Government, ignoring what the law specifically intended to avoid.¹⁸⁶ The same expert considers that:

“whenever the Law or the agreement recognizes in contractors the right to terminate said agreement, the general rule that sets forth that the termination of the agreement always requires a formal pronouncement by the Government must be replaced by the maxim *exceptio non adimpleti contractus*, as the only

¹⁸³ Ibid., para. 517.

¹⁸⁴ Ibid., para. 525.

¹⁸⁵ Ibid., para. 503.

¹⁸⁶ Ibid., para. 528.

possible way of avoiding an abuse by the Government under this rule, disregarding the contents of its provisions and forcing the contractor into a ruinous situation.”¹⁸⁷

250. The Claimant adduces extensive doctrinal opinion and Argentine and European administrative case law to defend the applicability of the *exceptio non adimpleti contractus* to the termination of the Concession Agreement.¹⁸⁸ The Claimant also refers to *Aucoven* where the arbitral tribunal, when faced with a similar situation found that, if the parties had intended to subject the termination of the concession agreement to a ruling by a judicial body, they would have expressly referred to such requirement in the clause in question.¹⁸⁹ The Claimant further argues that, if Article 14.1.4 is ambiguous, then it should be construed against its drafter.¹⁹⁰

251. According to the Claimant, the Province fabricated a case against Azurix to hide its own breaches while the Concessionaire continued to provide the service. The Concessionaire informed the Province on the day of the termination that it would continue to provide service for 90 days. In fact, it provided it for more than five months, which proves that the Concessionaire did not abandon the Concession.¹⁹¹

252. The Claimant draws the attention of the Tribunal to the fact that the Respondent continued to take measures that have aggravated the situation notwithstanding the Tribunal’s order to refrain from doing so. In particular, the Province indicated that it would not approve ABA’s proposal to creditors, collected payments of ABA’s customers, and cashed ABA’s and OBA’s performance bonds.¹⁹²

253. The Respondent argues that the Province had the exclusive power to terminate the Concession, that the Concessionaire had to request termination from the Province and, if the Province denied it, then the Concessionaire could file an action in the local courts to seek a judgment declaring contractual termination. In fact, ABA lodged an appeal against the Province’s termination before the Argentine Courts.

¹⁸⁷ Ibid., para. 528, quote from Professor Fernández’s legal opinion, Reply, Annex 1, para.160.

¹⁸⁸ Reply, paras. 541-555.

¹⁸⁹ Ibid., para. 557.

¹⁹⁰ Ibid., paras. 558-559.

¹⁹¹ Ibid., para. 571 and ff.

¹⁹² Ibid., para. 580 and ff.

According to Argentina's expert, Dr. Solomoni, Article 14.1.4 does not authorize the Concessionaire to declare the Concession Agreement terminated but it regulates the Province's prerogative to terminate the Concession Agreement even in the event of non-compliance by the Province. The Respondent alleges that the defense of the Claimant based on the *exceptio non adimpleti contractus* is not applicable here because it was never used by ABA when it defended its action. ABA always maintained that it had the right to terminate the Concession Agreement unilaterally.¹⁹³

254. The Respondent also raises the issue of a conflict between the BIT and human rights treaties that protect consumers' rights. According to Argentina's expert, a conflict between a BIT and human rights treaties must be resolved in favor of human rights because the consumers' public interest must prevail over the private interest of service provider.¹⁹⁴ On this point, the Claimant argues that the user's rights were duly protected by the provisions made in the Concession Agreement and the Province fails to prove how said rights were affected by the termination.¹⁹⁵

(c) Considerations of the Tribunal

255. Article 14.1.4 – Termination due to Fault of the Granting Authority - reads as follows in the translation furnished by the Claimant:¹⁹⁶

“The Concessionaire may claim termination of the Agreement based on the Concession Grantor's fault where a rule, act, fact or omission by the Concession Grantor results in a substantial noncompliance with the obligations undertaken by the Concession Grantor under the Agreement reasonably impairing its performance.

In such event, within thirty (30) days from knowledge or occurrence of said event, the Concessionaire shall demand the Concession Grantor to cease such noncompliance, and grant a reasonable term of at least thirty (30) days. In the event that Grantor fails to observe its obligations, the Agreement shall terminate.”

¹⁹³ Rejoinder, paras. 809-917.

¹⁹⁴ Dr. Solomoni's expert opinion, pp. 27-28.

¹⁹⁵ Reply, para. 565.

¹⁹⁶ Memorial, p. 128, footnote 528.

256. The Tribunal notes first that the last sentence quoted is not an accurate translation from the original Spanish version, which reads: “En el supuesto que el Concedente no cumpla con sus obligaciones, deberá declarar rescindido el Contrato.”

257. The Claimant has read this sentence as if the subject of the verb “deberá” were the Concessionaire. However, the Concessionaire is not mentioned at all in the sentence and it is more logical to consider the “Concedente” (the Grantor) as the subject. This reading is consistent with the first paragraph of the Article which refers to the ability of the Concessionaire to request the termination of the Agreement (“podrá solicitar”). The mandatory use of “deberá” (“shall”) would also seem to refer to the obligation of the Grantor since the Concessionaire may or may not wish to pursue its right. If the subject of the sentence were the Concessionaire, the term “may” would have been more appropriate.

258. This interpretation fits with Article 49-II of the Law that provides:

“The rescission of the contract or the salvaging of the services must be resolved by the Provincial Executive Authority with the intervention of ORAB.”

This text does not differentiate between rescission at the initiative or the nonperformance of one or the other of the parties. In all cases, the issue must be resolved by the Grantor. In the specific case of the Concession Agreement, the Grantor had no alternative but to declare the termination if its noncompliance continued, but this is where the parties disagreed. Both parties alleged noncompliance as a cause for their respective rescission of the Concession Agreement.

259. The above interpretation does not match the procedure for the rescission of the Concession Agreement on grounds of the Grantor’s fault in Article 14.4.4. When the Concession Agreement is terminated because of the Concessionaire’s fault, Article 14.4.3 provides that the Concessionaire shall deliver the service once it has been notified of the decree of the Grantor terminating the Concession. In contrast, Article 14.4.4 does not refer to any administrative act of the Grantor to rescind the Concession Agreement. It simply states that “Once the Contract shall have been terminated because of the Grantor’s fault...” without indicating by whom or by what action. The comparison of the two provisions seems to reflect the difference between the procedure

to be followed by a public authority which acts through decrees and resolutions and a private party which may simply notify the Grantor.

260. The difficulty in interpreting the provisions of Article 14 harmoniously is compounded by Article 49-II of the Law which, as already noted, prescribes that termination “must be resolved by the Provincial Executive Authority with the intervention of ORAB.” The Law does not distinguish between termination by the Grantor or the Concessionaire. It would seem appropriate that the Concession Agreement be interpreted consistently with the provisions of the Law. On the other hand, the Tribunal cannot ignore the practical result of this interpretation: if taken to the extreme, a concessionaire would be obliged to continue to provide the service indefinitely at the discretion of the government and its right to terminate the Concession Agreement would be deprived of any content. For this reason, the application of the maxim *exceptio non adimpleti contractus* provides a balance to the relationship between the government and the concessionaire. The Tribunal considers it immaterial whether ABA raised this defense in its recourse to the Argentine courts. The Tribunal is assessing the conduct of the Respondent and its instrumentalities in the exercise of its public authority against the standards of protection of foreign investors agreed in the BIT, and the application of the maxim *exceptio non adimpleti contractus* has been raised by the Claimant in these proceedings. This exception is not unknown to Argentine law and to legal systems generally as it is a reflection of the principle of good faith. The Tribunal will take it into account when evaluating the actions of the Province under the standards of protection.

261. The Respondent has also raised the issue of the compatibility of the BIT with human rights treaties. The matter has not been fully argued and the Tribunal fails to understand the incompatibility in the specifics of the instant case. The services to consumers continued to be provided without interruption by ABA during five months after the termination notice and through the new provincial utility after the transfer of service.

9. Conduct of the Province after Service Transfer

(a) Positions of the Parties

262. The Claimant points out that, on March 20, 2002, the ORAB issued Resolution 20/02 preventing ABA from collecting amounts owed in its accounts receivables for services provided prior to the date the service was transferred. Two days later an announcement in the press advised the public that all amounts payable to ABA for service before March 7, 2002 and not yet paid should be paid to the new service provider, and that payments made to ABA would not be honored. ABA requested the bankruptcy court to issue a protective measure. This measure was issued on June 4, 2002, “ordering the appropriate entities and agencies to refrain from collecting payments on invoices issued for services rendered by Azurix during periods preceding March 7, 2002, which shall only be paid to the debtor in these reorganization proceedings, at the domicile of such company. Furthermore, in the event that payments have already been collected on any such invoice, the appropriate entities shall deposit such amounts into an account opened for these proceedings and all other amounts shall be deposited at the Tribunales branch of Banco de la Ciudad de Buenos Aires.”¹⁹⁷

263. The Claimant notes that only one sanction had been imposed on ABA before the letter of July 18, 2001. Thereafter, there was a radical change and numerous penalties were levied against ABA as a clear harassment by the Province. The ORAB continued to impose sanctions on ABA even after the service was transferred. The Province was driven by the bankruptcy proceedings and the deadline to request the court to allow their claims. The deadline was June 3, 2002 and on such date the Province and its instrumentalities filed claims for AR\$187 million and US\$2.85 million as compared to AR\$15 million by all other creditors. The Claimant points out that the claims were filed four days before ABA itself was notified by Resolution No. 46/02, dated June 7, 2002, and that ABA was denied access to the documentation on which the penalty was based and an extension of the deadline to file an appeal. ABA filed an

¹⁹⁷ Memorial, p. 144 and Exhibit 203.

appeal to the trustee in bankruptcy who, according to the Claimant, considered most of the claims without merit.¹⁹⁸

264. Based on the report of the University of La Plata (“UNLP Report”),¹⁹⁹ the ORAB adopted Resolution No. 52/02 approving the final credit and debit account of the Concession resulting in a credit of the Province against ABA of AR\$640 million. According to the Claimant, the supporting documentation and a request for an extension of the deadline to file an appeal were denied. ABA filed an appeal on September 30, 2002 based on the hypothetical nature of the claims and their lack of grounds. Specifically, the Claimant alleges that damages concerning assets were estimated even though the ORAB never made the inventory required by Sections 14.4.3 and 14.4.4 of the Concession Agreement; the cost of new water and sewage connections were claimed although the Province released the new provider of making such investments; obligations not enforceable until years 3 and 5 of the Concession were considered unfulfilled and related damages were claimed; and damages concerning the same assets were duplicated. Furthermore, the credit and debit account includes hypothetical damages such as the loss in tax collections caused by the loss of possible increases in real estate properties value due to the interruption of the POES, the cost of a new bidding for the Concession which was never organized, increases in tax collection that the Province could have obtained from hotel, restaurant and tourism activities if ABA had continued as Concessionaire for 30 years.²⁰⁰

265. In the Counter-Memorial, the Respondent contests that the penalties reflected anything more than the non-performance of ABA. The Respondent notes first that the Claimant had failed to indicate to the Tribunal that ABA had a penalty holiday of six months after the takeover of the Concession. This grace period was a change introduced to the model contract included in the Bidding Documents. There was no doubt that such grace period was not part of the draft contract as confirmed by a reply of the Privatization Commission to a question.²⁰¹ The Respondent cites two other penalties imposed on ABA by Resolution No. 34/00 and Resolution No. 50/00. The

¹⁹⁸ Ibid., p. 135 and pp.145-146.

¹⁹⁹ Exhibit 175 to the Counter-Memorial.

²⁰⁰ Memorial, pp. 146-148.

²⁰¹ Rejoinder, para. 551, footnote 397, and Circular 21(A), reply to question 92.

Respondent points out that before imposing a penalty ORAB had to determine non-performance and follow the pertinent administrative proceedings. It was not a hostile attitude but respect for the administrative procedures to impose sanctions.²⁰²

266. According to the Respondent and on the basis of the UNLP Report, the damages to be borne by the Province as a result of failure to meet the goals undertaken in the POES and termination of the Concession Agreement for causes attributable to ABA exceeded AR\$149 million and the economic impact of the environmental damages caused by ABA amounted to over AR\$467 million.²⁰³ The Respondent observes that, in the statement of credits in favor of the Province, the amount collected for service prior to March 7, 2002 has been taken into account and that the relevant protective measure was revoked on appeal by the Commercial Court of Appeal. The Respondent also notes that ABA brought an action against Decree 508/02 terminating the Concession Agreement before the Supreme Court of the Province.²⁰⁴

267. In its Reply, the Claimant alleges that the sanctions imposed on ABA were part of a strategy to overwhelm Azurix's claim in these proceedings. They were a set of measures taken in a wider context of abusive measures by the Province and Argentina, including measures taken after the Decision on Provisional Measures of this Tribunal.²⁰⁵

268. In its analysis of the penalties imposed, the Claimant finds that: (i) 14 out of 16 fines were imposed after the termination of the Concession Agreement by ABA, (ii) during the two months that Decrees No. 2598/01 and 3039/01 were issued, ABA was fined seven times for a total of US\$555,000, (iii) seven more fines were imposed after the transfer of the service for a total of US\$1,960,000, and (iv) four fines for a total of US\$1,800,000 were levied between the filing of reorganization proceedings and the deadline for creditors to file a petition for allowance of claims.²⁰⁶

269. The Claimant points out, in particular, that the fine for the violation of biological parameters in Bahía Blanca related to an incident that happened in April 2000

²⁰² Counter-Memorial, paras. 559-569.

²⁰³ *Ibid.*, pp. 240-241.

²⁰⁴ *Ibid.*, para. 823.

²⁰⁵ *Ibid.*, paras. 602-603.

²⁰⁶ *Ibid.*, para. 590.

and ORAB did not file the charge until August 2001, and that in the case of 14 out of 16 fines, the drafts were prepared from July 2001 onwards.²⁰⁷

270. The Claimant observes that the six-month grace period is customary in this type of agreements to allow the concessionaires to adapt to the poor service management conditions that existed before privatization.²⁰⁸

271. In the Rejoinder, the Respondent enumerates 12 procedures underway at the time when ABA terminated the Concession Agreement to show that the process had started long before July 18, 2001 and before the penalties were imposed. The failures of ABA range from the breakage of an aqueduct, to over billing, breakage of a master pipe, deficiencies in operation and reconditioning of effluent purifying plants, lack of water quality standards at Bahía Blanca and Vedia.²⁰⁹ According to the Respondent, every single fine was imposed for a specific violation of the Concession Agreement by ABA. It was ABA that was exclusively responsible for supplying drinking water that met the quality and standards agreed in the Concession agreement and for performing under the POES.²¹⁰

272. The Respondent further notes that the Claimant in its Reply did not refer to the specific grounds of termination set forth in Decree 508/02, nor the effect of ABA's filing for bankruptcy and ENRON's bankruptcy on the Concession Agreement, nor ABA's filing against Decree 508/02.²¹¹

273. As to the damage sustained by the Province, the Respondent defends the calculation of the economic impact of the termination of the Concession as part of the damages for which ABA is liable and quotes from the UNLP Report: "The reasons that led the Province to start the bidding process – in which Azurix voluntarily submitted its bid – were to achieve positive environmental, sanitary, economic, fiscal, and operating results. All these privatization purposes may be assessed in economic terms. Azurix assessed them in order to submit the bid that secured Azurix the award of the contract;

²⁰⁷ Ibid., paras. 591-592.

²⁰⁸ Ibid., para. 600.

²⁰⁹ Ibid., para. 571 and Rejoinder, paras. 456-533.

²¹⁰ Rejoinder, paras. 555 and 557.

²¹¹ Ibid., paras. 842-850.

and the Province should assess them in order to determine the costs of the failure and seek fair compensation.”²¹²

274. The Respondent concludes on this point by observing that the allowance of the Province’s claim against ABA has yet to be adjudicated by the bankruptcy court.²¹³

(b) Considerations of the Tribunal

275. The Claimant has not questioned the underlying reasons for the penalties except in the case of Bahía Blanca and the fines and claims taken into account in the credit and debit account of the Concession, in particular the claims based on the UNLP Report. As noted by the Claimant, it is striking to note the contrast of administrative speed with which the fines and claims were processed after ABA gave notice of termination of the Concession and the deliberate pace with which other administrative matters were handled such as the construction variations or the valuations 2000. The Tribunal is surprised that the underlying documentation on which Resolutions 46/02 and 52/02 were based would be denied to ABA for purposes of filing an administrative appeal. The Tribunal is equally surprised that damages against ABA would be assessed in part on considerations that do not find any basis in the Concession Agreement or the Law.

VII. Breach of the BIT

1. Expropriation without compensation

(a) Positions of the Parties

276. Azurix claims that its investment, the Concession Agreement, has been expropriated as a result of “measures tantamount to expropriation”. For Azurix, what is important is not the form of the measures or their intent but their consequences. Azurix argues that the expropriation of its contract rights – and contract rights are included in the definition of investment - is the consequence of a series of acts that alone may not be sufficient to constitute expropriation but taken together constitute creeping

²¹² Ibid., quoted in para. 854. Emphasis of the Respondent.

²¹³ Ibid., para 858.

expropriation. Based on a review of case law and authorities, the Claimant defines this type of expropriation as “unreasonable or incidental interference that significantly deprives an owner of the control, use, benefits, enjoyment, access to, or reasonably-to-be-expected economic benefits of property, rights or interests to an extent that is more than ephemeral.”²¹⁴ Azurix notes that public utility companies are particularly exposed to this type of measures because the privatizing State “may be tempted to exploit the company once it has constructed a water system. When the water system is built the company can no longer walk away and take the pipelines with it, but is at the mercy of the regulator.”²¹⁵ The Claimant further observes that “The political capture of rents is equivalent to asset expropriation, as the company – whether public or private – will be unable to reap the rewards associated with those sunk costs.”²¹⁶

277. According to Azurix, the Province took away Azurix’s rights under the tariff regime of the Concession, compromised the ability of ABA to obtain financing, saddled ABA with unexpected expenses by not finishing the promised infrastructure included in Circular 31(A), and took away Azurix’s right to recover fully the Canon. After paying for the Concession, “Provincial officials used Azurix’s investment as their personal ‘whipping boy’ to stir the pot of ratepayer anger caused by years of neglect of the water infrastructure and misdirect it towards ABA.” The Province broke the Regulatory Compact and signaled that it was not committed to a sustainable Concession. To conclude, “Under any plausible construction of expropriation, the Province and the Republic deprived Azurix of the use and enjoyment of the reasonably-to-be-expected economic benefits of the Concession and expropriated its investments.”²¹⁷

278. The Respondent contests the definition of creeping expropriation arrived at by the Claimant. The Respondent argues that a central aspect of the test related to the notion of unlawfulness or unreasonableness is missing in that definition: “only if Buenos Aires Province has ignored ABA’s contractual rights may an evaluation be made about whether or not an expropriation has occurred. If Buenos Aires Province has

²¹⁴ Memorial, p.166.

²¹⁵ Ibid., p. 169 quoting from a World Bank study.

²¹⁶ Ibid., p. 168.

²¹⁷ Ibid., p. 180.

not ignored Azurix's contractual rights, there is no expropriation to complain about."²¹⁸ According to the Respondent, the Province acted at all times in accordance with the Law and the Concession Agreement. On the other hand, there has been a gradual violation of both by ABA which, from the beginning, attempted to renegotiate the Concession Agreement under more convenient terms to its own satisfaction and has failed to meet its obligations under the POES. According to Argentina, citing *Lauder* and *S.D. Myers*, in order to determine whether or not an expropriation has occurred the government's intention may not be disregarded:

"Detrimental effect on the economic value of property is not sufficient; Parties to [the Bilateral Treaty] are not liable for economic injury that is the consequence of *bona fide* regulation within the accepted police powers of the State."²¹⁹

"Both words ['tantamount' and 'expropriation'] require a tribunal to look at the substance of what occurred and not only at form. A tribunal should not be deterred by technical or facial considerations from reaching a conclusion that an expropriation has occurred. It must look at the real interests involved and the purpose and effect of the government measure." (emphasis added by the Respondent).²²⁰

279. The Respondent argues that respecting a contract may never be held to be an expropriation. The Concession Agreement stipulated the tariff structure for the entire term of the Concession, "an error in the Concession fee calculation might not be invoked for amending the tariffs."²²¹ If investment risk in the case of utilities is usually considered low, as stated by Azurix, this is because the utility provider knows "in advance the tariff regime to be applied throughout the term of the concession before submitting the Offer."²²²

²¹⁸ Counter-Memorial, para. 944.

²¹⁹ *Lauder v. Czech Republic*, UNCITRAL, Final Award, September 3, 2001, para. 198, quoted in Counter-Memorial, para. 950.

²²⁰ *S.D. Myers v. Canada*, Partial Award of November 13, 2000, para. 285, quoted in the Counter-Memorial, para 950.

²²¹ *Ibid.*, para. 952.

²²² *Ibid.*, para. 953.

280. The Respondent affirms that the sunken cost argument made by Azurix does not apply in this case; it was the Province that installed the infrastructure and the fee paid was to exercise “the natural monopoly facilitated by the investment previously made by the State.”²²³

281. The Respondent comments in relation to the tariff conflicts that, except in one case, they all referred to the non-metered regime which was a temporary regime, and, as regards the exception, no damage occurred because the tariff increase sought was based on a cost increase that never existed. The Respondent refers again to *S.D. Myers* where the tribunal held, on the facts of the case that a temporary measure should not be characterized as an expropriation, “the evidence did not support a transfer of property or benefit directly to others, simply an opportunity was delayed”.²²⁴ The Respondent points out that a reasonable period of time needs to pass to examine whether or not measures actually have the expropriating effect attributed to them, and that time is also important to determine when the expropriation took place:

“According to Azurix’s conduct ... the investment conflict had already arisen by January 5, 2001, that is to say only a few months after having executed the contract. This position is untenable and purely speculative. The operability of a Concession such as Azurix had in its hand is not defined in less than eighteen months. Moreover, validating the way Azurix acted would mean rewarding self-fulfilling prophecies. Azurix could not have negotiated in good faith because the investment conflict it was claiming could not have possibly arisen.”²²⁵

282. In the Reply, the Claimant argues that the measures alleged to constitute tantamount to expropriation are not limited to mere breaches of contract. The Claimant brings to the attention of the Tribunal that the tariff regime incorporated into the contract also represents “part of a regulatory system established by law whereby the regulatory agency ... -which is not a direct party to the contract – unilaterally interprets the Tariff Regime and holds the power to order the implementation of its interpretations. That is not a normal contract situation, and the refusal of the ORAB properly to interpret and

²²³ Ibid., para. 957.

²²⁴ Ibid., para. 967.

²²⁵ Ibid., para. 971.

implement the Tariff System is not a mere contract breach, although it does breach the contract as well.”²²⁶

283. The Claimant lists, as other measures tantamount to expropriation beyond the repudiation of the tariff regime, the repudiation by the Province of representations and assurances provided in the bidding process through circulars and information communiqués, the public call for customers not to pay their bills in August 1999 when the equalization subsidy was eliminated, the public calls by the provincial Governor and the Mayor of Bahía Blanca for users not to pay their water bills, the incorrect public statements by provincial office holders that the Concessionaire was wholly responsible for the incident, the incorrect public statements by public officials creating hysteria by suggesting that the water was toxic, the ORAB resolutions not allowing ABA to collect for its services, etc.²²⁷

284. The Claimant argues that, in any case, breaches of contract may constitute an expropriation and cites internal legislation of the United States, a party to the BIT, where it is stated that ‘any abrogation, repudiation, or impairment by a foreign government of its own contract with an investor ... and [which] materially adversely affects the continued operation of the project ...’²²⁸ According to the Claimant, breach of contract or actions affecting contract rights may constitute an expropriation in certain situations: a breach of contract which is part of a series of acts that combined would have the effect of a creeping expropriation (*Waste Management*), a fundamental breach of contract, which goes to the heart of the performance promised and adversely affects the continued operation of the project subject of the contract (*BP v. Libyan Arab Republic*), regulatory conduct that denies contract rights or requires their alteration (*CME v. Czech Republic*), repudiation of specific contract rights or a contract as a whole (*Phillips Petroleum v. Iran*), and a breach of a stabilization clause in a contract (*Agip v. Congo*).²²⁹

²²⁶ Reply, para. 641.

²²⁷ Ibid., paras. 643-644.

²²⁸ Ibid., para. 647.

²²⁹ Ibid., para. 648.

285. As regards whether the deprivation of rights or benefits is ephemeral, the Claimant observes that the relevant inquiry is the duration of the deprivation of rights or benefits, nor the duration of the expropriatory acts themselves. First, there is no set duration for a period of time to be classified as being more than ephemeral in international law. The Claimant in this respect refers to the General Conditions of Guarantee for Equity Investments of MIGA which require that the failure by an administrative agency to act remain uncured for one year. Second, the measures of the Province were permanent measures: ABA was permanently deprived from its right to eliminate the zoning subsidy, so were the repudiation of Circular 52(A) and the contract rights embodied in Articles 7.8 and 12.1.1 of the Concession Agreement to treat the Canon payment as an investment, the actions of the Province resulted in the permanent denial of multilateral financing, the Province permanently refused to return the unamortized portion of the Canon payment, the Province permanently repudiated the contractual rights to calculate tariffs in US dollars and to index the tariffs by US indexes. The effect of these measures was to drive ABA into bankruptcy and permanently put it out of business.²³⁰

286. According to the Claimant the notion advanced by the Respondent - that there cannot be an expropriation without an effect on an investor's contractual rights - ignores the authorities and the case law. According to the Claimant, "Conduct contrary to an investor's legitimate expectations that constitute a norm or were induced by the government also can amount to expropriation."²³¹ The Claimant refers to a long line of case law to prove this point, "*Middle East Cement, Goetz, Metalclad, Tecmed*, and other recent cases, "demonstrate that a State's actions need not affect formal contractual rights in order to constitute expropriation. Contrary to the GOA's assertions, the case law shows that actions that have the effect of depriving a foreign investor of the 'reasonably-to-be-expected economic benefit' of an investment can amount to an expropriation even if the actions do not affect or alter contract rights."²³²

²³⁰ Ibid., para. 655

²³¹ Ibid., para. 660.

²³² Ibid., para. 666.

287. According to the Claimant, expropriation also exists when a State repudiates former assurances or refuses to give assurances that it will comply with its obligations, “which deprives the investor, in whole or significant part, of the use or reasonably-to-be-expected economic benefit of its investment constitutes an expropriation. Similarly, Azurix was deprived of the reasonably-to-be-expected economic benefit of its investment in the Concession and is entitled to compensation for this expropriation.”²³³

288. The Claimant alleges also loss of control of its investment as grounds for expropriation. The effect of the measures taken not only took away the financial benefits from the Concession by making it unsustainable, but also stripped the investment of its legal security. The Claimant relies in particular on *Revere* where the tribunal held that “the government’s actions were expropriatory because they repudiated contract rights resulting in the inability of the investor to make rational, calculated decisions based on known contract rights, thus causing the investor to lose control of the investment.”²³⁴

289. The Respondent in its Rejoinder explains that its reference to contract rights in the Counter-Memorial was motivated by the fact that Azurix had based its claims on breaches of contract rights. The Respondent then relies on *Serbian Loans*, *Woolfruff*, *ELSI* and, in particular, *Vivendi*, *SGS v. Pakistan* and *SGS v. Philippines* to contest that contractual claims should be heard before arbitral tribunals. It is clear, according to the Respondent, that “arbitration tribunals do not accept hearing domestic contractual claims as if they were genuine international claims.”²³⁵ According to the Respondent, if “the Tribunal understood the substance of the claim in the way Azurix does, said Tribunal would lack jurisdiction and the award would be clearly null.”²³⁶

290. The Respondent then alleges that Azurix introduces a confusion by contending that umbrella clauses apply beyond specific investment agreements, in reality, these clauses can only be applied in case of an investment agreement breach but not for a breach of a concession agreement governed by the domestic and

²³³ Ibid., para. 228.

²³⁴ Ibid., para. 681.

²³⁵ Rejoinder, para. 971. Emphasis in the original.

²³⁶ Ibid., para. 980.

administrative law agreed in the forum clause: “Azurix intently confuses Investment Agreement with investment, terms that are not equivalent or amalgamable.”²³⁷

291. Argentina also argues against a pro-investor interpretation of the BIT. By protecting investors and investment broadly, the treaties would come to be regarded as guarantees and assurances, eliminating the notion of risk and venture as stated by the tribunal in *Tecmed*. According to Argentina, in this case the tribunal had, “to consider the elements forming the standard banning expropriation without compensation, it was far from claiming broad and vague interpretative assumptions in favor of the investor based on BIT supposed purposes. On the contrary, it acknowledged the principle of deference to the State in order to define the public interest or usefulness reasons upon which its actions are founded.”²³⁸

292. Argentina alleges that, in the Reply, the Claimant tries to reformulate the standard so that it can be read “exactly in the same way as what is under the protection of the general clauses (*umbrella clauses*).” According to Argentina, the Claimant alleges that some of the actions were expropriatory *per se*. The Respondent explains that in a progressive expropriation no action in itself is expropriatory. The Respondent relies on the dissident opinion of Keith Highet in *Waste Management*:

“a ‘creeping expropriation’ is comprised of a number of elements, none of which can - separately – constitute the international wrong. These constituent elements include non-payment, non-reimbursement, cancellation, denial of judicial access, actual practice to exclude, non-conforming treatment, inconsistent legal blocks, and so forth. The ‘measure’ at issue is the expropriation itself; it is not merely a sub-component part of expropriation.”²³⁹

293. The Respondent also quotes from *Santa Elena*,

“As it is well known, there is a wide spectrum of measures that a state may take in asserting control over property, extending from limited regulation of its use to a complete and formal deprivation of the owner’s legal title. Likewise, the period of

²³⁷ Ibid., para. 981.

²³⁸ Ibid., quote in para. 985.

²³⁹ Ibid., quote in para. 1001.

time involved in the process may vary – from an immediate and comprehensive taking to one that gradually and by small steps reaches a condition in which it can be said that the owner has truly lost all attributes of ownership. It is clear, however, that a measure or a series of measures can still eventually amount to a taking though the individual steps in the process do not formally purport to amount to a taking or to a transfer of title. What has to be identified is the extent to which the measures taken have deprived the owner of the normal control of his property.”²⁴⁰

294. Furthermore, according to the Respondent, in a creeping expropriation what matters is not the duration of the effects but the intensity of the expropriatory process. The Respondent contests the affirmation by the Claimant that international law fixes an exact limit as regards when to determine a creeping expropriation, only a reasonable period of time is required. The Respondent also contests the interpretation of MIGA’s General Conditions and observes that they have been only partially quoted by the Claimant. These Conditions require that, for some measures, the company concerned should not have been able, for three years, to operate without losses. In any case, the time would run from the measure that culminates in the expropriation, since none of the preceding measures *per se* constituted expropriation.

295. The Respondent concludes that the individual effect of each measure may never be expropriatory; to determine if a series of measures has an expropriatory effect, the intensity of the process globally considered should be measured; the expropriatory effect should have lasted until it consolidated and could be considered a permanent effect; the set time to lapse is not defined by international law as an algorithm, but it requires the passing of reasonable time.²⁴¹

296. The Respondent disagrees with Azurix’s insistence exclusively on the effect of the measures as the key element to determine whether an expropriation has occurred. There is another element. The investor needs to have a right to the specific treatment expected, “If there is no legal right to be treated in a specific manner, no

²⁴⁰ Ibid., quote in para. 1003.

²⁴¹ Ibid., para. 1017.

expropriation can be considered when someone is treated according to the law.” In this respect, the Respondent refers to the tribunal’s finding in *Feldman* that NAFTA and principles of customary international law do not require a State to permit a gray market of cigarette exports. Mexican law did not afford cigarette resellers a right to export cigarettes and the claimant’s investment remained under its complete control and with the right to export other Mexican products.²⁴²

297. Furthermore, the Respondent argues that the effect and intent of measures cannot be separated as Azurix has done. The intent is important to differentiate between legitimate regulation and confiscatory regulation. The Respondent refers approvingly to the statement in *Feldman* that,

“not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110. Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue.”²⁴³

298. The Respondent further refers to *Generation Ukraine*,

“Predictability is one of the most important objectives of any legal system. It would be useful if it were absolutely clear in advance whether particular events fall within the definition of an ‘indirect’ expropriation. It would enhance the sentiment of respect for legitimate expectations if it were perfectly obvious why, in the context of a particular decision, an arbitration tribunal found that a governmental action or inaction crossed the line that defines acts amounting to an indirect expropriation. But there is no checklist, no mechanical test to achieve that purpose. The decisive considerations vary from case to case, depending not only on the specific facts of a grievance but also on the way the evidence is

²⁴² Ibid., para. 1022.

²⁴³ Ibid., quote in para. 1024.

presented, and the legal bases pleaded. The outcome is a judgment, *i.e.*, the product of discernment, and not the printout of a computer program.”²⁴⁴

299. Faced with the task of judging, the tribunal in *Generation Ukraine*, set some negative criteria that the Respondent quotes as supporting its argument that mere effect is not enough:

“The fact that an investment has become worthless obviously does not mean that there was an act of expropriation; investment always entails risk. Nor is it sufficient for the disappointed investor to point to some governmental initiative, or inaction, which might have contributed to its ill fortune. Yet again, it is not enough for an investor to seize upon an act of maladministration, no matter how low the level of the relevant governmental authority; to abandon his investment without any effort at overturning the administrative fault; and thus to claim an international delict on the theory that there had been an uncompensated virtual expropriation. In such instances, an international tribunal may deem that the failure to seek redress from national authorities disqualifies the international claim, not because there is a requirement of exhaustion of local remedies but because the very reality of conduct tantamount to expropriation is doubtful in the absence of a reasonable – not necessarily exhaustive – effort by the investor to obtain correction.”

300. And further,

“There is, of course, no formal obligation upon the Claimant to exhaust local remedies before resorting to ICSID arbitration pursuant to the BIT. Nevertheless, in the absence of any *per se* violation of the BIT discernible from the relevant conduct of the Kyiv City State Administration, the only possibility in this case for the series of complaints relating to highly technical matters of Ukrainian planning law to be transformed into a BIT violation would have been for the Claimant to be denied justice before the Ukrainian courts in a *bona fide* attempt to resolve these technical matters.”²⁴⁵

²⁴⁴ Ibid., quote in para. 1027.

²⁴⁵ Ibid., quote in para. 1029.

301. Argentina agrees with this consideration of the tribunal “to avoid becoming an administrative tribunal that conscientiously goes through the actions and omissions of the host State administrative bodies.”²⁴⁶

302. As regards the protection of the investor’s expectations, the Respondent affirms that the cases adduced by the Claimant do not support the Claimant’s contentions because Azurix’s claim is based completely on alleged contractual breaches by the Province.²⁴⁷ Addressing the specific cases, Argentina argues that the *Aminoil* tribunal never analyzed whether Kuwait had expropriated legitimate expectations from the private petroleum company, but it considered that contractual rights have been expropriated. Legitimate expectations are not the basis for expropriation but the measure of compensation. Argentina considers that the same is true of *Middle East Cement*. This case simply shows that the contractual rights of the investor are able to be expropriated even when a contract has not been formally terminated and its contractual rights had been *de facto* revoked. Argentina points out that, in *Goetz*, the tribunal did not make a finding regarding legitimate expectations, but whether rights conferred by a unilateral act –such as granting of a license- can also be expropriated. Argentina considers that *Metalclad* and *Tecmed* are not applicable because in neither of these cases Mexico had entered into a contract with the investor and hence it was impossible for the tribunals to decide in favor of the expropriation of contractual rights.²⁴⁸

303. The Respondent emphasizes that there were no contractual breaches by the Province and that, if there had been, as held in *Waste Management*, contractual breaches did not generate international responsibility:

“In the Tribunal’s view, an enterprise is not expropriated just because its debts are not paid or other contractual obligations towards it are breached. There was no outright repudiation of the transaction in the present case, and if the City entered into the Concession Agreement on the basis of an over-optimistic assessment of the possibilities, so did Acaverde. It is not the function of Article

²⁴⁶ Ibid.

²⁴⁷ Ibid., para. 1049.

²⁴⁸ Ibid., paras. 1053-1062.

1110 to compensate for failed business ventures, absent arbitrary intervention by the State amounting to a virtual taking or sterilising of the enterprise.”²⁴⁹

304. And,

“The Tribunal concludes 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 contractual obligations is not the same thing as, or equivalent or tantamount to, an expropriation. In the present case the Claimant did not lose its contractual rights, which it was free to pursue before the contractually chosen forum. The law of breach of contract is not secreted in the interstices of Article 1110 of NAFTA. Rather it is necessary to show an effective repudiation of the right, unredressed by any remedies available to the Claimant, which has the effect of preventing its exercise entirely or to a substantial extent.”²⁵⁰

305. The Respondent concludes by referring to the Regulatory Framework, the Bidding Conditions and the Concession Agreement. The Respondent affirms that the circulars and information communiqués had no power to modify substantially the established contractual system, which had been known and accepted by Azurix and ABA and hence “it is not possible that Azurix may construe, in good faith, that there had been alleged rights or expectations, which are manifestly in conflict with this normative system.”²⁵¹

(b) Considerations of the Tribunal

306. The parties’ arguments raise issues ranging from whether the BIT should be interpreted in favor of the investor to the requirements of expropriation measures in terms of effect, intention and duration, and whether such measures may, or may not necessarily, be contractual breaches which cumulatively may be tantamount to expropriation or the taking of the benefits legitimately expected by the investor. The Tribunal will now address these arguments in that order.

²⁴⁹ Ibid., quote in para. 1063.

²⁵⁰ Ibid., quote in footnote 885.

²⁵¹ Ibid., para. 1067.

(i) Interpretation of the BIT

307. The Tribunal does not consider that the BIT should be interpreted in favor or against the investor. The BIT is an international treaty and should be interpreted in accordance with the interpretation norms set forth by the Vienna Convention on the Law of the Treaties (“the Vienna Convention”), which is binding on the States parties to the BIT. Article 31(1) of the Vienna Convention requires that a treaty be “interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.” The Tribunal observes that the BIT itself is an instrument agreed by the two State parties to encourage and protect investment. In the preamble of the BIT, the parties agreed that “fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources”. Therefore, the BIT itself is a document that requires certain treatment of investment which the parties have considered necessary to “stimulate the flow of private capital”. The Tribunal in interpreting the BIT must be mindful of the objective the parties intended to pursue by concluding it.

(ii) Effect, Intent and Duration of Expropriation Measures

308. The parties agree that cumulative steps which individually may not qualify as an expropriating measure may have the effect equivalent to an outright expropriation. The parties also agree on the varied nature of possible steps, including breach of contract: the Respondent affirms that if the Province had “ignored ABA’s contractual rights an evaluation could be made about whether or not an expropriation has occurred.”²⁵² The Respondent has adduced Mr. Highet’s definition of creeping expropriation, which includes in the list of examples of possible constituent elements non-payment and non-reimbursement, elements which refer to contractual non-performance. On the other hand, the Respondent has also relied on holdings of the tribunal in *Waste Management* to the effect that breach of contract is not the same as expropriation of a contractual right.

²⁵² Counter-Memorial, para. 180.

309. The parties disagree on the relevance of taking into account the intent pursued by the measures concerned and the time needed for the measures to consolidate into a creeping expropriation. Whether to consider only the effect of measures tantamount to expropriation or consider both the effect and purpose of the measures is a point on which not only the parties disagree but also arbitral tribunals. In *Santa Elena*, that the Respondent found a useful point of reference for the concept of creeping expropriation, the tribunal did not take into account the environmental purpose of the expropriatory measures: “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.”²⁵³ The same tribunal was persuaded by the finding in *Tippetts* that “The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.”²⁵⁴

310. For the Tribunal, the issue is not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that, being legitimate and serving a public purpose, should give rise to a compensation claim. In the exercise of their public policy function, governments take all sorts of measures that may affect the economic value of investments without such measures giving rise to a need to compensate. The tribunal in *S.D. Myers* found the purpose of a regulatory measure a helpful criterion to distinguish measures for which a State would not be liable: “Parties [to the Bilateral Treaty] are not liable for economic injury that is the consequence of *bona fide* regulation within the accepted police powers of the State.”²⁵⁵ This Tribunal finds the criterion insufficient and shares the concern expressed by Judge R. Higgins, who questioned whether the difference between expropriation and regulation based on public purpose was intellectually viable:

²⁵³ *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), Award, para. 72.

²⁵⁴ *Ibid.*, para. 77. Translation by the Tribunal.

²⁵⁵ Counter-Memorial, quote in para. 950.

“Is not the State in both cases (that is, either by a taking for a public purpose, or by regulating) purporting to act in the common good? And in each case has the owner of the property not suffered loss? Under international law standards, a regulation that amounted (by virtue of its scope and effect) to a taking, would need to be ‘for a public purpose’ (in the sense of in general, rather than for a private interest). And just compensation would be due. At the same time, interferences with property for economic and financial regulatory purposes are tolerated to a significant extent.”²⁵⁶

311. The argument made by the *S.D. Myers* tribunal is somehow contradictory. According to it, the BIT would require that investments not be expropriated except for a public purpose and that there be compensation if such expropriation takes place and, at the same time, regulatory measures that may be tantamount to expropriation would not give rise to a claim for compensation if taken for a public purpose. The public purpose criterion as an additional criterion to the effect of the measures under consideration needs to be complemented. The parties have referred in their exchanges to findings of the tribunal in *Tecmed*. That tribunal sought guidance in the case law of the European Court of Human Rights, in particular, in the case of *James and Others*. The Court held that “a measure depriving a person of his property [must] pursue, on the facts as well as in principle, a legitimate aim ‘in the public interest’”, and bear “a reasonable relationship of proportionality between the means employed and the aim sought to be realized”. This proportionality will not be found if the person concerned bears “an individual and excessive burden”. The Court considered that such “a measure must be both appropriate for achieving its aim and not disproportionate thereto.” The Court found relevant that non-nationals “will generally have played no part in the election or designation of its [of the measure] authors nor have been consulted on its adoption”, and observed that “there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals.”²⁵⁷

²⁵⁶ “The Taking of Property by the state: Recent Developments in International Law”, *Recueil des Cours*, vol. III (1982), p. 331.

²⁵⁷ *In the case of James and Others*, sentence of February 21, 1986, paras. 50 and 63, and *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2), paras. 121-122.

312. The Tribunal finds that these additional elements provide useful guidance for purposes of determining whether regulatory actions would be expropriatory and give rise to compensation.

313. The parties hold also different views on the time needed for a set of measures to have an expropriatory effect. There is no specific time set under international law for measures constituting creeping expropriation to produce that effect. It will depend on the specific circumstances of the case. Arbitral tribunals have considered that a measure is not ephemeral if the property was out of the control of the investor for a year (*Wena*) or an export license was suspended for four months (*Middle East Cement*), or that the measure was ephemeral if it lasted for three months (*S.D. Myers*). These cases involved a single measure. When considering multiple measures, it will depend on the duration of their cumulative effect. Unfortunately, there is no mathematical formula to reach a mechanical result. How much time is needed must be judged by the specific circumstances of each case. As expressed by the tribunal in *Generation Ukraine*: “The outcome is a judgment, *i.e.*, the product of discernment, and not the printout of a computer program.”²⁵⁸

(iii) Breach of Contract and Expropriation

314. Whether contract rights may be expropriated is widely accepted by the case law and the doctrine. The discussion by the parties reflects more a question of whether in the specifics of the instant case the alleged breaches of the Province can be considered to be such. As repeatedly stated by the Respondent, the Province with its actions did no more than to comply with the Concession Agreement and the Regulatory Framework. Therefore, according to the Respondent, ABA was not entitled to the alleged rights which supposedly the Province ignored.

315. The Tribunal agrees that contractual breaches by a State party or one of its instrumentalities would not normally constitute expropriation. Whether one or series of such breaches can be considered to be measures tantamount to expropriation will depend on whether the State or its instrumentality has breached the contract in the exercise of its sovereign authority, or as a party to a contract. As already noted, a State

²⁵⁸ Rejoinder, quote in para. 1027.

or its instrumentalities may perform a contract badly, but this will not result in a breach of treaty provisions, “unless it be proved that the state or its emanation has gone beyond its role as a mere party to the contract, and has exercised the specific functions of a sovereign.”²⁵⁹ In considering each of the grounds which the Claimant has advanced to justify its expropriation claim and to the extent that they may be characterized as breaches of the Concession Agreement, the Tribunal will assess them from the perspective of possible breaches of the BIT and of whether they reflect the exercise of specific functions of a sovereign.

(iv) Legitimate Expectations

316. The issue of whether an expropriation may take place without formally affecting the contract rights has been discussed by the parties in the context of the frustration of the investor’s legitimate expectations when a State repudiates former assurances, or refuses to give assurances that it will comply with its obligations depriving the investor in whole or significant part, of the use or reasonably-to-be-expected economic benefit of its investment. *Tecmed* is a clear example in which a tribunal took into account the expectations of the investor. Argentina has dismissed the relevance of this case on the basis that Mexico had no contract with the investor. In fact, the tribunal in that case considered attributable to Mexico, as the sovereign, certain acts that frustrated the expectations generated in the investor even when Mexico was not party to the contract. That tribunal determined that the conduct of INE, the Mexican federal agency which had issued the license, was attributable to the government. Hence, the considerations of that tribunal are not without significance for these proceedings:

“The political and social circumstances [...] which conclusively conditioned the issuance of the Resolution, were shown with all their magnitude after a substantial part of the investment had been made 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 [the vehicle used

²⁵⁹ *Consortium FRCC c. Royaume du Maroc* (Aff. No. ARB/00/6), Sentence arbitrale, para. 65 See also *Impregilo*, para. 260.

by the investor] 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."²⁶⁰

317. The tribunal then adds:

"Both the authorization to operate as 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 [footnote deleted]. 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."²⁶¹

318. The expectations as shown in that case are not necessarily based on a contract but on assurances explicit or implicit, or on representations, made by the State which the investor took into account in making the investment. That tribunal, for instance, took into account the declaration of 1994 and the implicit need of a long-term operation of the landfill for the investor to be able to have a reasonable return on the expected investment even when the specific permit was only a one-year permit. In the case before this Tribunal, the Respondent has questioned that any of the alleged expectations may have been created by the Province when these expectations are in conflict with the normative system.²⁶² Whether they actually are in conflict with the normative system of the Concession and they have been frustrated to the extent of

²⁶⁰ *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*(ICSID Case No. ARB(AF)/00/2), para 149.

²⁶¹ *Ibid.*, para. 150.

²⁶² Rejoinder, para 1067.

depriving the investor of the benefits of the investment is a matter that the Tribunal will now proceed to determine.

319. The measures and actions taken by the Province to be considered for purposes of determining whether they amounted to an expropriation are those related to the so called tariff conflicts, Canon recovery, the works under Circular 31(A) and the consequential effect on the ability of ABA to obtain financing. The actions of the provincial authorities in the case of the first tariff conflict and the Bahía Blanca works exceeded any contractual rights by inviting customers not to pay bills even before the administrative appeal of ABA against the decision of the ORAB was resolved, or notwithstanding the fact that the Province had not completed the works in the Paso las Piedras reservoir that it represented it would complete at the time of the bidding for the Concession. The same can be said of the public threats against officials of the ORAB for allowing ABA to resume billing of customers after the Bahía Blanca incident. These instances show the politicization of the Concession, as H & S noted, and the lack of commitment of the new provincial authorities to the privatization process undertaken by their predecessors.

320. The unhelpful attitude of the authorities is also evident in the procrastination in resolving the issue of the construction variations when the information given the bidders proved to be incorrect and in completing the works under Circular 31(A). Even if no specific date was established for their completion, the percentage of works completed given the bidders and the dates of completion in the respective contracts created a reasonable expectation that the works would be completed. Even if ABA had no right under the Concession Agreement to a revision of tariffs to recover the Canon, it had the right to recover it to the extent that this was feasible within the existing tariff framework; thus statements made by government officials that the Canon was not recoverable were not in accordance with the financial terms of the Concession. There is also no doubt that the image of the Concessionaire was damaged by the actions of the Province vis-à-vis its customers at the time when it was crucial for the privatized service to take hold.

321. However, the politicization of the Concession or the actions taken by the Province were not the only cause of OPIC's denial of financing. The letter of OPIC referred also to the capital requirements of the Concession as compared to the revenues generated by the existing tariff level were the tariff regime not amended. The conclusions reached by the Tribunal on the recovery of the Canon and the RPI are also significant for purposes of the determination of the degree of impact that the actions of the Province had on Azurix's investment. The Tribunal disagrees with the understanding of the Claimant of the terms of the Law and the Concession Agreement on these matters. Were this not the case, the Tribunal would agree that the breaches of the Concession Agreement would have had a devastating effect on the financial viability of the Concession, but the Claimant has been unable to convince the Tribunal of the correctness of its understanding of the terms of the Law and the Concession Agreement.

322. Therefore, the Tribunal finds that the impact on the investment attributable to the Province's actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation; Azurix did not lose the attributes of ownership, at all times continued to control ABA and its ownership of 90% of the shares was unaffected. No doubt the management of ABA was affected by the Province's actions, but not sufficiently for the Tribunal to find that Azurix's investment was expropriated.

323. The Tribunal will turn now to whether the other standards of protection in the BIT were violated as claimed by Azurix. The Tribunal has grouped the arguments made under the heading of "Transparency" under "Fair and Equitable Treatment."

2. Fair and Equitable Treatment

(a) *Positions of the Parties*

324. Azurix first refers to Article II(2)(a) of the BIT which provides that "[i]nvestment shall at all times be accorded fair and equitable treatment,...and shall in no case be accorded treatment less than required by international law." The BIT emphasizes this treatment by including it in the preamble: "agreeing that fair and equitable treatment of investment is desirable in order to maintain a stable framework

for investment and maximum effective use of economic resources...” Azurix notes that the BIT does not include a definition of the phrase “fair and equitable” and that its meaning revolves on whether it means the minimum standard required by international law or whether “the phrase represents an independent, self-contained principle, which must be given its ‘plain meaning’ pursuant to the general principle for interpreting treaties in Article 31 of the Vienna Convention.”²⁶³

325. The Claimant argues that, on the basis of the text of Article II(2)(a), doctrine and case law, the phrase in question does not refer to the minimum standard. In particular, the Claimant relies on the opinion of F.A. Mann:

“[t]he terms ‘fair and equitable treatment’ envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words. A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable. No standard defined by other words is likely to be material. The terms are to be understood and applied independently and autonomously.”²⁶⁴

326. The Claimant analyzes the text of the provision and considers that the comma separating the phrase of fair and equitable treatment from the treatment required by international law would seem to indicate a sequence of standards and, “strongly suggests that the latter is intended to be a self-contained standard independent of the former. Moreover, the introductory phrase, ‘in no case ... less than that required by international law’, appears to establish the international law standard as the minimum standard against which, *ipso facto*, the ‘fair and equitable treatment’ standard must be deemed a higher, more rigorous standard.”²⁶⁵

327. The Claimant notes that a position paper of UNCTAD on the meaning of ‘fair and equitable treatment’ reaches the conclusion that “[t]hese considerations point

²⁶³ Memorial, p. 181.

²⁶⁴ F.A. Mann, “*British Treaties for the Promotion and Protection of Investments*,” 52 *Brit. & B. International Law* (1982) p. 244. Quoted in the Memorial, p. 181.

²⁶⁵ Memorial, p. 182.

ultimately towards fair and equitable treatment not being synonymous with the international minimum standard.”²⁶⁶

328. The Claimant refers to *Pope & Talbot*, and to the fact that the tribunal in that case relied on Mann’s article and UNCTAD’s paper extensively in its reasoning. That tribunal held that the standard under NAFTA was different from the minimum international law requirement and considered that “compliance with the fairness elements must be ascertained free of any threshold that might be applicable to the evaluation of measures under the minimum standard of international law”. The tribunal rejected that the State’s conduct needed to be egregious, outrageous, shocking or otherwise extraordinary, which is the standard applied in *Neer*.²⁶⁷

329. The Claimant also refers to the plain meaning of fair and equitable. Fair means impartial, honest, free from prejudice, favoritism and self interest, equitable is just, conformable to the principles of justice and right.

330. The Claimant alleges that Argentina breached this standard because as it occurred in *Pope & Talbot*,

“Azurix’s Investment was subjected by the Province to refusals to provide necessary information (DPTC records), indefinite delays in verifying information and taking decisions (Resolution 7/00, property improvements and ABA’s proposal for equivalence of Valuations 1958), assertions of non-existent policy reasons and requests for unnecessary information (cost study for RPI adjustment), manipulation of contract language while ignoring express representations during the contracting process (Resolution 1/99 and Information Communiqué No. 12), changes of position (Canon), public vilification and administrative fines for actions for which the Province was responsible (Circular 31(A) Works), and threats of criminal action against ABA’s directors.”²⁶⁸

²⁶⁶ UNCTAD, “*Fair and Equitable Treatment*,” No. E. 99, II.D.15 (1999) Quoted in the Memorial, p. 182.

²⁶⁷ Memorial, pp.182-183.

²⁶⁸ *Ibid.*, p. 190.

331. All this occurred, according to the Claimant, because the Province needed money to balance its budget deficit and was unwilling to allow water increases because it would be a political problem for the new administration.²⁶⁹

332. In its Counter-Memorial, Argentina disagrees on the meaning of fair and equitable, which it considers inextricably attached to the international minimum standard, on the controversial appreciation of the facts, which do not constitute a violation of the standard, and on the autonomous characterization of the standard.

333. Argentina argues that there are very few awards and authors that postulate the assertion that the standard of fair and equitable treatment is different from the minimum international standard. Based on the findings of the tribunals in *Genin*, *Azinian*, and *S.D. Myers*, Argentina considers that the meaning of this standard is “related to the purpose of providing a basic and general principle”, “constitutes a minimum international standard”, and “for it to be violated it is necessary that the State receiving the investment incur in acts that demonstrate a premeditated intent to not comply with an obligation, insufficient action falling below international standards or even subjective bad faith.”²⁷⁰ The Respondent emphasizes that in *Myers* the tribunal stated that Article 1105(1) of the NAFTA imposes “fair treatment at a level acceptable to the international community, measured with the highest degree of deference towards domestic authorities.” Thus, “[o]nly the reasonableness of the measure claimed to be grievous must be measured, and this, with deference.”²⁷¹

334. Argentina expresses its agreement with the binding interpretation of Article 1105(1) of NAFTA by the Free Trade Commission (“FTC”). The FTC interpreted the article as follows:

“1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

²⁶⁹ Ibid., p. 191.

²⁷⁰ Counter-Memorial, para. 981.

²⁷¹ Ibid., para. 987. Emphasis added by the Respondent.

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 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).”

335. The Respondent also manifests its agreement with the provision of Article 10.4 of the Free Trade Agreement between the United States of America and Chile which in reference to “fair and equitable treatment” and “full protection and security” “does not require treatment in addition or beyond that which is required by that standard and does not create additional substantive rights.”²⁷²

336. The Respondent denies the contention of Azurix that this standard would refer to the expectations of the investor not being frustrated by legislation, rules and regulations and adduces as reasons for casting aside this conception that, “Fairness and equitableness may require (not merely allow) the amendment of a legal system. Such would be the case if, for example, the beneficiary of such legal system is causing harm to others. This is frequently true in environmental and health matters...thus violating the fundamental juristic principle forbidding causing harm.” The Respondent argues that, “Any acceptable concept of what constitutes ‘property’ incorporates as property rights the expectations based on the legal system that begets them. Therefore, in the event of changes to such system (or of the property rights or of the vested rights), the aggrieved party is faced not with unfair treatment but rather with an alleged expropriatory treatment. The legitimate expectations, as part of any reasonable concept of property, are protected by a different standard.”²⁷³

337. Argentina questions the facts on which the alleged breach of this standard is claimed by Azurix. Referring to the list of expectations reproduced early here, Argentina qualifies them as rash or extremely vague or semantic labels rather than

²⁷² Ibid., para. 993.

²⁷³ Ibid., para. 985.

description of the facts.²⁷⁴ Argentina argues that, in terms of the standard proposed, Argentina cannot be held responsible for a breach of the BIT nor can it be held to have breached it even under the standard proposed by Azurix. Neither the Province nor Argentina departed from applicable legislation, rules and regulations.

338. Argentina disagrees with the autonomous categorization of unfair and inequitable acts. The facts, measures, events, acts and omissions described by the Claimant in violation of the fair and equitable standard are the same as those alleged to be expropriatory, “[s]uch is the extent of this identification that when it comes to claiming a compensation only the expropriation of the investment is taken into account.”²⁷⁵

339. Argentina maintains that the events or acts that qualify as expropriation cannot be the same as those that qualify as unfair and inequitable treatment. Depending on their legal qualification, facts produce different legal consequences. According to Argentina, “confusion between expropriatory acts and acts constituting unfair treatment renders one of the two claims invalid.”²⁷⁶ Argentina then contests the supposed strategy of Azurix to pursue the two claims so that if the Tribunal would not consider the measures expropriatory then they could be considered as constituting unfair and inequitable treatment with a claim to the same compensation. Argentina questions that this could be the case,

“unfair treatment can never be characterized as the loss of a property right because that is precisely the core of an expropriation ... The unfair treatment should generate some other form of damage, a detrimental consequence other than the alleged loss of property rights. It should be a consequence as independent from the expropriation damage consequence as the acts that trigger the application of this second standard are (or ought to be) independent and autonomous of the events that caused the application (or non-application) of the first standard.”²⁷⁷

²⁷⁴ Ibid. para. 998.

²⁷⁵ Ibid., para 1000.

²⁷⁶ Ibid., para. 1004.

²⁷⁷ Ibid., para. 1006.

340. Argentina supports further its argument by referring to *Azinian*. In that case, the claimant had alleged violations of Articles 1110 and 1105 of NAFTA. The tribunal reasoned that,

“The only conceivably relevant substantive principle of Article 1105 is that a NAFTA investor should not be dealt with in a manner that contravenes international law. There has not been a claim of such a violation of international law other than the one more specifically covered by Article 1110. In a feeble attempt to maintain Article 1105, the Claimants’ Reply Memorial affirms that the breach of the Concession Contract violated international law because it was ‘motivated by non-commercial considerations, and compensatory damages were not paid.’ This is but a paraphrase of a complaint more specifically covered by Article 1110. For the avoidance of doubt, the Arbitral Tribunal therefore holds that under the circumstances of this case if there was no violation of Article 1110, there was none of Article 1105.”

Argentina considers that the same reasoning applies to the instant case.

341. In its Reply, the Claimant alleges that the interpretation of Article II(2)(a) of the BIT by the Respondent is erroneous. According to the Claimant, the basic touchstone of fair and equitable treatment is to be found in the legitimate and reasonable expectations of the parties. The Claimant considers that, as recommended by Jan Paulsson, the Tribunal should examine “the impact of the measure on the reasonable investment backed-expectations of the investor, and whether the state is attempting to avoid investment-backed expectations that the state created or reinforced through its own acts.”²⁷⁸ The Claimant finds support for this view in *Tecmed* where the tribunal held that fair and equitable treatment requires treatment by the Contracting Parties “that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.”²⁷⁹

342. The Claimant argues that this standard encompasses more specific standards recognized by international tribunals the breach of which entails the breach of

²⁷⁸ Reply, quote in para. 685.

²⁷⁹ Ibid.

the fair and equitable treatment standard, such as that a government will obey its own laws and customary international law, will act honestly, transparently, consistently with representations made and in good faith. As part of good faith, according to the Claimant, the State's rights must be exercised reasonably and within the limits of international law, domestic law and the contract, otherwise it incurs in abuse of those rights.²⁸⁰

343. The Claimant questions the interpretation of ICSID awards by the Respondent. According to the Claimant, in *Genin* the tribunal did not attempt to develop a comprehensive definition of the meaning of fair and equitable treatment, as opposed, for instance, to the full analysis provided in *Tecmed*. The standard in NAFTA is different from the standard in the BIT. Article 1105(1) of NAFTA states that investments must be provided "treatment in accordance with international law, including fair and equitable treatment and full protection and security" (emphasis added by the Claimant). This text differs from the corresponding provision of the BIT in the way "international law" and "fair and equitable treatment" are connected. For the Claimant, it is evident that, under the BIT, "fair and equitable treatment" is "a separate requirement and additional requirement from the international law standard, and that international law sets a floor, indicating that 'fair and equitable treatment' requires something different from and more, but never less, than international law."²⁸¹

344. According to the Claimant, even in *S.D. Myers* the tribunal did not say what the Respondent pretends. The tribunal held that the standard is breached when "an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective." That tribunal concluded that Canada had acted in a discriminatory manner and had breached Article 1102, and such breach also entailed a breach of the fair and equitable standard provided in Article 1105.²⁸²

345. The Claimant observes that the minimum standard argument of the Respondent is based on the standard set in *Neer* in the 1920s and that the standard

²⁸⁰ Ibid., paras. 687-693.

²⁸¹ Ibid., para. 699.

²⁸² Ibid., para. 701.

has evolved as pointed out in *Mondev*: The minimum standard today cannot be limited to the content of customary international law as recognized in arbitral decisions in the 1920s; what is unfair or inequitable to today's eye need not equate with the outrageous or egregious. In that tribunal's view: "there can be no doubt that, by interpreting Article 1105(1) to prescribe 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 under NAFTA, the term "customary international law" refers to customary international law as it stood no earlier than the time at which NAFTA came into force." The customary international law standard is defined by the ordinary meaning of the terms "fair and equitable".²⁸³ *Tecmed*, on the other hand, maintains that this standard 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."²⁸⁴

346. Then the Claimant turns to the Respondent's contention that Azurix's confuses the meaning of expropriatory acts and acts constituting unfair and inequitable treatment. The Claimant argues that the BIT provides rights that are independent from each other and the breach of any one of them would entitle the investor to resort to the dispute settlement procedure provided by the BIT and would give rise to a right to compensation for the economic harm sustained. What are independent are the rights under the BIT not necessarily the measures that have breached those rights.²⁸⁵

347. The Claimant addresses the question of which losses suffered by Azurix could be attributed to unfair and inequitable treatment and which to expropriation. According to the Claimant, unfair and inequitable treatment does not generate a different form of damage. The real question that Argentina is raising is whether Azurix is claiming double recovery. The Claimant affirms that this is not the case. Azurix is entitled to recover its full damages, but only once. The Claimant quotes from *S.D. Myers* on the cumulative nature of the rights and remedies under BITs:

²⁸³ *Ibid.*, para. 703.

²⁸⁴ *Tecmed*, para. 154, quoted in the Reply, para. 705.

²⁸⁵ Reply, paras. 715-718.

“When both Article 1102 and 1105 have been breached, as the Tribunal has found in this case, the usual principle to be applied is that rights and remedies under trade agreements are cumulative unless there is actual conflict between different provisions. The fact that a host Party has breached both Article 1102 and Article 1105 cannot be taken to mean that the investor is entitled to less compensation than if only Article 1103 were breached. A host Party does not reduce the extent of its liability by breaching more than one provision of the NAFTA.”²⁸⁶

348. The Claimant argues that it has provided the Tribunal a discrete damage evaluation that identifies which damages were caused by each of the measures. This should be sufficient to answer Argentina’s question. As regards the Respondent’s question about the causal relationship between an unfair act and the damage that the expropriatory is alleged to have caused, the Claimant considers that this concern has become meaningless once it has been shown that the same measure may breach more than one right under the BIT and the analysis of damages presented by Azurix allows the Tribunal to identify the impact caused by each measure of Argentina.²⁸⁷

349. The Claimant observes that the Respondent qualifies Azurix’s claims as rash and states that they are not independent and cannot be analyzed, but it does not explain the reasons for these statements. The Claimant alleges that Argentina is wrong on both counts and lists in non-exhaustive form the ways in which the Province frustrated Azurix’s expectations by not allowing to charge tariffs in accordance with the Concession Agreement, by repudiation of Circular 52(A), by refusing to accept ABA’s termination of the Concession, by refusal to return the non-amortized portion of the investments, by not allowing ABA to collect the receivables, by requiring that ABA continue to operate the service for more than 90 days, by imposing arbitrary penalties, by politicizing the tariff regime, by publicly calling on customers not to pay their bills, by provoking the illegal intervention of the Provincial Domestic Trade Bureau to enjoin ABA from billing for its services.²⁸⁸

²⁸⁶ Ibid., paras. 715-722.

²⁸⁷ Ibid., paras. 723-725.

²⁸⁸ Ibid., paras. 725-727.

350. In the Rejoinder, the Respondent points out that it never referred to *Neer* in the Counter-Memorial, and contests the interpretation given by the Claimant to *Tecmed*. According to the Respondent, *Tecmed* and *Genin* arrive to the same conclusion. The Mexican authorities had engaged in conduct that was notoriously unfair. This was not the case of ABA's treatment, which was never a cooperative investor and had breached the Concession Agreement. *Tecmed* supports the Argentine position because it distinguishes between "the object of protection (that could be legitimate expectations, good faith and transparency) from the level of protection granted by the Treaty". The Respondent emphasizes that its own concept of fair and equitable permits to differentiate between standards rather than collapse them. The Respondent notes that the Reply does not change the fact that NAFTA tribunals apply a minimum standard defined more recently in *Waste Management*.

"...despite certain differences in emphasis, a general standard for Article 1105 arises. Taken together, cases *S.D. Myers*, *Mondev*, *ADF* and *Loewen* suggest that the minimum standard 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 claimant to sectional or racial prejudice or involves a lack of due process leading to an outcome which offends judicial propriety- as may be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."²⁸⁹

351. The Respondent concludes that this is the standard applied in NAFTA, which delimits the level of violation from the object of the protection, and the scope that the Claimant gives to the standard would make irrelevant all the standards of protection because it would encompass them all.²⁹⁰

²⁸⁹ Rejoinder, quote in para. 1077.

²⁹⁰ *Ibid.*, paras. 1078 and 1080.

352. As regards Article II(7) of the BIT, the Claimant has argued that the Respondent breached its duty of transparency under this article. The Claimant points out that Article II(7) of the BIT requires that “each Party shall make public all laws, regulations, administrative practices and procedures, and adjudicatory decisions that pertain to or affect investments.” This requirement prevents States, according to the Claimant, from imposing undisclosed laws, regulations or practices that adversely affect investments. The Claimant refers to how the tribunal in *Metalclad* understood a similar provision in NAFTA. That tribunal understood the concept of transparency “to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the [NAFTA] should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters.”²⁹¹ The Claimant argues that the transparency provision under the BIT is reinforced by the requirement of a transparent regulatory environment under the Law and the Concession Agreement. Specifically, the ORAB never made public its “regulations, administrative practices and procedures”. The Concession Agreement requires the ORAB to rule on any proposals for tariff adjustment within the period set in the “procedural regulation”. If such regulation had been issued, compliance with it would have prevented the dilatory tactics that compromised the tariff regime.²⁹²

353. The Claimant observes that the ORAB was established as an autonomous entity under the Law and had exclusive authority to supervise the Concession. Regardless of this fact, the decisions of the ORAB were controlled and dictated by the MOSP. To this allegedly improper influence, the Claimant attributes the request of the RPI study and other instances may be established circumstantially:

“because the ORAB candidly told ABA that, although they believed it was correct in its position on Resolution 1/99, they could not undo it because of political pressures. This is confirmed by the statements to ABA by Minister Romero and Undersecretary García about the political problems created by increased water bills. And in fact (based on Minister’s Romero’s comments) newspapers reported

²⁹¹ Memorial, p. 216.

²⁹² Ibid., pp. 216-217.

that the ORAB would issue a resolution forcing withdrawal of the bills before the ORAB ever met to issue Resolution 1/99. Similarly, the ORAB President told ABA the ORAB could not grant the RPI adjustment because of political pressure from the MOSP, and ORAB directors said the Bahía Blanca ‘crisis’ was not ABA’s fault, but when the Governor and the MOSP Minister publicly attacked ABA, the ORAB also took actions against the company. These actions are consistent with the Governor’s pronouncement to Azurix and ABA.”²⁹³

354. The Minister also admitted before the provincial House of Representatives that there was still a great lack of transparency on the regulation of the concessionaires:

“The other element we consider worth mentioning is Resolution 16 under which controlling entities are to make public all their decisions. This is a point we should like to emphasize since we consider there used to be a great lack of transparency – and there still is – on the control of companies under concessions in Argentina”.²⁹⁴

355. In its Counter-Memorial, the Respondent considered that the *Metalclad* case was not relevant because of the different circumstances of that case which concerned a regulatory conflict between different jurisdictions of a Federal State.²⁹⁵

356. Azurix insists in its Reply that the case is analogous to the instant case and provides useful guidance on the application of the transparency standard: “the facts of the present case are more compelling than *Metalclad* since the BIT explicitly requires that ‘[e]ach party shall make public all...administrative practices and procedures [...]’ and the Province indisputably failed to do so.”²⁹⁶ The Claimant also observes that this standard has been applied by other tribunals besides in *Metalclad*. In *Maffezini* the tribunal held that the lack of transparency in a loan transaction was incompatible with Spain’s commitment to ensure fair and equitable treatment of the investor, and in *Tecmed* the tribunal found that the State had an obligation in applying the fair and

²⁹³ Ibid., p. 217.

²⁹⁴ Quoted in the Memorial, p. 216.

²⁹⁵ Counter-Memorial, para. 1049.

²⁹⁶ Reply, para. 756.

equitable treatment standard to act ‘totally transparently in its relations with the foreign investor...’²⁹⁷

357. The Respondent, in the Rejoinder, simply affirms its previous defense, and points out its surprise that the Province is accused of lack of transparency when it was Azurix and ABA “who after being in charge of the Service provision, pretended to make an attempt against the terms of the Contract that they had known and accepted.”²⁹⁸

(b) Considerations of the Tribunal

358. The arguments exchanged by the parties raise the following issues:

1. Whether the standard of fair and equitable treatment is a standard which entails obligations for the parties to the BIT in the treatment of foreign investment which are additional to those required by the minimum standard of treatment of aliens under customary international law;
2. What conduct attributable to the State can be characterized as unfair and inequitable? In other words, what is the substantive content of the standard?; and
3. Whether Article II(7) of the BIT has been breached.

359. In discussing the first issue, the Tribunal will start by considering the specific provision of the BIT on fair and equitable treatment and recall that the BIT is an international treaty that should be interpreted in accordance with the norms of interpretation established by the Vienna Convention. As already noted, the Vienna Convention is binding on the parties to the BIT. Article 31(1) of the Convention requires that a treaty be “interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”.

360. In their ordinary meaning, the terms “fair” and “equitable” used in Article 3(1) of the BIT mean “just”, “even-handed”, “unbiased”, “legitimate.”²⁹⁹ As regards the purpose and object of the BIT, in its Preamble, the parties state their desire to promote

²⁹⁷ Ibid., para. 757.

²⁹⁸ Rejoinder, para. 1087.

²⁹⁹ *Oxford English Dictionary*. These terms are similarly defined in *Diccionario de la lengua española*, 22nd edition at www.rae.es.

greater cooperation with respect to investment, recognize that “agreement upon the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties”, and agree that “fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources.” It follows from the ordinary meaning of the terms fair and equitable and the purpose and object of the BIT that fair and equitable should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. The text of the BIT reflects a positive attitude towards investment with words such as “promote” and “stimulate”. Furthermore, the parties to the BIT recognize the role that fair and equitable treatment plays in maintaining “a stable framework for investment and maximum effective use of economic resources.”

361. Turning now to Article II.2(a), this paragraph provides: “Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than required by international law.” The paragraph consists of three full statements, each listing in sequence a standard of treatment to be accorded to investments: fair and equitable, full protection and security, not less than required by international law. Fair and equitable treatment is listed separately. The last sentence ensures that, whichever content is attributed to the other two standards, the treatment accorded to investment will be no less than required by international law. The clause, as drafted, permits to interpret fair and equitable treatment and full protection and security as higher standards than required by international law. The purpose of the third sentence is to set a floor, not a ceiling, in order to avoid a possible interpretation of these standards below what is required by international law. While this conclusion results from the textual analysis of this provision, the Tribunal does not consider that it is of material significance for its application of the standard of fair and equitable treatment to the facts of the case. As it will be explained below, the minimum requirement to satisfy this standard has evolved and the Tribunal considers that its content is substantially similar whether the terms are interpreted in

their ordinary meaning, as required by the Vienna Convention, or in accordance with customary international law.³⁰⁰

362. Argentina has declared its agreement with the interpretation of Article 1105 of NAFTA by the “FTC. This article bears the heading of the “Minimum Standard of Treatment”. Paragraph 1 reads as follows: “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.” In this provision, the standards of fair and equitable and full protection and security are defined as part of the treatment in accordance with international law. As interpreted by the FTC, the standard of treatment, and as indicated in the title of the article, is the minimum required under customary international law.

363. Argentina has also drawn the attention of the Tribunal to recent Free Trade Agreements (FTAs) entered by the United States, such as the Free Trade Agreement with Chile, where the minimum treatment required is that required under international law. The interpretation of the FTC or the examples of FTAs adduced by the Respondent may be evidence of a significant practice by one of the parties to the BIT, but the Tribunal has difficulty in reading it in the text of the BIT which governs these proceedings. The fact that the FTC interpreted Article 1105 in reaction to a tribunal’s different understanding of this article and that, in recent agreements, the correlative clause has been drafted to reflect the FTC’s interpretation show that the meaning of that article and similar clauses in other agreements could reasonably be understood to have a different meaning.

364. The question whether fair and equitable treatment is or is not additional to the minimum treatment requirement under international law is a question about the substantive content of fair and equitable treatment and, whichever side of the argument one takes, the answer to the question may in substance be the same.

365. In 1927, the US-Mexican Mixed Claims Commission considered in the *Neer* case that a State has breached the fair and equitable treatment obligation when

³⁰⁰ See *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2), para. 155.

the conduct of the State could be described as outrageous, egregious or in bad faith or so below international standards that a reasonable and impartial person would easily recognize it as such. This description of conduct in breach of the fair and equitable treatment standard has been considered as the expression of customary international law at that time. In deciding the determinant elements of fair and equitable treatment, the question for the Tribunal is whether, at the time the BIT was concluded, customary international law had evolved to a higher standard of treatment.

366. The parties have interpreted differently how arbitral tribunals have understood this standard. We will turn to the cases discussed. Argentina has placed particular emphasis on *Genin*. In that case, the tribunal had to decide on whether the investor had been treated fairly and equitably in the context of the revocation of a banking license. The tribunal found no breach of the standard because there were ample grounds for the action taken by the Bank of Estonia. The tribunal in considering the meaning of fair and equitable did not engage in a textual analysis of the fair and equitable treatment clause in the US-Estonia BIT but simply referred to how this requirement has been generally understood under international law, namely, an international minimum standard separate from domestic law but “that is, indeed, a minimum standard.”³⁰¹ According to the same tribunal, for State conduct to breach such standard, it would need to reflect “a willful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.”³⁰²

367. Notwithstanding the finding that, in the circumstances of the case, Estonia did not breach the duty of fair and equitable treatment, the tribunal seems to have been uneasy about letting the conduct of Estonia stand without criticism and considered it necessary to express the hope that “Bank of Estonia will exercise its regulatory and supervisory functions with greater caution regarding procedure in the future.”³⁰³ In considering the award of costs, the same tribunal noted that “the awkward manner by which the Bank of Estonia revoked EIB’s license, and in particular the lack of prior notice of its intention to revoke EIB’s license and of any means for EIB or its

³⁰¹ Para. 367.

³⁰² *Ibid.*

³⁰³ *Ibid.*, para. 372.

shareholders to challenge that decision prior to its being formalized, cannot escape censure.”³⁰⁴

368. Arbitral tribunals under NAFTA have found, after the interpretation of the FTC, that the customary international law to be applied is the customary international law as it stood in 1994 not in 1927. In *Mondev*, the tribunal considered that “the content of the minimum standard today cannot be limited to the content of customary international law as recognized in arbitral decisions in the 1920s.”³⁰⁵ The tribunal noted that the parties in that case agreed that the international standard of treatment has evolved as all customary international law had evolved, and that the two other State parties to NAFTA also agreed with this point.³⁰⁶ Therefore, the customary international law to be applied “is not limited to the international law of the 19th century or even of the first half of the 20th century, although decisions from that period remain relevant. In holding that Article 1105(1) refers to customary international law, the FTC interpretations incorporate current international law, content, the content of which is shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce. Those treaties largely and concordantly provide for ‘fair and equitable’ treatment of and, and for ‘full protection and security’ for, the foreign investor and his investments.”³⁰⁷ Applying this evolutionary concept to customary international law, the tribunal found that “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.”³⁰⁸

369. The tribunal in *Loewen* came to a similar conclusion: “Neither State practice, the decisions of international tribunals nor the opinion of commentators

³⁰⁴ *Ibid.*, para. 381.

³⁰⁵ *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award of October 11, 2002, para. 123.

³⁰⁶ *Ibid.*, para. 124.

³⁰⁷ *Ibid.*, para. 125.

³⁰⁸ *Ibid.*, para.116. The tribunal in *ADF* affirmed the same point: “what customary international law projects is not a static photograph of the minimum standard of treatment of aliens as it stood in 1927 when the Award in the *Neer* case was rendered. For both customary international law and the minimum standard of treatment of aliens it incorporates, are constantly in a process of development.” *ADF Group, Inc. v. USA*, (ICSID Case No. ARB(AF)/00/1) Award of January 9, 2003, para.179.

support the view that bad faith or malicious intention is an essential element of unfair and inequitable treatment or denial of justice amounting to a breach of international justice.”³⁰⁹

370. After an analysis of arbitral decisions and awards under NAFTA, the tribunal in *Waste Management* reached the conclusion that:

“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 propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.”³¹⁰

371. The parties have also referred to *Tecmed*, which describes just and equitable treatment as requiring:

“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.”³¹¹

³⁰⁹ *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (ICSID Case No. ARB(AF)98/3), Award of June 26, 2003, para. 132.

³¹⁰ *Waste Management, Inc. v. The United Mexican States* (ICSID Case No. ARB(AF)/3) Award of 30 April 2004, para. 98.

³¹¹ *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/2), para. 154. Unofficial translation from the Spanish original published by ICSID on its web site.

372. Except for *Genin*, there is a common thread in the recent awards under NAFTA and *Tecmed* which does not require bad faith or malicious intention of the recipient State as a necessary element in the failure to treat investment fairly and equitably. As recently stated in *CMS*, it is an objective standard “unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard.”³¹² It is also understood that the conduct of the State has to be below international standards but those are not at the level of 1927. A third element is the frustration of expectations that the investor may have legitimately taken into account when it made the investment. The standards of conduct agreed by the parties to a BIT presuppose a favorable disposition towards foreign investment, in fact, a pro-active behavior of the State to encourage and protect it. To encourage and protect investment is the purpose of the BIT. It would be incoherent with such purpose and the expectations created by such a document to consider that a party to the BIT has breached the obligation of fair and equitable treatment only when it has acted in bad faith or its conduct can be qualified as outrageous or egregious.

373. Based on these considerations, the Tribunal will now turn to whether the Respondent breached its obligation to treat the Claimant’s investment fairly and equitably. To this effect, the Tribunal considers the instances described below to be particularly relevant:

374. The Tribunal is struck by the conduct of the Province after the Claimant gave notice of termination of the Concession Agreement. ABA had requested to terminate it in agreement with the Province. The Province refused what was a reasonable request in light of the previous behavior of the Province and its agencies. The refusal by the Province to accept that notice of termination and its insistence on terminating it by itself on account of abandonment of the Concession is a clear case of a breach of the fair and equitable treatment standard. It is evident from the facts before this Tribunal that the Concession was not abandoned.

³¹² *CMS Gas Transportation Company v. Argentine Republic* (ICSID Case No. ARB/01/8) Award of May 12, 2005, para. 280.

375. Although the Tribunal has rejected to a certain extent the interpretations of the Concession Agreement and the Law alleged by the Claimant regarding the RPI and the Canon, it is also clear that the tariff regime was politicized because of concerns with forthcoming elections or because the Concession was awarded by the previous government. The issues of the zoning coefficients and the construction variations are cases in point. It is significant that, once the service was transferred, the new service provider was allowed to raise tariffs reflecting the construction variations.

376. Finally, the repeated calls of the Provincial governor and other officials for non-payment of bills by customers verges on bad faith in the case of the Bahía Blanca incident when the Province itself had not completed the works that would have helped to avoid the problem in the first place.

377. Considered together, these actions reflect a pervasive conduct of the Province in breach of the standard of fair and equitable treatment.

378. It remains to be considered whether Argentina also breached Article II(7) of the Treaty. Azurix bases its claim on the fact that ORAB never published its regulations and lacked independence. Article II(7) requires publication of the laws, regulations, adjudicatory decisions and administrative practices and procedures pertaining or affecting investments. The Tribunal has already found that the politicization of the Concession is an element in the Tribunal's determination that the fair and equitable standard has been breached. On the other hand, the Tribunal has also found that ORAB's request for a study in the context of the RPI was a legitimate request. The Tribunal considers that, in view of the facts, what is at issue here is the conduct in the application of the regulatory framework rather than its publicity. There is no doubt that publication of ORAB's regulations would have been a desirable improvement, but the lack of it as argued by the Claimant is not sufficient to conclude that Article II(7) has been breached.

3. Failure to Observe Obligations

(a) Positions of the Parties

379. In its Memorial, the Claimant argues that the Province and the Republic have failed to observe their obligations as required by Article II(2)(c) of the BIT: “Each Party shall observe any obligation it may have entered into with regard to investments.” The Claimant refers to the fact that Article XIII of the BIT extends its application to the political subdivisions of the Respondent and concludes from it that the BIT imposes an obligation directly on the Province to observe its obligations to foreign investors.³¹³

380. In the Counter-Memorial, Argentina contends that contractual claims do not become automatically treaty claims, and that no tribunal has accepted such an argument. Furthermore, Azurix and ABA specifically renounced to raise contractual issues before an ICSID tribunal, and Article II(2)(c) of the BIT refers to obligations undertaken towards specific investment agreements and not to concession contracts governed by domestic administrative law. Argentina also observes that the Claimant has failed to prove the existence of a cause and effect link between the event and the loss and to provide a precise assessment of the losses. Argentina concludes its argument by affirming that it had not undertaken any contractual obligation whatsoever with Azurix and the same is true of the Province.³¹⁴

381. In its Reply, the Claimant notes that Article II(2)(c) refers to “any obligation”, it includes obligations arising under international law and under municipal law; it is not limited to breaches of international agreements, which in any case is a term that would include concession agreements. The Claimant alleges that “To limit this BIT provision to any one category of obligations would require that limiting language be read into the treaty, something the drafters could have done but intentionally chose not to do. The Tribunal’s task, of course, is to construe the treaty as written, not rewrite it as the GOA would prefer.” Any uncertainties should be interpreted in favor of the investor given the objectives of the BIT as expressed in its preamble.³¹⁵

³¹³ Memorial, p. 192.

³¹⁴ Counter-Memorial, paras. 1009-1015.

³¹⁵ Reply, para. 732.

382. Azurix adds that the phrase “entered into” is not limited to any particular mode or method and encompasses obligations undertaken through contract, legislation, decrees, resolutions or regulations. Moreover, the BIT does not limit the application of this clause to a specific investment as claimed by the Respondent, Article II(2)(c) refers to obligations in respect of investments in plural and generically. As regards the issue of the forum for contractual disputes provided for in the Concession Agreement, the Claimant argues that Article VII(2) of the BIT is very clear in giving a choice to the private party concerned between submitting the dispute to the forum previously agreed or international arbitration. Azurix re-affirms that it had already proved that damages had occurred during the Concession and were continuing annually as a result of the Province’s breaches.³¹⁶

383. In its Rejoinder, Argentina recalls the findings of the PCIJ in *Serbian Loans*, the ICJ in *ELSI*, the arbitral tribunal in *Woodruff*, the Ad hoc Annulment Committee in *Vivendi*, and the arbitral tribunals in the *SGS* cases, and concludes that general international law bluntly separates contractual claims from those under international law, that even in the case of BITs the prohibition to transubstantiate a contractual claim into a BIT claim remains, and that when a tribunal has established conditions for the application of an umbrella clause it has required the claimant to abide by the contract forum clause.³¹⁷

(b) Considerations of the Tribunal

384. As already stated by the Tribunal in affirming its jurisdiction within the limits permitted by the Convention and the BIT, the Tribunal finds that none of the contractual claims as such refer to a contract between the parties to these proceedings; neither the Province nor ABA are parties to them. While Azurix may submit a claim under the BIT for breaches by Argentina, there is no undertaking to be honored by Argentina to Azurix other than the obligations under the BIT. Even if for argument’s sake, it would be possible under Article II(2)(c) to hold Argentina responsible for the

³¹⁶ Ibid., paras. 729-737.

³¹⁷ Rejoinder, para. 987.

alleged breaches of the Concession Agreement by the Province, it was ABA and not Azurix which was the party to this Agreement.

4. Arbitrary Measures

(a) *Positions of the Parties*

385. The Claimant argues that arbitrary or discriminatory measures are listed as alternatives in the BIT and, therefore, it is sufficient that a measure be arbitrary to constitute a breach of the BIT. In its ordinary meaning arbitrary means “a characterization of a decision or action taken by an administrative agency... [as] willful and unreasonable action and without consideration or in disregard of facts or law or without determining principle.”³¹⁸ The Claimant also refers to the definition of arbitrary by the ICJ in *ELSI*, “Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law... It is willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.” The Claimant observes that this definition is too narrow and does not accord with the ordinary meaning of arbitrariness. The Claimant refers to *Pope & Talbot* and its comments on the evolution of international law, as characterized by the ICJ decision, that moves away from the *Neer* formulation. According to that tribunal, the formulation in *ELSI*:

“leaves out any requirement that *every* reasonable and impartial person be dissatisfied and perhaps permits a bit less injury to the psyche of the observer, who need no longer be outraged, but only surprised by what the government has done. And, of course, replacing the neutral ‘governmental action’, with the concept of ‘due process’ perforce makes the formulation more dynamic and responsive to evolving and more vigorous standards for evaluating what governments do to people and companies.”³¹⁹

386. The Claimant maintains that to determine whether an action is or not arbitrary in its ordinary meaning should meet four tests: it should be taken by the proper authority, for the proper purpose, because of relevant circumstances and should not be patently unreasonable. In accordance with these tests, the measures taken by the

³¹⁸ Memorial, p. 217.

³¹⁹ Ibid, p. 208.

Province were arbitrary. Resolution 1/99 was issued for an improper purpose, the tariff regime was improperly applied, the issues related to Circular 58(A) were not dealt within reasonable periods of time, the RPI was denied for irrelevant reasons, the Province induced a high bid price with Circular 52(A) and then claimed that the bidder paid too much and it could not be fully included in the base rate. The Province acted according to the electoral needs of its officials rather than in accordance with the rule of law.³²⁰

387. The Respondent considers that the definition in *ELSI* is the most appropriate. Argentina contests the relevance of *Pope & Talbot*, which was referring to the concept of fair and equitable treatment not to a definition of discriminatory measures.. The Respondent points out that, in *Genin*, the tribunal held that “in order to amount to a violation of the BIT, any procedural irregularity that may have been present would have to amount to bad faith, a willful disregard of due process of law or an extreme insufficiency of action.”³²¹

388. In its Reply, the Claimant insists that the meaning in the BIT should be the ordinary meaning of its terms. Article II.2(b) uses the most general of terms, “in any way” either party shall “impair” the management, operation, use, enjoyment, acquisition, expansion, or disposal of investment.” The verb “impair” means “to diminish, lessen, damage, deteriorate, or make worse.” From this the Claimant concludes that the terms used “indicate that the prohibition is to be applied broadly to any conduct that directly or indirectly achieves the prohibited result.”³²² If the drafters would have wished to limit the import of arbitrary measures to meaning a violation of the rule of law, they could have said it in no uncertain terms, directly and without bothering to draft the clause “with such precision and detail.”³²³

389. Argentina reaffirmed, in the Rejoinder, its understanding of arbitrary as defined by the ICJ and not by its ordinary meaning as pretended by the Claimant.

³²⁰ Ibid, p. 211.

³²¹ Counter-Memorial, para. 1024.

³²² Reply, para. 742.

³²³ Ibid., 746.

(b) Considerations of the Tribunal

390. Article II.2(b) provides: “Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For the purposes of dispute resolution under Articles VII and VIII, a measure may be arbitrary or discriminatory notwithstanding the opportunity to review such measure in the courts or administrative tribunals of a Party.”

391. The Tribunal agrees with the interpretation of the Claimant that a measure needs only to be arbitrary to constitute a breach of the BIT. This interpretation has not been contested by the Respondent and it follows from the alternative way in which the term “measures” is qualified by the adjectives “arbitrary or discriminatory”. The parties disagree on whether the meaning of arbitrary should be the ordinary meaning of “arbitrary” or the meaning to arbitrary given by the ICJ in *ELSI*. The parties also disagree on the relevance of *Pope & Talbot* to this case and Argentina has pointed out the description of arbitrary given in *Genin*. The Tribunal is required to consider the ordinary meaning of the terms used in the BIT under Article 31 of the Vienna Convention. The findings of other tribunals, and in particular of the ICJ, should be helpful to the Tribunal in its interpretative task.

392. In its ordinary meaning, “arbitrary” means “derived from mere opinion”, “capricious”, “unrestrained”, “despotic.”³²⁴ Black’s Law Dictionary defines the term, *inter alia*, as “done capriciously or at pleasure”, “not done or acting according to reason or judgment”, “depending on the will alone.” *Pope & Talbot* did not define arbitrary as it stood today. It only commented on the fact that the ICJ itself had moved from the standard advocated by Canada based on *Neer* to a less demanding standard. *Genin* does not seem to take notice of the change that has taken place when it adds the requirement of bad faith. The Tribunal finds that the definition in *ELSI* is close to the ordinary meaning of arbitrary since it emphasizes the element of willful disregard of the law.

³²⁴ *Oxford English Dictionary*. This term is similarly defined in the *Diccionario de la lengua española*, 22nd edition at www.rae.es.

393. The question for the Tribunal is whether the measures taken by the Province can be considered to be arbitrary and have impaired “the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal” of the investment of Azurix in Argentina. The Tribunal finds that the actions of the provincial authorities calling for non-payment of bills even before the regulatory authority had made a decision, threatening the members of the ORAB because it had allowed ABA to resume billing, requiring ABA not to apply the new tariff resulting from the review of the construction variations and affirming that zone coefficients apply in contradiction with the information provided to the bidders at the time of bidding for the Concession, restraining ABA from collecting payment from its customers for services rendered before March 15, 2002, and denying to ABA access to the documentation on the basis of which ABA was sanctioned are arbitrary actions without base on the Law or the Concession Agreement and impaired the operation of Azurix’s investment.

5. Full Protection and Security

(a) Positions of the Parties

394. In its Memorial, the Claimant argues that the standard of full protection and security imposes an obligation of vigilance and due diligence upon the government, as stated in *APPL*, “according to modern doctrine, the violation of international law entailing the state’s responsibility has to be considered constituted by ‘the mere lack or want of diligence’, without any need to establish malice or negligence”. The Claimant defines further the standard by referring to *AMT*. The tribunal in that case found that:

“It would not appear useful for the Tribunal to enter into the debate whether in the case on hand Zaire is bound by an obligation of result or simply an obligation of conduct. The Tribunal deems it sufficient to ascertain, as it has done, that Zaire has breached its obligation by taking no measure whatever that would serve to ensure the protection and security of the investment in question ... Zaire is responsible for its inability to prevent disastrous consequences of these events affecting the investments of AMT which Zaire had the obligation to protect.”³²⁵

³²⁵ Memorial, p. 213.

395. The Claimant proceeds to argue that the standard goes beyond physical protection and includes the protection described in *CME Czech Republic B.V.*: “The host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued.”³²⁶

396. The Claimant alleges that Argentina breached the standard so defined by failing to apply the regulatory framework and the Concession Agreement and thus destroying the security provided by them: the Province never revoked Resolutions 1/99 and 7/00 or decided on the RPI adjustment or on the issue of the valuations, ABA was never compensated for, *inter alia*, the Bahía Blanca damages, the Province insisted that ABA give up the right assured by the Law, Circular 52(A) and the Concession Agreement to recover the Canon in full, and the Respondent failed to take any action to protect the Claimant’s investment.

397. In its Counter-Memorial, the Respondent observes that Azurix had simply requested the use of its good offices to ensure the Province’s compliance with the Concession Agreement. Thus Azurix was requesting assistance in a contractual dispute between ABA and the Province.³²⁷ The Respondent refers to the view held by the *ad hoc* Committee in *Aguas del Aconquija* and the assertion of the tribunal in that case that “federal authorities could have reasonably considered the difference as being one of a contractual nature, and the scope of any federal obligation to react could have been reasonably influenced by this perception.”³²⁸

398. The Respondent argues that the nature of the dispute brought to its attention was a contractual dispute not a dispute related to an investment, and that no new ground may be adduced after filing, otherwise, either the claim was immature or there was a new dispute.³²⁹ The Respondent notes that the Claimant has not determined what specific duty to act it has breached under the BIT, and that the

³²⁶ *Idem.*

³²⁷ Counter-Memorial, para. 1035.

³²⁸ *Ibid.*, para. 1037.

³²⁹ *Ibid.*, para. 1039.

standard allegedly breached requires active behavior and not simply omissions in the duty of care.³³⁰

399. The Respondent also contests the relevance of cases such as *AAPL* and *AMT* which involved physical destruction of facilities of the investor by the armed forces. As for the relevance of *CME*, the Respondent points out that it is questionable to adduce *CME* without referring to *Lauder* where, on the basis of the same facts, the tribunal reached the opposite conclusion.³³¹

400. As a final argument, the Respondent requests the Tribunal, in examining Argentina's liability, to consider that, "during the period under review the country was undergoing the worst economic, social and institutional crisis in its history."³³²

401. In its Reply, the Claimant observes that the Respondent confuses "its obligation to comply affirmatively with the BIT standards in its own conduct with its ultimate responsibility under international law for violations of the BIT by its political subdivisions."³³³ Acts or omissions of the Province that violate the BIT are "necessarily and automatically" the responsibility of Argentina under international law. Furthermore, it is not correct that Azurix simply requested the good offices of Argentina in a contractual dispute. In its response, Argentina ignores clear statements in the communications of the Claimant addressed to Argentina whereby the latter is informed not only of contractual breaches but also of deviations from the regulatory framework and arbitrary acts of the officers and entities of the Province which constitute violations of the BIT "for which the Argentine Republic is directly responsible." (letter of January 5, 2001). In another letter dated May 24, 2001, Azurix stated:

"The purpose of this letter is to reiterate the need for the Argentine Republic to rectify the failure to comply with its obligations under the BIT, international law and the Concession Agreement. The Argentine Republic has an obligation to prevent violations of the BIT and international law within its territory whether committed by the federal government or its political subdivisions. The federal

³³⁰ Ibid., paras. 1043 and 1047.

³³¹ Ibid., para. 1050.

³³² Ibid., 1051.

³³³ Reply, para. 749.

government has an obligation to prevent expropriations [without compensation] by it or its political subdivisions. Azurix requests that the Argentine Republic take all necessary actions to prevent such violations ...”³³⁴

402. The Claimant considers that it has amply made its case on the responsibility of Argentina for the acts and omissions of the Province under international law, and that , “It is unnecessary, and perhaps confusing, to analyze the GOA’s liability as ‘absolute’ or ‘strict’ for the acts of its political subdivisions”, as mentioned by the Respondent.³³⁵

403. As regards the allegation of the Respondent that no new grounds may be stated, Rule 40 of the Arbitration Rules permits a party to present incidental, ancillary or additional claims arising directly out of the subject matter of the dispute not later than the reply memorial.³³⁶

404. The Claimant re-affirms that the standard of full protection and security is not limited to basic police functions as alleged by Argentina. The Claimant finds nothing in the language of the BIT that would limit the application of this standard to issues of physical security and protection. According to the Claimant, this standard requires the government to exercise “vigilance and use due diligence within its political and legal system to protect investments.”³³⁷

405. In its Rejoinder, the Respondent refers to *Tecmed* that held that “the guarantee of full protection and security is not absolute and does not impose strict liability upon the State that grants it.” Based on this interpretation of the standard, the Respondent concludes that the argument of the Claimant cannot be accepted.³³⁸

(b) Considerations of the Tribunal

406. While the cases of *APPL* and *AMT* refer to physical security, there are other cases in which tribunals have found that full protection and security has been breached because the investment was subject to unfair and inequitable treatment –

³³⁴ Ibid., para. 753.

³³⁵ Ibid., para. 754.

³³⁶ Ibid., para. 755.

³³⁷ Ibid., para. 758.

³³⁸ Rejoinder, para. 1088.

Occidental v. Ecuador – or, conversely, they have held that the obligation of fair and equitable treatment was breached because there was a failure to provide full protection and security – *Wena Hotels v. Egypt*. The inter-relationship of the two standards indicates that full protection and security may be breached even if no physical violence or damage occurs as it was the case in *Occidental v. Ecuador*.

407. In some bilateral investment treaties, fair and equitable treatment and full protection and security appear as a single standard, in others as separate protections. The BIT falls in the last category; the two phrases describing the protection of investments appear sequentially as different obligations in Article II.2(a): “Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and...” The tribunal in *Occidental* based its decision on a clause worded exactly like in the BIT, and nonetheless considered that, after it had found that the fair and equitable standard had been breached, “the question of whether in addition there has been a breach of full protection and security under this Article becomes moot as a treatment that is not fair and equitable automatically entails an absence of full protection and security.”³³⁹

408. The Tribunal is persuaded of the interrelationship of fair and equitable treatment and the obligation to afford the investor full protection and security. The cases referred to above show that full protection and security was understood to go beyond protection and security ensured by the police. It is not only a matter of physical security; the stability afforded by a secure investment environment is as important from an investor’s point of view. The Tribunal is aware that in recent free trade agreements signed by the United States, for instance, with Uruguay, full protection and security is understood to be limited to the level of police protection required under customary international law. However, when the terms “protection and security” are qualified by “full” and no other adjective or explanation, they extend, in their ordinary meaning, the content of this standard beyond physical security. To conclude, the Tribunal, having held that the Respondent failed to provide fair and equitable treatment to the

³³⁹ *Occidental Exploration and Production Company v. Ecuador* (LCIA Administered Case No. UN 3467) Award, dated July 1, 2004, para. 187.

investment, finds that the Respondent also breached the standard of full protection and security under the BIT.

VIII. Compensation

1. Positions of the Parties

409. Azurix has requested full compensation for expropriation as required by the BIT under Article IV paragraph 1. Azurix has also argued that the expropriation was unlawful because it did not satisfy the form and substance requirements of due process nor was full or fair compensation paid. Therefore, Azurix claims that it is entitled to enhanced compensation that, in the words of the Permanent Court of International Justice in the *Chorzów Factory* case, “wipe-out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed.”³⁴⁰

410. Azurix has proposed four possible dates for purposes of determining the compensation due for expropriation: (A) July 1999 just before the issuance of Resolution 1/99 on August 4; (B) December 2000, when the MSP Undersecretary had promised that the tariff issues would be resolved in favor of Azurix and they were not; (C) August 2001 when the Province denied any breaches of the Concession Agreement, the Tariff Regime or the Regulatory Framework and refused to permit ABA to fully recover the Canon payment; and (D) November 2001 when Decree No 2598/01 was issued refusing to accept ABA’s notice of termination of October 5, 2001. Professor Riesman in his opinion cautioned that, in a case of creeping expropriation, the use of a later date may reward the Province for its own arbitrary conduct in regulating the Concession.³⁴¹ Azurix takes the position that “No matter what date is fixed by this Tribunal, the Province should not be permitted to benefit from its own unlawful acts.”³⁴²

411. Azurix discusses the compensation methodologies for expropriation, and submits claims under each one of them without expressing a preference for one or another method. Under the actual investment method, Azurix claims to have invested

³⁴⁰ Memorial, pp. 218-221.

³⁴¹ Exhibit to the Memorial, pp. 71-72.

³⁴² Memorial, p. 223.

\$449 million when it acquired the Concession, \$102.4 million in additional capital contributions to ABA, and \$15 million on consequential costs including corporate expenditures and legal costs related to negotiations with the Province. Under the book value method and based on NERA's report calculation for each of the four dates referred to above, Azurix considers that the book value of the Concession in August 1999 was \$516.9 million, in January 2001 \$484.6 million, in August 2001 \$483.9, and in November 2001 \$482.2 million.³⁴³ Alternatively, Azurix submits the possibility for the Tribunal to consider compensation based on unjust enrichment - on the benefits received by the Province. On this basis, the Province was enriched by the Canon, the further investment of \$102.4 million, and the time value - interest - of the funds. In the case of the Canon, Azurix submits that in accordance with the NERA report, the consideration of the time value would raise it to \$450.5.³⁴⁴

412. Additionally, Azurix has claimed the amount due by customers to ABA when the Concession was taken over by the Province and which the Province publicly requested the customers not to pay to ABA. According to Azurix, these accounts receivable amounted approximately to AR\$120 million.

413. In its Counter-Memorial, the Respondent does not comment on the compensation claimed by Azurix. Azurix in its Reply, considers that, by not responding, Argentina has conceded Azurix's damages and reaffirms them. In its Rejoinder, Argentina notes that Azurix claimed compensation only for expropriation and questioned the dates chosen by the Claimant as possible dates for purposes of calculating compensation. Furthermore, Argentina argues that the standard of compensation under the BIT is the fair market value and that value cannot be the amount paid for the Concession when extraneous considerations influence it. Argentina recalls that the bid of Azurix was out of line with the other bids for the concession areas and calculates that, "considering the bids that would have maximized the revenues of the Province from those regions [A, C1, C2, C3, and C4] excluding Azurix's bid, the maximum amount that would have been paid by the other bidders for the ABA Concession is

³⁴³ Ibid., pp. 225-227.

³⁴⁴ Ibid., pp. 227-228.

38.52 million dollars.”³⁴⁵ In any case, argues Argentina, Azurix would not be entitled to more than 90% of the fair market value of ABA and the effect of the deep economic crisis that affected the country on asset values cannot be disregarded.³⁴⁶

414. In the Post-Hearing Memorial, the Claimant has defined “full compensation” as including, as a minimum, “(i) the unamortized value of all investments made, including the US\$438.55 million Canon payment and Azurix’s additional capital contributions to ABA through 2002 of US\$114,864,000, which were lost as a result of the GOA [Government of Argentina]’s actions, (ii) discrete damages in excess of US\$55 million, and (iii) costs.”³⁴⁷

2. Considerations of the Tribunal

415. On compensation, three issues have to be addressed by the Tribunal: (i) the difference in compensation claimed by Azurix in its various submissions, (ii) the starting point for the calculation of damages, and (iii) the principle upon which those damages should be based.

416. First, the Tribunal notes that Azurix’s request for compensation in its Memorial is limited to amounts related to the Canon payment, the additional capital contributions made, the accounts receivable and consequential costs. This request is confirmed in the Reply. In the Post-Hearing Memorial the accounts receivable are not included in the definition of “full compensation” and, on the other hand, an amount in excess of \$55 million is claimed on account of discrete damages detailed in the NERA report. The Tribunal considers that the Post-Hearing Memorial is not the place to change the submissions for compensation since the simultaneous timing of the memorials of the parties does not permit the other party to comment on the changes made. Thus, the Tribunal shall retain for consideration the compensation requested in the Memorial and confirmed in the Reply. The Tribunal is aware that the discrete damages listed in the NERA report are part of the allegations made in the Memorial but they were not included in the calculation of compensation pleaded then by the Claimant.

³⁴⁵ Rejoinder, para. 1107.

³⁴⁶ *Ibid.*, para. 1112.

³⁴⁷ Post-Hearing Memorial, para. 68.

417. As to the second issue, various dates in 2001 have been proposed by Azurix. In a case of direct expropriation, the moment when expropriation has occurred can usually be established without difficulty. In the case where indirect or “creeping” expropriation has taken place or, as the *Santa Elena* tribunal put it, “the date on which the governmental ‘interference’ has deprived the owner of his rights or has made those rights practically useless”³⁴⁸, it will be much more difficult for the tribunal to establish the exact time of the expropriation. The difficulty is no less severe, unless the decision is based on a single act creating liability, when the Tribunal concludes that an investor has not received fair and equitable treatment or that it has been subjected to arbitrary treatment or that the host State has not provided the investor the full protection and security guaranteed by the BIT. The Iran-U.S. Claims Tribunal, in one of its awards, decided that “where the alleged expropriation is carried out by way of a series of interferences in the enjoyment of property”, the date of the expropriation is “the day when the interference has ripened into a more or less irreversible deprivation of the property rather than on the beginning date of the events”.³⁴⁹ It has been sometimes argued that applying this formula would lead to an inequitable situation where the investment’s value would be assessed at the time when the cumulative actions of the State would have led to a dramatic devaluation of the investment. However, such a view does not take into account that, in assessing fair market value, a tribunal would establish that value in a hypothetical context where the State would not have resorted to such maneuvers but would have fully respected the provisions of the treaty and the contract concerned.

418. There can be legitimate disagreement as to the date in 2001 at which the cumulative actions of the Province led to breaches of the Treaty; but, in the Tribunal’s view, there can be no doubt that, by March 12, 2002 when the Province put an end to the Concession, alleging abandonment by ABA, its breaches of the BIT had reached a watershed. For purpose of calculating the compensation due to Azurix, this is the date which will be retained by the Tribunal.

³⁴⁸ *Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica* (ICSID Case No. ARB/96/1), Award of February 17, 2000, 39 ILM 1317, 1330 (2000).

³⁴⁹ *Malek v. Iran*, award 534-193-3, para. 114 (1992) (citing *Int’l Technical Prods. Corp. v. Iran*, Award No. 190-302-3, at 49, 9 Iran-U.S. Cl. Trib. Rep. 206, 240-241 (1985)).

419. The Tribunal will now proceed to deal with the third issue relating to compensation, i.e., the basis upon which the damages should be assessed. The Tribunal points out that the Treaty only provides for the measure of compensation in the case of an expropriation that meets the Treaty's requirements that it be done for a public purpose and be non-discriminatory. In such case, Article IV (1) of the BIT provides:

“Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation”.

420. The tribunal, in the recent *CMS v. Argentina* case, when faced with a similar situation, was “persuaded that the cumulative nature of the breaches discussed here is best dealt with by resorting to the standard of fair market value. While this standard figures prominently in respect of expropriation, it is not excluded that it might also be appropriate for breaches different from expropriation if their effect results in important long-term losses”.³⁵⁰

421. Under NAFTA, tribunals which have held that a standard of protection was breached and no expropriation had occurred were in the same position as the Tribunal, since NAFTA does not provide for a measure of compensation in such situations. In three NAFTA cases, tribunals awarded damages for breaches other than expropriation, *S.D. Myers, Pope & Talbot* and *Feldman*. The tribunal in *Feldman* after having considered the other two cases concluded: “It is obvious that in both of these earlier cases, which as here involved non-expropriation violations of Chapter 11, the tribunals exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages consistent with the requirements of NAFTA.”³⁵¹

³⁵⁰ *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), para. 410.

³⁵¹ *Marvin Roy Feldman Karpa v. The United Mexican States* (ICSID Case No. ARB(AF)/99/1), Award of December 16, 2002, para. 197.

422. In fact, in *S.D. Myers* the tribunal considered that the lack of a measure of compensation in NAFTA for breaches other than a finding of expropriation reflected the intention of the parties to leave it open to the tribunals to determine it in light of the circumstances of the case taking into account the principles of both international law and the provisions of NAFTA.³⁵²

423. In *MTD*, another ICSID case, the tribunal found that the respondent had breached the fair and equitable treatment obligation and accepted the Claimants' proposal to apply the standard of compensation formulated in *Chorzów*. The tribunal noted that the Respondent had not objected to the application of this standard and that "no differentiation has been made about the standard of compensation in relation to the grounds on which it is justified. Therefore, the Tribunal will apply the standard of compensation proposed by the Claimants to the extent of the damages awarded."³⁵³

424. In the present case, the Tribunal is of the view that a compensation based on the fair market value of the Concession would be appropriate, particularly since the Province has taken it over. Fair market value has been defined as: "the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts."³⁵⁴

425. Azurix has submitted, in its Memorial, two methodologies to measure fair market value in the present case: the actual investment and the book value. It has asserted in addition that the argument in support of using actual investment is compelling as the investment is recent and highly ascertainable. The Tribunal agrees that the actual investment method is a valid one in this instance. However, the Tribunal considers that a significant adjustment is required to arrive at the real value of the Canon paid by the Claimant.

³⁵² *S.D. Myers v. Canada*, Partial Award of November 13, 2000, paras. 303-319.

³⁵³ *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile* (ICSID Case No. ARB/01/7), Award of May 21, 2004, para. 238.

³⁵⁴ *International Glossary of Business Valuation Terms*, American Society of Appraisers, ASA website, June 6, 2001, p. 4.

426. First of all, in the Tribunal's view, no well-informed investor, in March 2002, would have paid for the Concession the price (and more particularly, the Canon) paid by Azurix in mid-1999, irrespective of the actions taken by the Province and of the economic situation of Argentina at that time. In that regard, the Tribunal refers to some of the concerns expressed by OPIC at the time it denied financing the investment plan of ABA. As already noted, OPIC pointed out the size of the investments needed to achieve the Concession's objectives as compared to the estimated revenues expected from the tariffs in effect, and considered that failure to agree on a modification of the Concession in order to establish a sustainable situation was an obstacle to OPIC's financing. Yet, at the time Azurix won the Concession, the Province accepted the price paid by Azurix as the fair market price for the Concession and the Province benefited from the alleged aggressive price paid. Furthermore, there is no doubt that the loss in value is partly attributable to the actions of the Province and the politicization of the Concession.

427. More importantly, the Tribunal refers to the conclusions it reached concerning the RPI review process and the impossibility of including the Canon in the recoverable asset base for the purpose of tariff increases. Azurix has argued that the right price for an auctioned item is the price paid by the winning bidder. Argentina, for its part, argues that the fair market value of the Concession should be based on the much lower competing bids. The function of the Tribunal is not to second-guess the values established by the various bidders at the time of the privatization of AGOSBA, but to try and determine what an independent and well-informed third party would have been willing to pay for the Concession in March 2002, in a context where the Province would have honored its obligations. In that regard, being aware that the RPI tariff adjustment was not automatic and that the Canon could only be recoverable over the remaining duration (some 27 years and 9 ½ months) of the Concession and on the basis of the existing tariffs as adjusted periodically through the review process spelled out in the Concession Agreement, such investor would have realized that his only hope of recouping the Canon was essentially through expansion of the system and through efficiency improvements between the periodic 5-year tariff reviews. On the other hand, as to the RPI review process, it would have been reasonable for such an investor to

conclude that the ORAB would have approved tariff increases from time to time to take into account the Argentine inflation rate, if not the American one.

428. At the same time, the Tribunal cannot ignore the fact that the Province, through its actions and inaction, contributed to the loss in value of the Concession. When the Province accepted Azurix's bid, it considered it as the fair market value for the Concession and the Province benefited from the alleged aggressive price paid.

429. Considering those factors and valuing the Canon at present-day value, the Tribunal is of the opinion that no more than a fraction of the Canon could realistically have been recuperated under the existing Concession Agreement. The Tribunal therefore concludes that the value of the Canon on March 12, 2002 should be established at US\$60,000,000 (sixty million US dollars).

430. Secondly, Azurix should be compensated, as part of the fair market value of the Concession, for the additional investments to finance ABA. In its Memorial, Azurix has claimed US\$102.4 million in additional capital contributions to the initial sum invested of US\$449 million of which US\$438,555,551 represent the payment for the Canon. The amount of US\$102.4 million when added to the difference between the initial sum invested and the Canon results in investments additional to the Canon of US\$112,844,446 (one hundred and twelve million eight hundred forty-four thousand four hundred forty-six US dollars). However, the Tribunal considers that this amount should be reduced by US\$7,603,693 (seven million six hundred and three thousand six hundred ninety-three US dollars) which represent the aggregate of the claims presented by Azurix on account of damages which the Tribunal has found to be related to contractual claims -those related to the works listed in Circular 31(A) except for Bahía Blanca³⁵⁵- and that should be borne by Azurix as part of its business risk. Therefore, the amount awarded on account of additional investments is US\$105,240,753 (one hundred and five million two hundred forty thousand seven hundred fifty-three US dollars).

431. Thirdly, Azurix has claimed AR\$120 million on account of unpaid bills to ABA for services rendered prior to the take over of the Concession by the Province and which the Province directed customers not to pay to ABA. According to Argentina, only

³⁵⁵ NERA Report, p.170. Exhibit 19-C to the Memorial.

an amount of about half million pesos has been paid and it is held separately. The Tribunal notes that the amount claimed by Azurix represents all bills due by customers on March 7, 2002. The Tribunal considers that this amount is owed by the Province to ABA and, therefore, should not be part of the compensation awarded to Azurix..

432. Fourthly, Azurix has claimed US\$15,000,000 (fifteen million US dollars) on account of consequential damages in order to wipe out the consequences of a breach of an international obligation. This amount relates to: (i) corporate expenditures for negotiations with the Province, termination of the Concession and transfer of the service (US\$7.1 million), and (ii) costs for the preparation, registration, and participation in these proceedings (US\$7.9million). The Tribunal will consider the second component as part of the award of costs of these proceedings. As for the first component, the Tribunal finds that it has not received sufficient evidence in support of such costs and that, in any case, these are costs related to the business risk that Azurix took when it decided to make the investment. Therefore, while the Tribunal agrees that in principle compensation should be such that wipes out the consequences of an illegal act, in the circumstances of this particular case, the Tribunal does not find the amount claimed to be justified.

433. Fifthly, bearing in mind the responsibility of the Province in the failure of the Concession and the fact that the implementation of the POES was spread over a five-year period, while the Concession was cancelled after less than half of that time, the Tribunal concludes that Azurix should bear no liability with regard to the non-execution of that plan.

434. The Claimant has proposed, as an alternative to the fair market value of the investment, that compensation be based on “the theory of unjust enrichment”. In this respect, the Claimant has referred to the decision of the court (in fact, an arbitral tribunal) in *Lena Goldfields* which chose to base the award on unjust enrichment rather than damages. As stated by the court and quoted in the Memorial:

“The Court further decides that the conduct of the Government was a breach of the contract going to the root of it. In consequence, Lena is entitled to be relieved from the burden of further obligations thereunder and to be compensated in

money for the value of the benefits of which it had been wrongfully deprived. On ordinary legal principles this constitutes a right of action for damages, but the Court prefers to base its award on the principle of “unjust enrichment,” although in its opinion the money result is the same.”³⁵⁶

435. The Tribunal observes that the court did not give any reason for its choice of unjust enrichment as opposed to damages. This decision has been criticized for its lack of clarity and the reference to the same result in monetary terms,

“raises the suspicion that these considerations, far from being decisive for the outcome of the award, were merely used to add an appearance of broad general justice. This case, although frequently quoted in support of a ‘principle against unjustified enrichment’ in international law, has probably contributed nothing but a great deal of confusion.”³⁵⁷

436. The Tribunal further observes that damages and unjust enrichment are conceptually distinct in terms of the principles of liability and the measure of restitution. In the case of damages, liability rests on an unlawful act, which is not necessarily the case in unjust enrichment. As to compensation on account of an unlawful act, it is based on the loss suffered, while, in the case of unjust enrichment, it is based on restitution: for instance, what can be claimed, at least under some civil law regimes, is restitution of the lower of the amount contributed by the impoverished or the gain made by the enriched.³⁵⁸

437. The Iran-US Tribunal, which has dealt with claims based on the principle of unjust enrichment on several occasions, defined the principle of unjust enrichment and its applicability as follows:

“There must have been an enrichment of one party to the detriment of the other, and both must arise as a consequence of the same act or event. There must be

³⁵⁶ Memorial, p. 227.

³⁵⁷ Christoph Schreuer, “Unjust Enrichment in International Law”, *The American Journal of Comparative Law*, vol. XXII, No. 2, p. 289.

³⁵⁸ Bryce Dickson, “Unjust Enrichment Claims: a Comparative Overview”, *Cambridge Law Journal*, 54(1), March 1995, pp. 100-126; G. Bonet, “L’enrichissement sans cause, droit privé et droit public”, *LITEC, Extrait du Juris-Classeur Civil*, 1989; Jason W. Neyers, Mitchell McInnes & Stephen G.A. Pitel, *Understanding Unjust Enrichment*, Oxford: Hart, 2004.

no justification for the enrichment, and no contractual or other remedy available to the injured party whereby he might seek compensation from the party enriched.”³⁵⁹

438. The Tribunal has found that Argentina breached the Treaty, an unlawful act under international law. The Claimant has chosen the remedy provided for in the Treaty and the Tribunal has also found that the measure of compensation applicable in this case is not the restitution of the Claimant’s investment in respect of which the breach has been found but its fair market value before the breach occurred. For these reasons the Tribunal has not pursued the alternative of compensation on account of unjust enrichment proposed by the Claimant.

IX. Interest

439. The Claimant has requested the award of interest on all damages suffered at the average rate applicable to US six-month certificates of deposit compounded semi-annually. The Respondent has affirmed that it would not be legitimate to award compound interest and that, were the Tribunal to find for Azurix, a simple rate of interest should be used.

440. The Tribunal considers that compound interest reflects the reality of financial transactions, and best approximates the value lost by an investor. Therefore, compound interest should be paid on the amount of damages awarded as from the date at which the Province terminated the Concession – March 12, 2002 - until the date of dispatch of this award to the parties at the average rate applicable to US six-month certificates of deposit. In case the amount awarded is not paid in full 60 days after such date, the Respondent shall pay interest at the rate applicable to US six-month certificates of deposit until the day of payment in full and such rate shall also be compounded.

X. Costs

441. The Claimant has partially prevailed on the merits. The Tribunal declined to issue the provisional order requested by the Claimant and Argentina failed in its

³⁵⁹ *Sea-Land Service, Inc. v. Iran* (6 Iran-U.S.C.T.R.) p. 169.

objections to the jurisdiction of the Tribunal and its challenge to the president of the Tribunal. The Claimant did not submit its own copy of envelopes 1 and 2 as requested by the Tribunal, and Argentina requested that the Claimant bear the costs related to this procedural incident. For these reasons, the Tribunal decides: (1) that each party shall pay its own costs and counsel fees, and (2) that the arbitrators' fees and expenses and the cost of the ICSID Secretariat shall be borne by Argentina, except for the amount of US\$34,496 (thirty-four thousand four hundred ninety six U.S. dollars), which shall be borne by the Claimant and correspond to the said provisional measures and the procedural incident.

XI. Decision

442. For the reasons above stated, the Tribunal unanimously decides:

1. That the Respondent did not breach Article IV(1) of the BIT.
2. That the Respondent breached Article II(2)(a) of the BIT by failing to accord fair and equitable treatment to Azurix's investment.
3. That the Respondent failed to accord full protection and security to Azurix's investment under Article II(2)(a) of the BIT.
4. That the Respondent breached Article II(2)(b) of the BIT by taking arbitrary measures that impaired Azurix's use and enjoyment of its investment.
5. To award compensation to Azurix on account of the fair market value of the Concession in the amount of US\$165,240,753 (one hundred sixty-five million two hundred forty thousand seven hundred fifty-three US dollars), including in part the additional investments made by Azurix to finance ABA.
6. To award interest compounded semi-annually on the amount referred to in paragraph 5 of this decision: (i) as from March 12, 2002 to June 30, 2006 at the rate of 2.44%, which is the average rate applicable to US six-month certificates of deposit during that period, and (ii) as from 60 days after the dispatch of this award to the parties until such amount has been fully paid at the average rate applicable to US six-month certificates of deposit.

7. That each party shall be responsible for their own costs and counsel fees, and the Respondent shall bear the fees and expenses of the arbitrators and the costs of the ICSID Secretariat except for US\$34,496 (thirty-four thousand four hundred ninety six U.S. dollars) which shall be borne by Claimant.

8. That all other claims are dismissed.

Made in Washington, DC, in English and Spanish, both versions equally authentic.

[SIGNED]

Dr. Daniel Hugo Martins

Arbitrator

Date: 19 June 2006

[SIGNED]

Mr. Marc Lalonde, P.C., O.C., Q.C.

Arbitrator

Date: 14 June 2006

[SIGNED]

Dr. Andrés Rigo Sureda

President

Date: 23 June 2006