ICSID Case No. ARB(AF)/99/1 - **AWARD**
International Centre for Settlement of Investment Disputes ICSID

Award

ICSID Case No. ARB(AF)/99/1 (AWARD) Marvin Feldman (Claimant) v United Mexican States (Respondent)

Industry: Tobacco and tobacco products
Case Type: International
Award Amount: $16,961,055.97
Claimant's Attorney: Mark B. Feldman; Mona M. Murphy; Douglas R.M. King; Nathan Lewin; Stephanie Martz
Respondent's Attorney: Hugo Perezcano Díaz
Award Date: 16 December 2002
Arbitrator:Konstantinos D. Kerameus (President); Jorge Covarrubias Bravo; David A. Gantz
Country: Canada

Award history:

- Mexican Fifth District Judge in Administrative Matters, April 1991

- Mexican Supreme Court of Justice, August, 1993

- Procedural Order No.1, 10 March 2000

- Procedural Order No.2, 3 May 2000

- Procedural Order No.3, 18 July 2000

- Procedural Order No.4, 3 August 2000

- Interim Decision on Preliminary Jurisdictional Issues, 6 December 2000

- Procedural Order No.5, 6 December 2000

- Procedural Order No.6, 19 June 2001

- Mexican Fiscal Tribunal of the Federation

Case No. ARB(AF)/99/1,

between

Mr. Marvin Roy **Feldman** Karpa,

represented by

Mr. Mark B. **Feldman**, Ms. Mona M. Murphy, Mr. Douglas R.M. King of **Feldman** Law Offices, P.C. (formely Feith & Zell, P.C.), and

Mr. Nathan Lewin and Ms. Stephanie Martz of the Law Firm of Miller, Cassidy, Larroca & Lewin, L.L.P.

and

The United Mexican States,

represented by Lic. Hugo Perezcano Díaz, Consultor Jurídico Subsecretaría de Negociaciones Comerciales Internacionales

Ministry of Economy

THE TRIBUNAL,

Composed as above,

Makes the following Award

A INTRODUCTION AND SUMMARY OF THE DISPUTE

1. This case concerns a dispute regarding the application of certain tax laws by the United Mexican States (hereinafter »Mexico« or »the Respondent«) to the export of tobacco products by Corporación de Exportaciones Mexicanas, S.A. de C.V. (»CEMSA«), a company organized under the laws of Mexico and owned and controlled by Mr. Marvin Roy Feldman Karpa (hereinafter »Mr. Feldman« or »the Claimant«), a citizen of the United States of America (»United States«). The Claimant, who is suing as the sole investor on behalf of CEMSA, alleges that Mexico's refusal to rebate excise taxes

applied to cigarettes exported by CEMSA and Mexico's continuing refusal to recognize CEMSA's right to a rebate of such taxes regarding prospective cigarette exports constitute a breach of Mexico's obligations under the Chapter Eleven, Section A of the North American Free Trade Agreement (hereinafter »NAFTA«). In particular, Mr. Feldman alleges violations of NAFTA Articles 1102 (National Treatment), 1105 (Minimum Level of Treatment), and 1110 (Expropriation and Indemnification).[FN1] Mexico denies these allegations.

B REPRESENTATION

2. The Claimant is represented in these proceedings by Mr. Mark B. **Feldman** of **Feldman** Law Offices, P.C. (formerly Feith & Zell, P.C.) The Respondent is represented by Lic. Hugo Perezcano Díaz, Consultor Jurídico, Subsecretaría de Negociaciones Comerciales Internacionales, Secretaría de Economía, Government of Mexico.

C THE ARBITRAL AGREEMENT

3. The dispute is subject to arbitration under the North American Free Trade Agreement, concluded between the Government of the United States of America, the Government of Canada and the Government of the United Mexican States, and which entered into force on January 1, 1994.

4. NAFTA Article 1117 entitles an investor to bring a claim against a NAFTA State Party on behalf of an enterprise of another NAFTA Party which the investor owns or controls. NAFTA Article 1139 provides that an »enterprise of a Party means an enterprise constituted or organized under the law of a [NAFTA] Party.«

5. NAFTA Article 1120 provides that arbitral proceedings may be instituted under the Additional Facility Rules of the International Centre for Settlement of Investment Disputes (»ICSID«), as modified by the provisions of Chapter Eleven, Section B of the NAFTA, provided that either the disputing Party whose measure is alleged to be a breach referred to in Article 1117 (in this case, Mexico) or the Party of the investor (in this case, the United States), but not both, is a party to the ICSID Convention.[FN2] The ICSID Additional Facility Rules, rather than the ICSID Convention, are applicable in this case since only the United States, as the Party of the investor, but not the United Mexican States, as the Respondent in this case, is a Contracting State to the ICSID Convention. Under NAFTA Article 1122(1), in conjunction with NAFTA Articles 1116, 1117 and 1120, Mexico expresses its consent to the submission to arbitration of claims of investors who are nationals of another State Party to the NAFTA either under the ICSID Convention, under the Additional Facility Rules, or under the UNCITRAL Arbitration Rules.

D FACTS AND ALLEGATIONS

6. Much of the complexity of this case results from the parties' disagreements with regard to the facts. The reasons for this are several. First, in some instances, records are not available because they have been destroyed, as records are routinely destroyed at the Mexican Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito* Público, hereinafter »SHCP«) after five years (counter-memorial, para. 144). Secondly, there are disagreements to particular facts which the Tribunal cannot rectify on the basis of the material presented, either because the information does not exist or because the Respondent has been unwilling or unable to produce it. As a result, in some instances, the »evidence« presented by both sides results in an assertion of facts rather than proof of facts. This section summarizes what the Tribunal believes to be the key facts and assertions, noting when the »facts« are from a particular party's point of view. They are discussed in more detail in the relevant sections of this award.

7. The case concerns the tax rebates which may be available when cigarettes are exported. Mexico imposes a tax on production and sale of cigarettes in the domestic market under the Impuesto Especial Sobre Producción y Servicios (»IESP«) law, a special or excise tax on products and services. In some circumstances, however, a zero tax rate has been

applied to cigarettes that are exported. According to the Respondent, the IEPS Law »has basically remained the same since its origins [in 1981], although the underlying methodology of the tax has changed several times« (counter-memorial, para. 85). Review of the various versions of the IEPS law between 1990 and 1999 confirms this conclusion.

8. Under the 1991 IEPS law, certain activities generated liability for the tax, including, *inter alia*, selling domestically, importing and exporting the goods listed in Article 2, section I of the Law. The IEPS law also included the tax rate for each product. In the case of domestic sales and imports of cigarettes, the rates were 139.3% from 1990 through 1994, and 85% from 1995 through 1997 (Article 2). However, the IEPS rate on exports of cigarettes from 1990 through 1997 was 0%. From 1992, only exports to countries that were not considered low income tax jurisdictions (tax havens) -- in general, countries with an income tax rate above 30%-- were eligible for a 0% rate. In most instances, when cigarettes were purchased in Mexico at a price that included the tax, and subsequently exported, the tax amounts initially paid could be rebated.

9. The Claimant's firm, CEMSA, first began exporting cigarettes in 1990. According to the Respondent, the record shows that SHCP paid the IEPS rebates to the claimant for 1990-1991 in full (including amounts properly owing to inflation and interest) and declined only to pay the demanded »financial costs« for which there was no provision under the Fiscal Code (counter-memorial, para. 142(b)). While the Claimant contended that CEMSA had by 1991 established a cigarette export business, the Respondent alleges that CEMSA's request for IEPS rebates in November 1990-1991 related solely to exports of beer and alcoholic beverages (counter-memorial, para. 142(a)).

10. According to the Claimant, an authorized producer of cigarettes in Mexico, Carlos Slim »protested [regarding Claimant's exports] and the government took administrative steps and passed legislation to cut off rebates to CEMSA in 1991« (memorial, p. 2). This assertion is contested by the Respondent. The 1991 legislation was apparently designed to provide IEPS rebates to exports undertaken by producers of cigarettes (such as Cigatam, a firm allegedly controlled by Carlos Slim), but to deny rebates for exports by resellers of cigarettes, such as CEMSA (memorial, p. 2, counter-memorial, para. 93). The amendments to Article 2, Section III in 1991, specified that a 0% rate applied to final exports, under the terms of the customs legislation, by producers and bottlers of the goods, and by foreign trade companies, as well as by persons entering into contracts with producers and bottlers, including for sale abroad, as long as they complied with certain requirements to be issued by SHCP (counter-memorial, para. 93). The Claimant, as a reseller, became ineligible for rebates.

11. The Claimant initiated an *Amparo* action before the Mexican courts in February, 1991, challenging the constitutional validity of Article 2, Section III, in that it limited the 0% tax rate to producers and bottlers. The *Amparo* alleged that these measures infringed upon the constitutional principle of »equity of taxpayers« by excluding all other exporters from the possibility of obtaining the 0% rate (counter-memorial, para. 102). In April, 1991, the Fifth District Judge in Administrative Matters dismissed CEMSA's *Amparo*, in part, but granted it, in part, citing that SHCP had no authority to issue the implementing fiscal regulations for 1991, which CEMSA was challenging. The decision was appealed by both sides in May, 1991. In July, CEMSA also filed a criminal complaint against the SHCP officials responsible for enactment of the 1991 amendment to Article 2 section III of the IEPS Law, for abuse of authority and conspiracy (counter-memorial, para. 107).

12. Pending final resolution of the *Amparo*, the Mexican Congress amended the IEPS law, effective January 1, 1992, to allow IEPS rebates to all cigarette exporters, and CEMSA was able to export cigarettes with rebates most of that year. Effectively,

this new law reverted to the system in force in 1990, making all final exports eligible for application of the 0% rate (counter-memorial, para. 93). As far as the Tribunal is able to determine, the 1992 legislation remained unchanged in all aspects relevant to this case through 1997.

13. According to the Claimant, after the IEPS law was amended in 1992, the Claimant began to export cigarettes. Claimant claims to have received rebates thereafter (counter-memorial**,** paras. 144, 146); this assertion is neither confirmed nor denied by the Respondent, because the records have been destroyed after five years in accordance with normal SHCP policies (counter-memorial, para. 144).

14. In January, 1993, according to the Claimant, the Respondent shut down CEMSA's cigarette export business for a second time, (memorial, p. 3) because the Claimant could not meet other requirements of the IEPS law (counter-memorial, paras. 151-152). The reasons for the Claimant's inability to produce invoices are rather complicated.

15. The IEPS requires cigarette producers to pay the 85% tax, which is then passed on to purchasers in their purchase price (Article 8 of IEPS). The taxable base is the sales price to the retailer, and further tax is not paid on subsequent sales (Article 4, Section 8 of IEPS). To be eligible for the tax rebate, the IEPS tax on the cigarettes must be stated »separately and expressly on their invoices« (memorial, p. 3; counter-memorial, paras. 89, 91). This is required by Article 4 of the IEPS Law, which applies to all taxes covered by the IEPS, not just taxes on cigarettes. Only producers, and not resellers, have access to the itemized invoice. CEMSA purchased the cigarettes from volume retailers such as Wal-Mart or Sam's club (rather than the producers), at a price that included the IEPS tax, but was not itemized separately on the invoice. CEMSA thus was never able to obtain invoices separating the tax.

16.In August, 1993, the Supreme Court of Justice ruled in favor of CEMSA, finding unanimously that »measures allowing IEPS rebates only to producers and their distributors violated constitutional principles of tax equity and non-discrimination« (memorial, p. 2; see also counter-memorial, para. 108). The court did not discuss or rule explicitly on any other relevant issues, such as whether the Claimant was entitled to rebates notwithstanding the Claimant's inability to produce invoices stating the tax amounts separately.

17. During the period 1993-1995, the Respondent recognized that CEMSA was a taxpayer entitled to the 0% tax rate on cigarette exports, but continued to demand that the Claimant meet the invoice requirements of Article 4 of the IEPS law, even though it was impossible for CEMSA to meet those requirements.

18. CEMSA claims that Mexican tax officials gave the Claimant »assurances« in 1995-1996 that rebates would be paid (memorial, p. 2) and alleges that negotiation of an oral »agreement« took place in 1995, confirmed and finally implemented in 1996, which would permit CEMSA to resume exporting cigarettes in large quantities in June 1996. As discussed in detail in Section F5, the Respondent vigorously denies the existence of any such agreement, and asserts that it was complying with the 1993 Supreme Court *Amparo* decision by affording Claimant access to the 0% tax rate for exports. Neither party was able to produce conclusive evidence of the existence or non-existence of such an agreement or understanding.

19. Regardless of the possible existence or non-existence of an agreement, the Claimant states that he was paid rebates from June 1996 to September 1997, a total of sixteen months (memorial, pp. 2, 3). CEMSA claims that during these sixteen months, »Hacienda officials knew that CEMSA was receiving IEPS rebates on cigarette exports without having obtained invoices separating the tax« (memorial, p. 4). The Respondent counters by observing that it is standard practice for SHCP to pay requests for rebates promptly as they are submitted, given that they have the authority to audit IEPS tax

returns to determine if the requirements of the law have been complied with. According to the Claimant, »by late 1997, CEMSA accounted for almost 15% of Mexico's cigarette exports« (memorial, p. 4).

20. However, this situation did not last. The Respondent finally terminated rebates to CEMSA on or before December 1, 1997. According to the Claimant, this was done without prior warning (memorial, pp. 2, 4), and the Respondent refused to pay rebates of US $2.35 million owed to CEMSA on exports made in October and November 1997 (memorial, p. 4) .

21. Since December 1, 1997, the IEPS law has been amended to bar rebates to cigarette resellers such as CEMSA, limiting such rebates to the »first sale« in Mexico. Articles 11 and 19 of the IEPS were amended so as to provide that tax rebates are not allowed on sales subsequent to those made to the retailer. The amendments also imposed an obligation on exporters of certain goods, including cigarettes, of registering in the Sectorial Exporters Registry in order to be entitled to apply for the 0% IEPS rate on exports. Subsequently, under the 1998 amendment, CEMSA was also refused registration as an authorized exporter of cigarettes and alcoholic beverages (memorial, p. 4, see also reply, para. 5). Absent such registration, Mexican Customs authorities will not issue the »pedimento« (export documentation) that is required to export goods from Mexico. The Respondent contends that this refusal was a result of an ongoing audit of CEMSA's earlier claims for IEPS tax reimbursements.

22. On July 14, 1998, SHCP began an audit of CEMSA and demanded that CEMSA repay the approximately US$25 million for IEPS rebates SHCP asserts the Claimant received during the twenty one-month period of January 1996 to September 1997, with interest and penalties. To avoid forfeiture and criminal sanctions for non-payment, CEMSA challenged the »assessment« in the Mexican courts. This assessment proceeding in the Mexican courts remains pending. A separate proceeding, which has been concluded, challenged the Respondent's denial of IEPS rebates for the period October-November 1997.

23. The Claimant is not the only reseller/exporter of cigarettes in Mexico. The Claimant and the Respondent agree that at least two other firms, Mercados I and Mercados II, owned by named Mexican nationals (the »Poblano Group«) are resellers of cigarettes in »like circumstances« with CEMSA (counter-memorial, paras. 460-470, 48). The Claimant asserts that these Mexican firms have been permitted to obtain rebates for taxes on exported cigarettes during periods when such rebates have been denied to the Claimant, notwithstanding the inability of these firms to produce the necessary invoices stating the tax amounts separately. The Respondent concedes that at least five companies have been registered as cigarette exporters, but has been unable or unwilling to provide any detailed information on the status of those firms or their access to IEPS tax rebates. The Respondent, however, alleges that the Claimant and the »Poblano Group« belong effectively to the same business entity and, therefore, are not eligible to be compared to each other for national treatment purposes.

E THE PROCEEDINGS

24. The present arbitration was initiated on April 30, 1999, when the Claimant, pursuant to NAFTA Article 1120, submitted a Notice of Arbitration and request for approval of access to the Additional Facility to the Secretary-General of ICSID. The Claimant asserted that Mexico's actions in this case were »tantamount to nationalization or expropriation and constitute[d] a denial of justice in violation of the rules and principles of international law and NAFTA Articles 1110 and 1105(1).«[FN3] The Claimant requested the following relief:

(a) a declaration that Mexico has breached its obligations to Marvin **Feldman** by expropriating his investments without providing prompt, adequate and effective compensation, and by failing to accord to CEMSA fair and equitable treatment and full protection and security;[FN4]

(b) an order directing Mexico to pay Marvin **Feldman** damages in respect of the loss CEMSA has suffered through Mexico's conduct described above of US$50 million, or approximately $475 million Mexican pesos, along with interest on the **award** to be computed at the applicable rate of interest; and

(c) any other legal or equitable relief deemed just and warranted.

The Acting Secretary-General of ICSID approved access to the Additional Facility on May 27, 1999 and issued a Certificate of Registration of the Notice of Arbitration on the same day.

25. An arbitral tribunal was constituted in accordance with NAFTA Articles 1123 and Article 6 of the ICSID Arbitration (Additional Facility) Rules (hereinafter »the Arbitration Rules«). The Claimant appointed Professor David A. Gantz (a national of the United States) and Mexico appointed Mr. Jorge Covarrubias Bravo (a national of Mexico), as arbitrators. Following a request made by the Claimant under NAFTA Article 1124, and after extensive consultation with the parties, the Secretary-General of ICSID appointed Professor Konstantinos D. Kerameus (a national of Greece) as President of the Tribunal. On July 30, 1999, in accordance with NAFTA Article 1125, the Claimant agreed in writing to the appointment of all the arbitrators. On January 18, 2000, in accordance with Article 14 of the Arbitration Rules, ICSID informed the parties that all the arbitrators had accepted their appointment and that the Tribunal was therefore deemed to be constituted, and the proceeding to have begun, on that date. Mr. Alejandro A. Escobar, Senior Counsel, ICSID, was assigned to serve as the secretary of the Tribunal. All subsequent written communications between the parties were to be made through the ICSID Secretariat.

26. The first session of the Tribunal was held, with the parties' agreement, in Washington, D.C. on March 10, 2000. Among the matters agreed on at the first session, it was determined that the languages of the proceeding would be English and Spanish. In accordance with NAFTA Article 1130 and Articles 20 and 21 of the Arbitration Rules, the Tribunal then issued Procedural Order No. 1, determining that the place of arbitration would be Ottawa, Province of Ontario, Canada, without prejudice to the Arbitral Tribunal meeting at any other place, with or without the parties, as may be convenient. The parties accepted this determination.

27. On February 15, 2000, the Claimant had submitted a request for provisional measures for the preservation of his rights, to which the Respondent replied on March 6, 2000. Proposals and observations on the scheduling of the proceedings were also exchanged. Following further discussion on these matters at the first session of the Tribunal, on May 3, 2000 the Tribunal issued Procedural Order No. 2, declining, under NAFTA Article 1134, to grant the Claimant's request for provisional measures. In Procedural Order No. 2, the Tribunal also determined a schedule for the request, disclosure and production of documents, and for the filing of a memorial and counter-memorial, reserving any instructions that the parties file a reply and a rejoinder.

28. In the context of the parties' requests for documentation, the Claimant submitted communications of May 23, June 20, and July 11, 2000, to which the Respondent replied by a communication of July 11, 2000. Finding that the foregoing communications raised »jurisdictional issues that both parties wish[ed] the Tribunal to consider and rule upon before the exchange of written pleadings on the merits,« the Tribunal, on July 18, 2000, issued Procedural Order No. 3 directing the parties to exchange written pleadings on preliminary jurisdictional matters and suspending the schedule set forth in the second procedural order. Under this order, the Claimant was requested to file a memorial on jurisdictional issues, the Respondent was then to file a counter-memorial, and the parties were then simultaneously to file further observations on such jurisdictional issues.

29. On July 18, 2000, the Claimant requested the

revision of Procedural Order No. 3 asking for the jurisdictional issue to be joined to the merits, for the briefing schedule on other issues to be adjusted, and for a direction that discovery proceed pending such disposition. On July 20, 2000, the Respondent replied opposing the Claimant's request for revision of Procedural Order No. 3.

30. Referring to the correspondence from both the Claimant and the Respondent subsequent to the issuance of Procedural Order No. 3, the Tribunal on August 3, 2000 issued Procedural Order No. 4 reaffirming the directions given in Procedural Order No. 3 and fixing a revised schedule for the briefing of preliminary jurisdictional issues.

31. By respective communications of August 15, 2000, Canada and the United States requested that the Tribunal permit each of them to make submissions pursuant to NAFTA Article 1128 on the jurisdictional issues raised in the case within 14 days of the date of the last filing by a party on such issues. By letter of August 18, 2000, the Respondent referred to those communications from Canada and the United States, and requested an additional time period for commenting on their submissions made under NAFTA Article 1128 as well as on the Claimant's additional observations on jurisdiction. By letter of August 21, 2000, the Claimant opposed such modification of the briefing schedule sought by the Respondent, and on the same day submitted his memorial on jurisdictional issues as directed by the Tribunal.

32. By letter of the Secretary of August 24, 2000, the Tribunal determined it unnecessary to modify the briefing schedule set forth in Procedural Order No. 4, under which »the parties have been afforded an opportunity of a simultaneous second round of written pleadings on preliminary issues in order to address, by way of further explanation, arguments already made.« Also on August 24, 2000, the Tribunal invited Canada and the United States to file any NAFTA Article 1128 submissions on preliminary issues by October 6, 2000.

33. On August 29, 2000, the Respondent requested that the Tribunal order the production of documents by the Claimant concerning the preliminary issues briefed by the parties. On September 1, 2000, the Tribunal directed both parties to promptly comply with any requests for the production of documents which they regard to be in good faith, and after exhaustion of all best efforts, to be admissible, relevant and otherwise inaccessible to the party requesting them.

34. On September 8 and 11, 2000, respectively, the Respondent filed English and Spanish versions of its counter-memorial on preliminary issues. On September 13, 2000, following a request by the Claimant, the Respondent filed an English translation of the Appendixes of its counter-memorial.

35. On September 22, 2000, the parties simultaneously filed their additional observations on the preliminary jurisdictional issues in English and, in Spanish on September 27 and 28, 2000, respectively. On October 6, 2000, Canada and the United States of America filed their respective submissions under NAFTA Article 1128.

36. The Claimant, by letter of October 6, 2000, opposed what it alleged were two new motions made by the Respondent in its additional observations as submitted on September 22, 2000 regarding the production of documents and the matter of confidentiality with regard to public statements made by the parties in the case. On October 20, 2000, the Respondent submitted its observations on the submissions of Canada and the United States, the Claimant's communication of October 6, 2000 and the Claimant's additional observations of September 22, 2000. The Respondent further requested a hearing on the preliminary issues briefed by the parties. The Claimant submitted a letter on October 24, 2000 in which it opposed a hearing on preliminary issues. The Tribunal decided not to hold a hearing on these matters.

37. On December 6, 2000, the Tribunal issued its Interim Decision on Preliminary Jurisdictional Is-

sues (the »Interim Decision«), ruling on certain jurisdictional questions and joining others to the merits of the case, as described further below. Also on December 6, 2000, the Tribunal issued its Procedural Order No. 5, declining to grant the requests of the Respondent regarding the production of documents and the confidentiality of matters related to the proceedings. The Tribunal set forth a new schedule for the exchange of documents and pleadings on the merits.

38. On December 22, 2000, the Claimant requested the Secretariat to distribute certain documents he had filed with the Secretariat in response to a request by the Respondent. On December 29, 2000, in accordance with Procedural Order No. 5, the parties filed their submissions on the presentation of witnesses and the production of documents. On January 5, 2001 the Tribunal issued further directions regarding the production of documents.

39. Pursuant to the Tribunal's directions of January 5, 2001, the Claimant filed, on January 10, 2001, a letter indicating the reasons for which he opposed the production of certain documents and informed which documents have already been produced to the Respondent. Similarly on January 11, 2001, the Respondent indicated the reasons for which it opposed the production of certain documents requested by the Claimant and commented on the Claimant's communication of December 29, 2000.

40. The Claimant, by letter of January 16, 2001, commented on the Respondent's previous correspondence regarding the production of documents. On February 5, 2001, the Tribunal issued further directions regarding the production of documents.

41. The Claimant's memorial and the Respondent's counter-memorial on the merits were filed respectively on March 30 and May 24, 2001. The Claimant filed his reply to the counter-memorial on the merits on June 11, 2001. The Tribunal, on June 19, 2001, issued its Procedural Order No. 6 concerning the marshalling of evidence at the hearing on the merits. The Respondent's rejoinder was filed on June 25, 2001.

42. On June 28, 2001, Canada made a NAFTA Article 1128 submission on issues concerning the merits. The United States made no such submission.

43. From July 9 to July 13, 2001, the Tribunal held its hearing on the merits in Washington, D.C., at which both parties appeared and presented witnesses. Witnesses called by the Claimant for cross-examination were Rafael Obregón-Castellanos and Fernando Heftye-Etienne; witnesses called for cross-examination by the Respondent were Oscar Roberto Enríquez Enríquez, Marvin Feldman Karpa and Jaime Zaga Hadid. Full verbatim transcripts in English were made of the hearing and distributed to the parties.

44. On April 17, 2002, the Tribunal asked the parties and the NAFTA Parties to submit their views on how the Tribunal should treat parallel proceedings and on the issue of relief. The Claimant filed his submission on May 28, 2002 and the Respondent its submission on May 29, 2002. The NAFTA Parties made no submission in this respect.

45. The Deputy Secretary-General, by letter of August 5, 2002, informed the Tribunal that Mr. Alejandro A. Escobar, to the Secretariat's regret, left ICSID for private legal practice and indicated that Ms. Gabriela Alvarez Avila, Counsel, ICSID, was replacing him as Secretary of the Tribunal.

F JURISDICTION

46. In its Procedural Order No. 4, the Tribunal identified the five preliminary jurisdictional questions on which the parties were to submit their written pleadings:

a. Whether the Claimant, being a citizen of the United States of America, and a registered permanent resident in Mexico, had standing to sue under Chapter Eleven of NAFTA?

b. Whether the Respondent was entitled to raise any defense on the basis of the time limitation set forth in NAFTA Article 1117(2), and in particular wheth-

er such time limitation affected the Tribunal's consideration of facts relevant to the claim or claims, and whether the Respondent was estopped from relying on such time limitation?

c. Whether the Claimant had properly submitted a point of claim in this arbitration proceeding concerning an alleged violation of NAFTA Article 1102?

d. Whether the Claimant was allowed to submit additional claims, if any, or amend its claim, on the basis of an alleged violation of NAFTA Article 1102?

e. Whether measures alleged to be taken by the Respondent in the period between late 1992 and January 1, 1994, when NAFTA came into force, and which are alleged to be in violation of NAFTA, general international law, or domestic Mexican law, were relevant for the support of the claim or claims?

47. The Tribunal, in its Interim Decision of December 6, 2000, decided most of the jurisdiction issues, which will be summarized below under the headings of standing, time limitation, admissibility of an additional claim under NAFTA Article 1102, and relevance of claims pre-dating NAFTA's entry into force. Discussion of additional jurisdiction issues, not addressed in the Interim Decision, will follow, including issues of estoppel with regard to the period of limitation and the basis of the claim and exhaustion of local remedies.

F.1 Standing

48. On the issue of the Claimant's standing, the Tribunal ruled in its Interim Decision of December 6, 2000 (paras. 24-38), that the Claimant, being a citizen of the United States and of the United States only, and despite his permanent residence (*inmigrado* status) in Mexico, has standing to sue in the present arbitration under NAFTA Chapter 11. The Tribunal accordingly dismissed the Respondent's preliminary defense pertaining to the Claimant's lack of standing because of his permanent residence in Mexico, and found that it was not necessary to address the Claimant's allegation that Respondent's defense about the Claimant's standing is not timely.

F.2 Time Limitation

49. Regarding the issue of time limitation under NAFTA Article 1117(2) for submitting claims to arbitration, the Tribunal found in its Interim Decision (paras. 39-47) that the cut-off date of such three-year limitation period is April 30, 1996 rather than February 16, 1995. Two additional questions concerning such time limitation were joined to the consideration of the merits of the case and are discussed further below (paras. 53-65).

F.3 Admissibility of an Additional Claim under NAFTA Article 1102

50. As to whether the Claimant has submitted or is allowed to submit additional claims, or amend his claims, on the basis of an alleged violation of NAFTA Article 1102 concerning denial of national treatment, the Tribunal found in its Interim Decision (paras. 50-59) that the point of claim concerning an alleged violation of NAFTA Article 1102 was properly before the Tribunal because it had been in substance included in the notice of intent to submit the claim to arbitration (i.e., »the notice of arbitration« referred to in the Interim Decision), and had been presented in a timely fashion. In addition, to the extent that such point of claim was subsequently presented as ancillary claim, the Tribunal accepts such incidental or additional claim to be within its jurisdiction.

F.4 Relevance of Claims Pre-Dating NAFTA's Entry into Force

51. On the issue whether measures alleged to be taken by the Respondent in the period between late 1992 and January 1, 1994, when NAFTA came into force, and which are alleged to be in violation of NAFTA, general international law, or domestic Mexican law, are relevant for the support of the claim or claims, the Tribunal found in its Interim Decision (paras. 60-63) that only measures alleged to be taken by the Respondent after January 1,

1994, when NAFTA came into force, and which are alleged to be in violation of NAFTA, are relevant for the support of the claim or claims under consideration.

52. The Tribunal hereby confirms each of the findings on jurisdictional questions, and the reasons on which they are based, set forth in its Interim Decision of December 6, 2000, which is attached to this Award and forms an integral part hereof.

G ADDITIONAL JURISDICTIONAL ISSUES

G.1 Estoppel with regard to the Period of Limitation and the Basis of the Claim

53. In its Interim Decision of December 6, 2000, the Arbitral Tribunal, joined the following questions to the examination of the merits (Interim Decision para. 49):

(a) whether the Parties on or about June 1, 1995 reached an agreement concerning CEMSA's right to export cigarettes and to receive tax rebates on such exports, and whether deviation from this agreement was formally confirmed in February 1998, thus bringing about a suspension of the limitation period for some 32.5 months, i.e. from June 1, 1995 to mid-February 1998; and

(b) whether the Respondent is equitably estopped from invoking any limitation period because it gave the Claimant assurances that exports would be permitted and rebates paid to CEMSA (*ibid.*, para. 48).

During the examination of the merits, the Claimant enlarged his invocation of estoppel, in order for it to cover not merely the defense of limitation but the very basis of the damages claim itself (see Claimant's memorial, Introduction and Summary, p. 8, and paras. 179-186).

54. The first, and more technical, issue of a possible suspension of the limitation period for about 32.5 months has been addressed by the Claimant in his memorial (paras. 62-68, 184, 187) and partly in his reply (para. 65), and by the Respondent partly in its counter-memorial (paras. 18-20, 57, 401-427) and partly in its rejoinder (paras. 106-143).

55. In essence, the Claimant alleges several meetings with middle- and high-ranking SHCP officials in 1995 concerning the resumption of cigarette exports by CEMSA with rebates of the IEPS. During these meetings, Claimant alleges that oral assurances were given by the Mexican tax administration to the Claimant. The Claimant understands such assurances as amounting to an agreement. He concludes by asserting that a suspension or »tolling« of the period of limitation is »appropriate in a case such as this one where a lawsuit was discouraged by the actions of a defendant. Although the clearest example is where a defendant has expressly agreed not to raise a defence based upon a statute of limitations, other representations, promises, or actions will suffice to estop a party from invoking a statute of limitations« (memorial, para. 187; footnotes omitted).

56. The Respondent denies that any oral agreement was reached. Even if there had been an oral agreement, such an agreement could have no legal effect under Mexican law, and the Claimant was or should have been aware of that (counter-memorial, paras. 19-20).

57. The scope of this issue seems to be more limited than it appears at first sight. In fact, the Claimant asks for a suspension of the period of limitation for about 32.5 months. If accepted, such suspension would effectively extend backwards the cut-off date of the three-year limitation period under NAFTA Article 1117(2) from April 30, 1996 to mid-August 1993. Since, however, the Tribunal's jurisdiction *ratione temporis* starts only from January 1, 1994, when NAFTA came into force (see *supra*, para. 51, and in more detail, the Interim Decision of December 6, 2000, para. 62), the same date would necessarily be the *terminus post quem* for limitation purposes if a suspension, as requested, were to be admitted.

58. In substance, in view of the Tribunal, such suspension or »tolling« of the period of limitation is

unwarranted. NAFTA Article 1117(2) does not provide for any suspension of the three-year period of limitation. Even under general principles of law to be applied by international tribunals, it should be noted that in several national legal systems such suspension is provided only in the final part of the limitation period (*e.g.* in the last six months) and only either in cases of act of God or if the debtor maliciously prevented the right holder from instituting a suit (see *e.g.* German Civil Code para. 203; Greek Civil Code Article 255). In this case no such unavoidable events have been pleaded. Basically, the Claimant maintains that a lawsuit was »discouraged« by the Respondent's actions (memorial, para. 187), among other things because the Claimant took the revocation of an audit as a confirmation of alleged previous agreements (*ibid.*, para. 68). However, »discouraging« a lawsuit does not amount to preventing it. The decision whether, and when, to bring a lawsuit lies with the prospective plaintiff, who also bears the respective benefits and risks. Among the various factors to be taken into consideration is the running of the period of limitation and its interruption as well. Nothing in the file shows that the Claimant, appropriately represented by counsel, was prevented from taking into consideration all relevant factors. Therefore, the Tribunal confirms April 30, 1996 as the cut-off date of the three-year limitation period under NAFTA Article 1117(2).

59. We turn now to the more general issue of the Respondent's estoppel from invoking any limitation period because it gave the Claimant assurances that exports would be permitted and rebates paid to CEMSA, as well as from denying the very basis of the damages claim itself (see *supra*, para. 53). According to the Claimant, the IEPS law in force from January 1, 1992 through December 31, 1997 recognized that all cigarette exporters were entitled to rebates of the IEPS tax included in the purchase price of cigarettes. The Respondent is estopped from asserting a contrary view in this arbitration, because Mexican officials confirmed that interpretation to the Claimant over the years both in writing and verbally (memorial, para. 170 b). The formal requirement of the IEPS law that a taxpayer seeking a rebate obtain a vendor's invoice stating the IEPS tax separately and expressly is not applicable to CEMSA as a matter of Mexican or international law because that requirement could not be complied with by CEMSA for reasons beyond its control (*ibid.*, para. 170 c). SHCP was fully aware of CEMSA's export activities and, without requiring invoices stating the IEPS tax separately and expressly, agreed to grant rebates, which they did until the policy was changed in November 1997 (memorial, para. 175). SHCP officials made express commitments to the Claimant that SHCP would rebate IEPS taxes to CEMSA, and that CEMSA was entitled to calculate the tax itself without having invoices from its vendors stating the IEPS tax separately and expressly. The Claimant and CEMSA relied on such commitments and representations to their detriment when CEMSA purchased cigarettes including an 85% IEPS tax. The Respondent is, therefore, estopped from (1) denying CEMSA's application for rebates in October-November 1997, and (2) claiming repayment for rebates on exports in 1996-1997 (memorial, paras. 184, 185).

60. In addition, the Claimant asserts, within the same issue of estoppel, that a statement regarding how a law is applied is a statement of fact. In any event, the distinction is not relevant under international law. Estoppel can be availed of to deny both statements as well as their legal consequences. Domestic tax law rules do not have the function or the authority of establishing or refuting the estoppel principle. The doctrine of estoppel, based on the fundamental legal interest in predictability, reliance and consistency, is particularly important in the context of NAFTA, a regime designed to protect and promote trade and investment among the parties (reply, paras. 59-63).

61. The Respondent, on the other hand, denies that any oral agreement to waive the invoice requirement was ever reached. Even if existent, such

agreement would have been legally irrelevant under Mexican law. Under the tax systems of all three NAFTA countries, taxpayers are precluded from raising an estoppel preventing the enforcement of tax laws, as they are written, through the methods followed by the Claimant (counter-memorial, para. 20). More generally, estoppel may have effect only in relation to statements of fact, not to statements on the meaning of a law. Presently, the alleged estoppel results not from statements of fact but rather from statements, if any, as to the meaning of the IEPS law, an alleged agreement as to the calculation of IEPS and so on (counter-memorial, paras. 401-407). The Respondent alleges that the approach taken to the issue of estoppel by the three NAFTA countries is relevant to a consideration of estoppel under international law. In Mexico, only a written resolution by SHCP to resolve a real and concrete issue of tax law is binding. In Canada, a government official cannot create an estoppel in relation to the interpretation of legislation. In the United States, an erroneous interpretation of the law by tax authorities does not estop them from asserting an appropriate tax (counter-memorial, paras. 411-427). There can be no agreement whereby CEMSA could overstate the amount of IEPS claimed so that it receives more money than paid by the original taxpayers. Indeed, the Claimant has grossly miscalculated the IEPS tax paid (counter-memorial, paras. 428-433).

62. In addition, according to the Respondent, the cases cited by the Claimant in support of estoppel involve state boundary disputes and even there it is not clear whether the International Court of Justice really applied the doctrine of estoppel. An attempt to borrow underdeveloped and peripheral principles from such an area of international law and apply them to another should be made with caution. The same legal effect that attaches to the conduct of States in boundary disputes, which they are presumed to have considered with the utmost seriousness, cannot apply in cases where a large state bureaucracy deals with an individual taxpayer (rejoinder, paras. 108-111, 127). Finally, preclusion of estoppel under the domestic law of the NAFTA countries is important because it disproves the Claimant's allegations (1) that there was reliance on his part, (2) that there is an international law of estoppel directly applicable to SHCP, as it would be extraordinary to conclude that the NAFTA Parties had imposed on their tax authorities an obligation contrary to their domestic laws, and (3) that such an estoppel is part of customary international law (*ibid.*, paras. 38-143).

63. In view of conflicting arguments by the Parties (*supra*, paras. 59-62), the Arbitral Tribunal stresses that, like many other legal systems, NAFTA Articles 1117(2) and 1116(2) introduce a clear and rigid limitation defense which, as such, is not subject to any suspension (see *supra*, para. 58), prolongation or other qualification. Thus the NAFTA legal system limits the availability of arbitration within the clear-cut period of three years, and does so in full knowledge of the fact that a State, *i.e.*, one of the three Member Countries, will be the Respondent, interested in presenting a limitation defense. The quality of one Party as a State as well as all specificities and constraints necessarily connected to any state activity neither exclude nor qualify resort to the defense of limitation. Of course, an acknowledgment of the claim under dispute by the organ competent to that effect and in the form prescribed by law would probably interrupt the running of the period of limitation. But any other state behavior short of such formal and authorized recognition would only under exceptional circumstances be able to either bring about interruption of the running of limitation or estop the Respondent State from presenting a regular limitation defense. Such exceptional circumstances include a long, uniform, consistent and effective behavior of the competent State organs which would recognize the existence, and possibly also the amount, of the claim. No such circumstances were presented to the Tribunal in this case. It is true that some assurances on CEMSA's entitlement to IEPS tax rebates were given to Claimant and CEMSA at various times by various middle-and high-ranking SHCP officials, and with

varying content. But such assurances never amounted to either an authorized and formal acknowledgment of the claim by the Respondent or to a uniform, consistent and effective behavior of Respondent. Therefore, the Tribunal does not deem that the Respondent is estopped from invoking the three-year limitation period under NAFTA Article 1117(2).

64. Analogous, although not identical, considerations prevail with regard to the next issue, to wit whether the Respondent is, on account of the same assurances and promises, estopped from denying the very basis of the damages claim itself (see *supra*, paras. 53 *in fine*, 59). Here again the criterion is a long, uniform, consistent and effective behavior of the competent State organs (see *supra*, para. 63). The Tribunal recognizes again that some assurances on CEMSA's entitlement to IEPS tax rebates were given to Claimant and CEMSA at various times, probably over a longer period, by various middle- and high-ranking SHCP officials, and with varying content. However, the Tribunal misses the uniform, consistent and effective character of such behavior as well as its connection with the competent State organs at all times. In this respect, the Tribunal also takes into consideration that in any state governed by the rule of law there is no way to impose, to reduce, to claim, to recuperate, or to transfer any tax burdens by agreements with some tax officials not provided by the law. Such agreements would necessarily have a *quasi* private character and could neither bind the State nor be enforced against it.

65. Accordingly, the Tribunal does not find that the Respondent is equitably or otherwise estopped from denying the very basis of the damages claim itself. Notwithstanding this finding, the Tribunal will consider such behavior of several SHCP officials while examining the bases of »creeping« or otherwise relevant form of expropriation, or effective denial of national treatment, under NAFTA Articles 1110 and 1102. Indeed, it is possible that behavior of some State organs such as the ones under consideration here may have led the Claimant to initiate, or to expand, his investment and, thus, may have contributed to the occurrence or the amount of his damage, if any. This may be particularly relevant with respect to more or less technical or »procedural« aspects of Mexican legislation on taxation, such as the requirement of separately and expressly stating the IEPS tax in invoices issued to CEMSA.

G.2 Exhaustion of Local Remedies

66. Both Parties have addressed the relationship between domestic litigation in Mexico and this international arbitration as well as the related doctrine of exhaustion of local remedies (memorial, paras. 214-219; counter-memorial, paras. 365-378; reply, paras. 34-52; rejoinder, paras. 41-51).

67. In essence, the Claimant alleges that NAFTA Chapter 11, and particularly its Section B, was designed to provide investors of the NAFTA Parties with impartial international dispute resolution. A prospective claimant must make an election. If he wants to pursue a damage claim under NAFTA, he has to waive his rights to pursue damages in the local courts. Thus, Mexico traded its traditional position on the exclusive jurisdiction of its courts in exchange for the enormous benefits to be drawn from NAFTA (see opening statement by Mr. Feldman on July 9, 2001, transcript, vol. 1, pp. 52-53). Accordingly, this Arbitral Tribunal may well examine both Mexican domestic laws and the conduct of Mexican tax authorities to determine whether they meet minimum standards of international law, including due process of law, fair and equitable treatment, and full protection and security, as incorporated by NAFTA Articles 1110(1)(c) and 1131(1) (*ibid.*, pp. 54-55). Therefore, an international tribunal reviewing state action under international law may reach a different result than a domestic tribunal reviewing the same conduct under domestic law. The potential difference of results is due to the difference of standards. This could readily happen in a case where the domestic statutory framework was designed to discriminate against the claimant (see closing statement by Mr. Feldman on

July 13, 2001, transcript, vol. 5, p. 182).

68. In addition, the Claimant maintains that both the investor and the investment have waived their right to claim damages in the Mexican courts, as required by NAFTA Article 1121 (reply, para. 34). Whatever proceedings may be pending now in Mexico, they do not constrain the Arbitral Tribunal since (1) under Mexican procedure, the Claimant was required to challenge SHCP's actions in order to avoid seizure of property and, likely, imprisonment; and (2) after this Tribunal was constituted, the Claimant filed papers seeking to terminate all domestic litigation (reply, para. 39). In sum, the Claimant neither has any effective legal remedy under Mexican law nor can be required to introduce every year a new *Amparo* procedure in order to meet all annual minor amendments to the IEPS law, no matter how marginal and irrelevant these legislative amendments may be.

69. The Respondent basically denies that the Claimant has any right to receive IEPS rebates as a matter of Mexican law. Subject to constitutional questions, the particular issue of the requirement of separate and express invoices has been resolved in two separate proceedings before the Mexican courts, which have sole jurisdiction over issues of Mexican law, and is likely to be addressed again in one of the proceedings for an extended period of time. Neither is there any international legal right to IEPS rebates nor is this Arbitral Tribunal authorized to substitute its views of domestic law for those of the local courts (rejoinder, paras. 29-33). According to the Respondent, the Claimant is having his day in court in Mexico, and in any event, as those proceedings involve issues of Mexican law they are not relevant to this proceeding. Those proceedings would be relevant only if the Claimant were in a position to challenge the Mexican court actions as constituting a denial of justice under international law, which the Claimant has not done. Consequently, it would be incorrect to state that there were an absence of an effective legal remedy just because the Claimant lost in one of the proceedings; at the time of the Respondent's submission, the Claimant appears to be prevailing in the second action, but it is not final. If that were true, every disappointed litigant who otherwise met the standing requirements of NAFTA Chapter Eleven, Section B, would bring a claim under international law (rejoinder, paras. 40, 41). The Respondent concludes therefore that, with the exception of the claim for an alleged denial of national treatment, all of the claims advanced in this proceeding would require the Arbitral Tribunal to apply domestic law in the place of the proper judicial body (counter-memorial, para. 40).

70. In addition, the Respondent maintains that, in any event, any CEMSA's claimed right to IEPS rebates would depend on issuing invoices separately and expressly stating the tax. This particular condition, which was never complied with by the Claimant, is now *sub judice* on appeal in the Mexican courts (counter-memorial, paras. 11, 360-364). Accordingly, the international responsibility of a State cannot be engaged unless and until the measure in issue has been tested at the local level and has become final by pronouncement of the highest competent authority (counter-memorial, para. 371). The exhaustion of local remedies rule is applicable under NAFTA as in general under international law. Nor does any relevant waiver exist here, since the waiver required by NAFTA Article 1121 is limited to damages only (transcript, vol. 2, pp. 79, 81) and, in any event, the Claimant neither discontinued proceedings in the domestic courts nor did he refrain from initiating others with respect to measures allegedly in breach of NAFTA Chapter Eleven, Section A (rejoinder, paras. 47-51).

G.3 Analysis

71. The decision on the issue of exhaustion of local remedies as a condition for claim admissibility primarily depends on the wording and construction of the relevant NAFTA provisions. Indeed, it is generally understood that the local remedies rule may be derogated from, qualified, or varied by virtue of any binding treaty (*Case Concerning*

Elettronica Sicula, S.p.A., United States of America v. Italy, 1989, I.C.J. Reports 4, para. 50). Such qualification took place here under NAFTA Articles 1121 and Annex 1120.1.

72. Article 1121(2)(b) and (3) in its relevant parts provides as follows:

2. A disputing investor may submit a claim under Article 1117 [Claim by an Investor of a Party on Behalf of an Enterprise] to arbitration only if both the investor and the enterprise:

.....

(b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

3. A consent and waiver required by this Article shall be in writing, shall be delivered to the disputing Party and shall be included in the submission of a claim to arbitration.

73. It appears that this Article, rather than confirming or repeating the classical rule of exhaustion of local remedies, envisages a situation where domestic proceedings with respect to the same alleged breach referred to in Article 1117 are either available or even pending in a court or tribunal operating under the law of any Party. In such case, Article 1121(2)(b) requires, for a recourse to arbitration to be open, that the disputing investor waive his right to initiate or continue the other domestic proceedings. Therefore, in contrast to the local remedies rule, Article 1121(2)(b) gives preference to international arbitration rather than domestic judicial proceedings, provided that a waiver with regard to the latter is declared by the disputing investor. This preference refers, however, to a claim for damages only, explicitly leaving available to a claimant »proceedings for injunctive, declaratory or other extraordinary relief« before the national courts. Thus, Article 1121(2)(b) and (3) substitutes itself as a qualified and special rule on the relationship between domestic and international judicial proceedings, and a departure from the general rule of customary international law on the exhaustion of local remedies. The thrust of such substitution seems to consist in making recourse to NAFTA arbitration easier and speedier, as opposed to the general pattern of opening up international arbitration to private parties as against third states.

74. In particular with respect to Mexico as Respondent, Annex 1120.1 of NAFTA restricts resort to arbitration. According to this provision in its relevant parts,

»With respect to the submission of a claim to arbitration:

.....

(b) where an enterprise of Mexico that is a juridical person that an investor of another Party owns or controls directly or indirectly alleges in proceedings before a Mexican court or administrative tribunal that Mexico has breached an obligation under

(i) Section A .....

.....,

the investor may not allege the breach in an arbitration under this Section«.

75. Annex 1120.1 of NAFTA gives, thus, a statutory preference to domestic proceedings in Mexico vis-à-vis a possible international arbitration under NAFTA Chapter 11, Section A, by obviously preventing the disputing investor from instituting, then waiving domestic proceedings and, only thereafter resorting to arbitration, as provided under Article 1121(2)(b) (see *supra*, paras. 72, 73). This prohibition applies, however, only if the Claimant »alleges

in proceedings before a Mexican court or administrative tribunal that Mexico has breached an obligation under ... Section A«. In any event, since the Respondent expressly confirms that »the Claimant has also not sought to submit an alleged breach of the NAFTA to the Mexican courts, so there is no conflict with Annex 1120.1« (rejoinder, para. 48), the Tribunal does not see any obstacle to the present arbitration connected to Annex 1120.1 of NAFTA.

76. As far as the waiver requirement under Article 1121(2)(b) and (3) is concerned, the Arbitral Tribunal is satisfied that the appropriate waivers were attached by both the Claimant and CEMSA as Exhibits B and C to the Notice of Arbitration of April 30, 1999 and also delivered to the Respondent, as indicated in the Notice of Arbitration (p. 3 under B(1)(a)), noting that the Respondent has not challenged the delivery or the sufficiency of the waivers (rejoinder, para. 46).

77. Under Article 1121(2)(b), the waivers are required for, and limited to, claims for damages only. Indeed, the Notice of Arbitration presents as requests four related claims for damages (p. 11 under D); they do not apply to »proceedings for injunctive, declaratory or other extraordinary relief.« A later request by the Claimant with regard to the illegality or invalidity of a tax assessment by the Respondent for about US$25 million asks for declaratory relief only and, therefore, does not require a waiver under Article 1121(2)(b) (see *supra*, paras. 72, 73). It has to be examined below, however, whether this request, while relieved from the requirement of waiver, stands properly before the Tribunal in terms of its scope of authority (see *infra*, para. 88).

78. The Respondent observes that the Claimant, in spite of the waiver, did not in fact withdraw from several related domestic proceedings in Mexico; nor does the Respondent suggest that it was incumbent upon the Claimant to withdraw (see rejoinder, paras. 47, 48). The Arbitral Tribunal, however, does not find the point to be pertinent. Mexican courts are hailed by the Respondent as the appropriate forum for determining the Claimant's rights under the IEPS law (see, *e.g.*, counter-memorial, paras, 367, 368; rejoinder, paras. 48-51). In the first instance, we agree. However, questions as to whether Mexican law as determined by administrative authorities or Mexican courts is consistent with the requirements of NAFTA and international law are to be determined in this arbitral proceeding, and we are not barred from making that determination by the fact that not all of the issues have yet been resolved by Mexican courts. Otherwise, any arbitral tribunal could be prevented from making a decision simply by delaying local court proceedings. Nor is an action determined to be legal under Mexican law by Mexican courts necessarily legal under NAFTA or international law. At the same time, an action deemed to be illegal or unconstitutional under Mexican law may not rise to the level of a violation of international law.

G.4 Other Jurisdictional Constraints

79. As noted earlier, several jurisdictional issues in this arbitration have been resolved by the Tribunal's »Interim Decision on Preliminary Jurisdictional Issues« rendered on December 6, 2000. However, this decision was limited to »the specific preliminary issues set forth in [the Tribunal's] Procedural Order No. 4 and at paragraph 11« of the Interim Decision itself. Other jurisdictional issues were not precluded, to the extent they have arisen in the course of this arbitral proceeding.

80. Such an additional jurisdictional issue, which arose later, pertains to the authority of this Tribunal to grant declaratory relief with respect to the validity or legality of the 1998 audit and the corresponding tax assessment by SHCP vis-à-vis CEMSA.

81. It appears to be common ground between the Parties (memorial, paras. 121-126; counter-memorial, paras. 240-268) that in July 1998 SHCP launched an audit, or a verification visit by an audit team (*visitadores*), with regard to CEMSA's 1996-1997 exports. The audit was conducted with the presence of the police and with the use of sever-

al photocopying machines brought by the visiting team for that purpose. Several months later, on March 1, 1999, SHCP issued its determination by which it concluded the audit through a tax assessment against CEMSA in the amount of $250,551,635 Mexican pesos for wrongfully obtained tax rebates in 1996-1997, plus interest, fines, and actualization on account of inflation. The Claimant (memorial, para. 123) alleges that this amount is equal to about US$25 million, including a claim of recovery of some US$9.1 million in IEPS rebates paid in 1996 and 1997.

82. Thereafter, in March 1999, CEMSA challenged the audit of the April 1996 - September 1997 IEPS rebates and the ensuing tax assessment before the first-instance Fiscal Tribunal of the Federation. The Claimant argued that there was a fatal inconsistency between his right to the 0% tax rate under Article 2 of the IEPS and the invoice requirements under Article 4 of the same law. The Fiscal Tribunal's decision held in favor of CEMSA on some points and in favor of SHCP on others. Apparently the decision held that SHCP could not require invoices with the IEPS expressly transferred and stated separately since it was a requirement with which it was impossible to comply in the case of cigarette exports (see counter-memorial, paras. 261, 571-574). On the other hand, the decision denied any tax rebates on processed tobacco exports to »low tax jurisdictions«, notably Honduras, in accordance with Article 2 of the IEPS law. As a result, however, the tax assessment by SHCP was quashed.

83. Both parties opposed this decision (*supra*, paras. 68-69). The Claimant also filed an *Amparo* proceeding before the Circuit Court; SHCP availed itself of a »recourse of revision« before the same court. The circuit courts held that the requirements of Articles 2 and 4 were not contradictory. Further appeals ensued. In the most recent (March 29, 2002) determination in this litigation, a Mexican court of appeals has apparently held that the Claimant did have a constitutional right under the IEPS law in force in 1996-1997 notwithstanding his inability to produce invoices showing the tax amounts separately, on the ground that the invoice »formality« discriminates among different taxpayers (producers and exporters) who carry on the same activity. The decision also appears to hold unconstitutional the provision of the IEPS law that precludes receipt of tax refunds for exports to low tax jurisdictions (s*ee* Claimant's May 8 submission, 2002, paras. 7-8.). However, both Parties agree that this most recent decision is not final so that the proceeding remains *sub judice* before the competent federal courts (Claimant's May 8, 2002 submission, para. 17; Respondent May 8, 2002 submission, para. 18; memorial, para. 124; counter-memorial, para. 268).

84. What, then, is the relevance of these Mexican court decisions for this Tribunal? The Tribunal is not inclined to give them significant weight, in part because neither of the Parties has suggested that they are controlling, although the Mexican courts' discussion of legal issues provides necessary background to the Tribunal's understanding of these issues as required for a proper application of NAFTA and international law. First, of course, the 1998 assessment proceeding is not final. While the most recent decision favors the Claimant, the Respondent may prevail at the next step. Second, the 1998 decision, related to the negative response to a request presented to the tax authority (this decision differs from the Claimant's position specifically with regard to the exigency of separately stating the IEPS amounts in the invoices) which is final, essentially reinforces the Respondent's position, creating a conflict which this Tribunal cannot and should not try to resolve. Third, and probably most important, Mexican courts are applying Mexican law, while this Tribunal must apply the provisions of NAFTA and international law, which do not necessarily provide the same results as under Mexican law. Finally, as noted earlier, the Claimant has not challenged any of the Mexican court decisions, even those unfavorable to the Claimant, as breaching the international law standard for denial of justice, and it is premature to consider any question of possible

non-compliance of a Mexican court decision by the Respondent, since the issue of compliance has not yet arisen.

85. The purely declaratory character of the relief sought by the Claimant, to wit to declare the Respondent's 1999 tax assessment as invalid, is not necessarily inconsistent with NAFTA Chapter 11, Section B, in particular Articles 1116(1) and 1117(1), which appear to limit relief to claim for »loss or damage by reason of, or arising out, that breach«. It may also not be generally inconsistent with the exception of taxation measures in view of NAFTA Article 2103(6). Particular attention should be drawn, however, to the question whether such declaratory relief is admissible in the circumstances of this case.

86. The Claimant qualifies the requested declaration as »an incidental or additional claim respecting the audit and tax assessment ... The issues and the evidence are the same as those in the original claim, and the Tribunal will necessarily decide the new claim when it decides the first« (reply, para. 31). The Claimant concludes on this point by asserting a denial of justice if the Tribunal should award damages to the Claimant and the Respondent could seek to set off against those damages any audit liability assessed by the Mexican tax authorities, given that the issues at stake are the same with the ones litigated before the Tribunal (reply, paras. 32-33).

87. The Respondent answers by denying this Tribunal's jurisdiction to entertain the Claimant's request for »a declaration that Respondent is not entitled to recover rebates paid to CEMSA in respect of cigarette exports in 1996-1997« because

(a) NAFTA Chapter Eleven, Section B, vests the Tribunal only with jurisdiction to award monetary compensation;

(b) the Claimant has not submitted to arbitration a claim in respect of the 1998 audit; and

(c) the requested declaration would usurp the jurisdiction of the Mexican courts and would not be enforceable in any event (counter-memorial, para. 575).

Further, according to the Respondent, the Tribunal has no jurisdiction to entertain the claim that a contingent award be issued in the amount of any tax assessment levied against the Claimant as a result of the 1998 audit, for the additional reason that such claim would not yet be ripe (*ibid*., paras. 576, 577).

88. In view of conflicting arguments by the Parties (*supra*, paras. 86-87), the Arbitral Tribunal stresses that, according to NAFTA Article 1136(1), an award made by a Tribunal shall have binding force between the disputing Parties and in respect of the particular case. This rule also implies that a NAFTA State Party must comply with a final arbitral award in its entirety as well. *In casu*, CEMSA's entitlement to tax rebates in the critical period necessarily constitutes an important segment of the present arbitration. Any decision by this Arbitral Tribunal thereon is bound to have, under the terms of NAFTA Article 1136(1), a direct bearing upon any domestic litigation (pending or final) on the entitlement to tax rebates. Therefore the validity or legality of the 1999 tax assessment with respect to the tax rebates obtained in the years 1996 and 1997 hardly constitutes an independent or unrelated count in this arbitration. Rather, the validity or recovery of these tax rebates functionally have an impact on, and belong to, the Tribunal's evaluation whether a »creeping« or any other relevant (under NAFTA Articles 1110 and 2103(6)) form of expropriation has taken place. In addition, it appears to the Arbitral Tribunal that the Claimant as well understands this declaratory relief in the context of expropriation under NAFTA Article 1110 since his request seeks an arbitral finding that such tax assessment by the Respondent »constitutes a measure tantamount to expropriation under, and in breach of, NAFTA Article 1110« (memorial, submission A(4), p. 130). Similarly, the validity or recovery of these tax rebates may be relevant to determining whether Respondent has violated Article 1102, to

the extent the Tribunal determines that Claimant has been treated less favourably with regard to the tax rebates than domestic investors in like circumstances, as discussed in Section I, *infra*.Therefore, since the Claimant submits this allegation of invalidity within the framework of NAFTA Articles 1102 and 1110, the invalidity issue will be dealt with within the appropriate framework but does not warrant an autonomous answer in the operative part of this Award.

H MERITS

H.1 Expropriation: Overview of the Positions of the Disputing Parties

89. In this proceeding, the Claimant's key contention is that the various actions of Mexican authorities, particularly SHCP, in denying the IEPS rebates on cigarette exports to CEMSA, resulted in an indirect or »creeping« expropriation of the Claimant's investment and were tantamount to expropriation under Article 1110. They were also arbitrary, confiscatory and discriminatory, a violation of the Claimant's right to due process (see memorial, Introduction and Summary, p. 6; first Swan's affidavit, paras. 30-34). The Claimant asserts that the »measures« he has complained about may also be characterized as a »denial of justice« (one aspect of denial of due process) under article 1110 (memorial, paras. 189-203). Nor does the Claimant believe that the Mexican government policy of limiting cigarette exports is justified by public policy concerns, particularly in light of the stated purpose of the IEPS law in 1980, which was to encourage Mexican exports (memorial, para. 189, quoting Statement of Purpose of IEPS Law for 1981, Diario Oficial, Dec. 30, 1980).

90. In particular, the Claimant asserts that the 1993 Supreme Court *Amparo* decision required Mexican officials not only to provide CEMSA with the 0% excise tax rate on exports, but also to permit CEMSA to obtain rebates of the tax amounts included in the price CEMSA paid its suppliers, Walmart and Sam's Club. According to the Claimant, the decision makes no sense if it holds Article 2 of the IEPS Law -- permitting only manufacturers, not resellers, to obtain the 0% tax rate for exported cigarettes -- unconstitutional, but continues to permit SHCP to deny the rebates to firms that are not IEPS taxpayers and do not have invoices showing the tax amounts stated separately, as Article 4(III) of the IEPS law specifies. In seeking the rebates, the Claimant asserts that he reasonably relied on a series of letters from SHCP officials, oral assurances from those officials, and their actions in granting the rebates during some periods (1992 and April 1996 to September 1997). Rebates were granted although the officials were fully aware at all relevant times that the Claimant lacked invoices that stated the tax amounts separately, and would rely on their actions. Some of the same officials had denied those rebates during earlier periods. In fact, according to the Claimant, there was effectively an oral agreement or understanding with SHCP officials, concluded through a series of meetings and exchanges of letters in 1994 and 1995, to the effect that the 1993 *Amparo* decision provided the Claimant the right to receive rebates, rather than simply the right to a 0% IEPS tax on cigarette exports (memorial, paras. 68-69). This understanding, according to the Claimant, resulted from the impossibility of the Claimant's obtaining the invoices, the influences of the U.S. Embassy and the entry into force of NAFTA (memorial, Introduction and Summary, pp. 3-4).

91. It is the Claimant's view, however, that the Mexican government did not comply with the *Amparo* decision, despite the oral agreement to afford the Claimant the rebates. Rather, Mexican government officials sought return of the rebates that had been granted between April 1996 and September 1997, and ultimately denied the Claimant's rebates for October and November 1997, effectively preventing the Claimant from exporting cigarettes. The application of the IEPS law by Mexican authorities (particularly strict application of Article 4(III)) requiring invoices with the separate statement of tax amounts, even though it was impossible for CEMSA to obtain them, had the intended result.

SHCP's actions effectively drove CEMSA out of the cigarette export business, in violation of Article 1110. According to the Claimant, these facts precisely fit the traditional definition of indirect or creeping expropriation: Mexico's intent was to put the Claimant out of the cigarette export business through manipulation or interpretation of IEPS legal requirements, and by denying the IEPS rebates over a period of time. The Claimant concludes that the fact that tax laws are applied in such a way as to accomplish the expropriation does not convert an expropriation into valid regulation.

92. The Respondent disagrees on a variety of grounds. First, SHCP's actions -- demanding invoices with the IEPS tax amounts stated separately as a condition of the IEPS rebates -- were required by the IEPS law. That requirement in the Respondent's view is fully consistent with the 1993 Mexican *Amparo* Supreme Court case, which applied to both cigarette and alcoholic beverage exports, and decided *only* that resellers such as the Claimant, as well as producers, were entitled to the 0% IEPS tax rate on their exports (counter-memorial, paras. 1-2). SHCP was prepared to apply the 0% tax rate and to grant the rebates, but if and only if the Claimant complied with the other requirements of the IEPS law, including those relating to invoices. According to the Respondent, the question of the requirement that the person seeking the rebates be a taxpayer and, particularly, of invoices stating the tax amounts separately was never before the Mexican Supreme Court and was not decided by it (counter-memorial, para. 23). Moreover, there was never any intent on the part of SHCP officials to waive the requirements of Article 4 of the IEPS law. Rebates are initially granted in a virtually automatic process, with SHCP reserving the right under the law to audit recipients to determine whether they were entitled to the rebates and whether the amounts sought were correct.

93. According to the Respondent, there is no basis for finding an »agreement« between the Claimant and SHCP that the Claimant was entitled to rebates under the *Amparo* decision. There was no such agreement beyond the obvious understanding of SHCP officials, communicated to the Claimant both orally and in writing, that they would comply with the *Amparo* decision. That decision goes no further than to require that the Claimant be afforded the 0% tax rate. SHCP officials did not, and could not have, abrogated the other requirements of the IEPS law, including but not limited to providing invoices with tax amounts separately stated, in accordance with Article 2 (counter-memorial, paras. 168, 172).

94. Also, the Mexican circuit court has determined, *inter alia*, in the »nullification« proceeding initiated by the Claimant in 1998, that IEPS legal provisions requiring invoices stating the tax amounts separately as a condition of obtaining rebates are not inconsistent with principles of tax equity. In the Respondent's view, this is a determination under Mexican law that is not properly before the Tribunal (rejoinder, para. 16). While the arguments are in general detailed and complex, the Respondent believes that this litigation proves that Mexican administrative authorities acted consistently with Mexican law and court decisions (even though the case only applies by its actual terms to applications for rebates submitted in November and December 1997). Thus, there is no denial of justice under Mexican law, or other violation of international law that could be considered the basis for a violation of Article 1110.

95. The Respondent also questions whether the Claimant can demonstrate the ownership of an »investment« that was allegedly expropriated in Mexico by Mexican authorities; in the absence of an investment, the Claimant has no standing to bring an action under Chapter 11. In particular, to the extent the Claimant is seeking payment of rebate amounts for October and November 1997, this is a debt obligation that is specifically excluded from the definition of investment under NAFTA Article 1139. Nowhere is there an »investment« of which the Respondent seized ownership and control (counter-memorial, para. 302 ff.).

H.2 Applicable Law: NAFTA Article 1110 and International Law

96. A threshold question is whether there is an »investment« that is covered by NAFTA. The term »investment« is defined in Article 1139, in exceedingly broad terms. It covers almost every type of financial interest, direct or indirect, except certain claims to money. The first listed item under »investment« is »an enterprise.« There is no disagreement among the parties that Corporación de Exportaciones Mexicanas, S.A. (CEMSA) is a corporate entity organized under the laws of Mexico, essentially wholly owned by the American citizen investor, Marvin Roy **Feldman** Karpa (first **Feldman** statement, para. 1). Among the dictionary definitions of »enterprise« are »a unit of economic organization or activity; *esp.* a business organization« (Webster's New Collegiate Dictionary, 1977 ed.). As such, the Tribunal determines that CEMSA comes within the term »enterprise« and is thus an »investment« under NAFTA. This conclusion is consistent with that reached by other NAFTA Chapter 11 tribunals. For example, the tribunal in *S.D. Myers v. Canada* concluded that a Canadian corporation organized for the purpose of facilitating hazardous waste exports to the United States, an affiliate of S.D. Myers in the United States owned by the same shareholders as S.D. Myers, satisfied the NAFTA requirements for an »investment.« (*S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 230-231, http://www.state.gov/documents/organization/3992.pdf.)

97. Expropriation under Chapter 11 is governed by NAFTA Article 1110, although NAFTA lacks a precise definition of expropriation. That provision reads in pertinent part as follows:

1. No Party may *directly or indirectly* nationalize or expropriate an investment of an investor of another Party in its territory or *take a measure tantamount to nationalization or expropriation* of such an investment (»expropriation«), except:

(a) for a public purpose;

(b) on a non-discriminatory basis;

(c) in accordance with due process of law and article 1105(1); and

(d) on payment of compensation in accordance with paragraphs 2 through 6.[FN5]

The key issue, in general and in the instant case, is whether the Respondent's actions constitute an expropriation.

98. The Article 1110 language is of such generality as to be difficult to apply in specific cases. In the Tribunal's view, the essential determination is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid governmental activity. If there is no expropriatory action, factors a-d are of limited relevance, except to the extent that they have helped to differentiate between governmental acts that are expropriation and those that are not, or are parallel to violations of NAFTA Articles 1102 and 1105. If there is a finding of expropriation, compensation is required, *even if* the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).

99. The view that the conditions (other than the requirement for compensation) are not of major importance in determining expropriation is confirmed by the Restatement of the Law of Foreign Relations of the United States, a source relied on by many American and Canadian lawyers that has been discussed in the memorials of both the Claimant and the Respondent in this proceeding.[FN6] For example, according to the Restatement, the public purpose requirement »has not figured prominently in international claims practice, perhaps because the concept of public purpose is broad and not subject to effective reexamination by other states.« (AMERICAN LAW INSTITUTE, Restatement of the Law Third, the Foreign Relations of the United States, USA, American Law Institute Publishers,

Vol. 1, 1987, (hereinafter Restatement), Section 712, Comment g.). Similarly, the Restatement suggests that if proper compensation is paid for an expropriation, the fact that the taking was not for a public purpose and was discriminatory, »might not in fact be successfully challenged.« A comment observes, perhaps somewhat inconsistently, that »economic injuries [falling under section 712(3)] are generally unlawful because they are discriminatory or are otherwise arbitrary.« (*Id.*, Sec. 712, Comment i.) This last clause suggests that if the government actions (legislative, administrative or judicial) are discriminatory or arbitrary (or perhaps unfair or inequitable), as arguably is the case here, they are more likely to be viewed as expropriatory, imparting a degree of circularity to the »expropriation versus regulation« dichotomy.

100. Most significantly with regard to this case, Article 1110 deals not only with direct takings, but indirect expropriation and measures »tantamount to expropriation,« which potentially encompass a variety of government regulatory activity that may significantly interfere with an investor's property rights. The Tribunal deems the scope of both expressions to be functionally equivalent. Recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control. However, it is much less clear when governmental action that interferes with broadly-defined property rights -- an »investment« under NAFTA, Article 1139 -- crosses the line from valid regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.

101. By their very nature, tax measures, even if they are designed to and have the effect of an expropriation, will be indirect, with an effect that may be tantamount to expropriation. If the measures are implemented over a period of time, they could also be characterized as »creeping,« which the Tribunal also believes is not distinct in nature from, and is subsumed by, the terms »indirect« expropriation or »tantamount to expropriation« in Article 1110(1). The Claimant has alleged »creeping expropriation.« The Respondent has objected that the Claimant has in effect added a new element to the case which, among other things, should have been submitted to the Competent Authorities under Article 2103(6) for a determination as to whether it should be excluded from consideration as an expropriation. The Restatement defines »creeping expropriation« in part as a state seeking »to achieve the same result [as an outright taking] by taxation and regulatory measures designed to make continued operation of a project uneconomical so that it is abandoned« (Restatement, Section 712, Reporter's Note 7). Since the Tribunal believes that creeping expropriation, as defined in the Restatement, noted above, is a form of indirect expropriation, and may accordingly constitute measures »tantamount to expropriation«, the Tribunal includes consideration of creeping expropriation along with its consideration of these closely related terms.[FN7]

102. Ultimately, decisions as to when regulatory action becomes compensable under article 1110 and similar provisions in other agreements appear to be made based on the facts of specific cases. This Tribunal must necessarily take the same approach.

103. The Tribunal notes that the ways in which governmental authorities may force a company out of business, or significantly reduce the economic benefits of its business, are many. In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary inter-

national law recognizes this (see *infra* para. 105).

104. Drawing the line between expropriation and regulation has proved difficult both in the pre-NAFTA context and for the handful of NAFTA Chapter 11 tribunals that have considered the issue. Here again, despite the less specific language and the lack of references to »tantamount to expropriation,« the Restatement is somewhat helpful, particularly the comments, in understanding customary international law in this area. Section 712 reads in pertinent part as follows:

»A state is responsible under international law for injury resulting from:

(1) a taking by the state of the property of a national of another state that

(a) is not for a public purpose, or

(b) is discriminatory, or

(c) is not accompanied by provision for just compensation.«

While the language itself differs considerably from Article 1110, many of the essential substantive elements are the same, particularly the concept of a taking and the conditions.

105. The »comments« to the Restatement are designed to assist in determining, *inter alia*, how to distinguish between an indirect expropriation and valid government regulation:

A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory... *A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory*....(Restatement, Section 712, comment g, emphasis supplied.)

106. It is notable that the Restatement comment specifically includes »taxation« as a possible expropriatory action and establishes state responsibility, *inter alia*, for unreasonable interference with an alien's property. At the same time, non-discriminatory, bona fide *general* taxation does not establish liability. The Reporter's Notes to the Restatement further suggest that »whether an action by the state constitutes a taking and requires compensation under international law, or is a police power regulation or tax that does not give rise to an obligation to compensate even though a foreign national suffers loss as a consequence« must be determined in light of all the circumstances (Restatement, Section 712, Reporter's Note 5).

107. Along with the Restatement, this Tribunal has also sought guidance in the decisions of several earlier NAFTA Chapter 11 Tribunals that have interpreted Article 1110. The Tribunal realizes that under NAFTA Article 1136(1), »An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case,« and that each determination under Article 1110 is necessarily fact-specific. However, in view of the fact that both of the parties in this proceeding have extensively cited and relied upon some of the earlier decisions, the Tribunal believes it appropriate to discuss briefly relevant aspects of earlier decisions, particularly *Azinian v. United Mexican States* and *Metalclad v. United Mexican States.*Nevertheless, there has been only one prior finding of a taking under Article 1110, in *Metalclad*, and the principal rationale for that decision was substantially overruled by the reviewing court, the Supreme Court of British Columbia. In the other decisions to date which have considered allegations of a violation of Article 1110 and attempted to articulate criteria for the determination (*S.D. Myers v. Canada* and *Pope & Talbot v. Canada*) the tribunals for various reasons have failed to find violations of Article 1110.

H.3 Respondent's Actions as an Expropriation Under Article 1110.

108. The Tribunal has struggled at considerable length, in light of the facts and legal arguments presented, the language of Article 1110 and other relevant NAFTA provisions, principles of customary international law and prior NAFTA tribunal decisions, to determine whether the actions of the Respondent relating to the Claimant constituted indirect or »creeping« expropriation, or actions tantamount to expropriation. (There is in this case no allegation of a direct expropriation or taking under Article 1110.) The conclusion that they do not is explained below.

109. The facts presented here might, depending on their interpretation, appear to support a finding of an indirect or creeping expropriation. The Claimant, through the Respondent's actions, is no longer able to engage in his business of purchasing Mexican cigarettes and exporting them, and has thus been deprived completely and permanently of any potential economic benefits from that particular activity.[FN8] Between 1991, when the Claimant brought his *Amparo* action, and December 1997, when SHCP definitively refused to provide CEMSA with tax rebates on exported cigarettes, SHCP followed an inconsistent and nontransparent course of action. In some instances, SHCP authorized and paid the rebates (for 1992 exports, for example), in others, for significant periods of time (1994 -1995), it denied them. At various times SHCP officials provided written documentation to the Claimant that might have led some persons--reasonably or otherwise-- to believe that SHCP had agreed with the Claimant's position that the 1993 *Amparo* decision required that the Claimant be afforded the rebates (see, *e.g.*, letters of March 12, 1992, May 10, 1994 and March 16, 1997). SHCP has sought through a tax audit a refund of rebates paid to the Claimant in 1996 and 1997, increased by an inflation factor, interest and possible penalties. Also, under Article 2103(6) of NAFTA, the State Parties expressly confirm that tax regulatory activity may be expropriatory under Article 1110, albeit with significant limitations.[FN9]

110. No one can seriously question that in some circumstances government regulatory activity can be a violation of Article 1110. For example, in *Pope & Talbot*, Canada argued that »mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required.« [FN10] That tribunal rejected this approach:

Regulations can indeed be characterized in a way that would constitute creeping expropriation... Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation. (*Id., para.* 99.)

However, the *Pope & Talbot* tribunal failed to find a violation of Article 1110 in that case. This Tribunal finds the legal arguments against a finding of expropriation more persuasive, for reasons described in detail below, and reaches the same conclusion on facts very different from those in *Pope & Talbot.*

111. This Tribunal's rationale for declining to find a violation of Article 1110 can be summarized as follows: (1) As *Azinian* suggests, not every business problem experienced by a foreign investor is an expropriation under Article 1110; (2) NAFTA and principles of customary international law do not *require* a state to permit »gray market« exports of cigarettes; (3) at no relevant time has the IEPS law, as written, afforded Mexican cigarette resellers such as CEMSA a »right« to export cigarettes (due primarily to technical/legal requirements for invoices stating tax amounts separately and to their status as non-taxpayers); and (4) the Claimant's »investment,« the exporting business known as CEMSA, as far as this Tribunal can determine, remains under the complete control of the Claimant, in business with the apparent right to engage in the exportation of alcoholic beverages, photographic

supplies, contact lenses, powdered milk and other Mexican products-- any product that it can purchase upon receipt of invoices stating the tax amounts-- and to receive rebates of any applicable taxes under the IEPS law. While none of these factors alone is necessarily conclusive, in the Tribunal's view taken together they tip the expropriation / regulation balance away from a finding of expropriation.

H.3.1 Many Business Problems Are Not Expropriations

112. First, the Tribunal is aware that not every business problem experienced by a foreign investor is an indirect or creeping expropriation under Article 1110, or a denial of due process or fair and equitable treatment under Article 1110(1)(c). As the *Azinian* tribunal observed, »It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities... It may be safely assumed that many Mexican parties can be found who had business dealings with governmental entities which were not to their satisfaction...« (*Robert Azinian and Others v. The United Mexican States*, Award, November 1, 1999, para. 83, 14 ICSID Review. FILJ 2, 1999.) To paraphrase *Azinian,* 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.

113. Here, it is undeniable that the Claimant has experienced great difficulties in dealing with SHCP officials, and in some respects has been treated in a less than reasonable manner, but that treatment under the circumstances of this case does not rise to the level of a violation of international law under Article 1110. Unfortunately, tax authorities in most countries do not always act in a consistent and predictable way. The IEPS law on its face (although not necessarily as applied) is undeniably a measure of general taxation of the kind envisaged by Restatement Comment g (see *supra,* paras. 105, 106). As in most tax regimes, the tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favored, with others less favored or even disadvantaged.

114. Moreover, the Claimant could have availed himself early on of the procedures available under Mexican law to obtain a formal, binding ruling on the invoice issue from SHCP, but apparently chose not to do so (see prepared testimony of Fernando Heftye, paras. 7-9). Despite the legal uncertainties of the issues upon which the success of his business depended, the Claimant asked for clarification of the legal issues under Article 4 of the IEPS law only when effectively forced to do so, in April 1998 after SHCP denied the Claimant's request for tax rebates for the October 1997 - January 1998 exports, and in March 1999 when as a result of a tax audit SHCP demanded return of rebates, plus interest, inflation adjustment and penalties, for rebates earlier received in 1996 and 1997[FN11]. It is unclear why he refrained from seeking clarification, but he did so at his peril, particularly given that he was dealing with tax laws and tax authorities, which are subject to extensive formalities in Mexico and in most other countries of the world.

H.3.2 Gray Market Exports and International Law

115. Second, NAFTA and principles of customary international law do not, in the view of the Tribunal, *require* a state to permit cigarette exports by unauthorized resellers (gray market exports). A prohibition to this effect may rely on objective reasons. Such reasons include discouragement of smuggling (of cigarettes purportedly exported back into Mexico), which may deprive a government of substantial amounts of tax revenue, maintenance of high cigarette taxes to discourage smoking (as in Canada) and, as a Mexican government official has suggested, assisting producers in complying with

trademark licensing obligations under private agreements (see statement of Ismael Gomez Gordillo, App. 6045-6054). It is undeniable, as both parties in this proceeding have recognized, that smuggling of cigarettes is a serious problem not only for Mexico but for many other nations.[FN12]

116. The conclusion that neither NAFTA nor rules of customary international law require a state to permit gray market cigarette exports is to some extent reinforced by the determination of the U.S. Competent Authority that Mexico's action in enacting legislation effective January 1, 1998, which restricted the availability of rebates of excise taxes to those who purchase cigarettes in the »first sale« within Mexico (i.e., the sale from the producer to the producer's customer, but not any subsequent resales) was not an expropriation under Article 1110 of NAFTA. (Letter of Feb. 17, 1999 from Assistant U.S. Treasury Secretary Donald C. Lubick to Mexican Under Secretary of Revenue Tomas Ruiz.) The effect of this 1998 IEPS amendment had exactly the same objective as the 1991 IEPS amendment that denied resellers the availability of the zero tax rate for their exports. (This was the 1991 IEPS amendment that was held unconstitutional in the *Amparo* decision by the Mexican Supreme Court in 1993.) The U.S. Competent Authority letter attempts to delink the 1998 measure to the earlier measures by stating that »No inference should be drawn concerning my views or the views of the United States government regarding whether the first two measures described above [the alleged refusal of Mexico to implement the *Amparo* decision and its refusal to provide the IEPS rebates] is an expropriation under Article 1110 of the NAFTA,« but the comparison is inescapable. At minimum, it suggests that tax law and policy changes are intended to be given relatively broad leeway under NAFTA, even if their effect is to make it impractical for certain business activities to continue.

H.3.3 Continuing Requirements of Article 4(III) of IEPS Law

117. Third, in the present case, a *per se* government ban on reseller exports of cigarettes (or other products) from Mexico was *not* in force during the entire 1990-1997 period. The Respondent's efforts to impose such a ban legislatively in 1990 were held unconstitutional by the Supreme Court in a 1993 *Amparo* decision. In a narrow interpretation of that decision - that it required both producers and resellers be offered the zero percent tax rate for exports, but no more - it was legally possible for the Claimant to export cigarettes at the 0% rate if the Claimant could meet the other requirements of the IEPS law.[FN13] However, the Claimant was effectively prevented from benefiting from the 0% rate, and therefore from exporting cigarettes, unless he could also obtain a rebate of the taxes reflected (but not separately stated) in the price that the Claimant paid to large retailers - Walmart and Sam's - for his cigarettes. This problem resulted from the fact that Mexican cigarette producers -- particularly Cigatam, the Mexican licensee of the Marlboro brand - refused to sell to him because they wanted to maintain an export monopoly (according to first Feldman statement, para. 14) or perhaps for other reasons, a refusal which was apparently within their right under Mexican law. In economic terms, it would have been impossible for the Claimant to pay the price of the cigarettes in Mexico, including the 85% excise tax required under the IEPS law, and then sell the cigarettes in any foreign country. (Once the foreign nation added its own excise taxes upon importation, the Mexican cigarettes with both tax amounts included would have been priced far out of the market.)

118. In his efforts to obtain the rebates, the Claimant was stymied by a long-standing requirement of the IEPS law, the requirement in Article 4(III) that when seeking rebates he, as non-taxpayer, present invoices showing that the IEPS tax had been separately transferred to the taxpayer (see *supra* para.15). However, even assuming that the Claimant is a »taxpayer« under this provision given the peculiarities of the tax calculation for cigarettes - and there is some doubt as to this conclusion - he could not obtain the required invoices at any relev-

ant time. The Claimant could not obtain the information from the retailers who supplied his cigarettes (since they did not know the tax amounts themselves), and the producers of the cigarettes were unwilling to provide the information.[FN14] Thus, it appears to the Tribunal that the Claimant never really possessed a »right« to obtain tax rebates upon exportation of cigarettes, but only a right to the 0% tax rate. This is important, because as far as the Tribunal can determine, the only significant asset of the investment, the enterprise known as CEMSA, is its alleged right to receive IEPS tax rebates upon exportation of cigarettes, and to profit from that business.[FN15] We also note that the Claimant concedes that »discrimination between cigarette producers and resellers is [not] necessarily a violation of international law.« (See Claimant's May 8, 2002 submission, para. 9.) The Claimant relies, rather, on the alleged refusal of Mexican authorities to comply with the 1993 *Amparo* decision and the alleged subsequent agreement between the Claimant and SHCP officials that the Claimant would be permitted the rebates despite the absence of invoices stating the tax amounts separately.

119. The key contentious issue here is whether the denial of IEPS rebates for failure to meet with the invoice requirement constituted expropriation of the Claimant's investment (a right to export cigarettes) under Article 1110. A related issue is the denial of tax rebates for exports allegedly made to a low tax jurisdiction (Honduras), also purportedly barred under the IEPS law (see *supra* para.8). However, in determining whether the Claimant was deprived of a »fundamental right of ownership« (the term used by the *Pope & Talbot* tribunal) by Mexican government actions in the critical 1996-1997 period, it is important to observe that the invoice requirements of the IEPS law were not new, and had not been changed by Mexican officials (except to the extent or non-extent of enforcement) to the detriment of the Claimant. At *all* times between January 1, 1987, including April 1990, when CEMSA was first registered as an export company, and January 1, 1998, when the new IEPS law definitively denied rebates except for the »first sale« in Mexico, Article 4(III) of the IEPS law as written (even if not always as applied) effectively required resellers such as CEMSA to obtain invoices stating the tax amounts separately. Even if the 1999 Mexican Fiscal Court proceeding ultimately results in a decision that the denial of the rebates for 1996-1997 is unconstitutional under Mexican law, this is not a situation in which the Claimant can reasonably argue that post investment changes in the law destroyed the Claimant's investment, since the IEPS law at all relevant times contained the invoice requirements. Of course, Mexico had first sought to ban such exports in 1990 by denying the 0% tax rate to resellers, but that effort was defeated by the Supreme Court. Thus, in retrospect, the Claimant's most intractable problem with regard to cigarette exports was *not* the 0% tax rate, but the technical requirements of the IEPS law with regard to invoices and, much later, the denial of tax rebates for exports to low tax jurisdictions, also clearly stated in the IEPS law during all relevant periods.

120. The Claimant argues that the 1993 *Amparo* Supreme Court decision resolved not only the 0% tax rate, but the invoice and taxpayer limitations in the IEPS law as well, and contends that SHCP improperly limited the scope of that decision to the 0% tax rate. There is language in the opinion that condemns discrimination between producers and other sellers generally, which is not limited to the 0% tax rate. Also, there is some inherent logic behind the Claimant's position; if the Claimant were correct, this would be a strong argument for finding a creeping expropriation or denial of justice. If the *Amparo* decision resolves only the 0% tax rate, but the Claimant cannot satisfy the other requirements of the IEPS law, including Article 4 regarding invoices, there is no possibility of CEMSA's benefiting from that decision with regard to cigarette exports, as the company is still prevented from carrying on its cigarette export business.

121. The problem for the Claimant is that a careful reading of the *Amparo* Supreme Court decision re-

veals no mention of Article 4; the discussion is confined solely to the availability of the 0% tax rate under Article 2 of IEPS law to resellers as well as producers, and to a general assessment of the unconstitutionality of discrimination. For various reasons, Article 4 was not raised by the Claimant and was not discussed by the Supreme Court, even though the issue of the 0% tax rate was specifically raised with regard to both alcoholic beverages and cigarettes.[FN16] There is no indication in the opinion that the Supreme Court intended to abrogate or modify this critical provision of the IEPS law, since it apparently did not even consider the issue, and the Tribunal has no way of guessing what the result would have been had the Article 4 issue been squarely presented to the Supreme Court. In this respect, even the Claimant admits that the court in the *Amparo* case did not review the mechanics of IEPS (reply, para. 43). Rather, as noted above, no Mexican court directly addressed these issues until the Claimant brought the April 1998 and March 1999 challenges.

122. Moreover, the *Amparo* judgment limited to Article 2 (and a parallel *Amparo* decision sought by another company, Lynx) *were* successful in protecting the Claimant's (and Lynx's) rights to export alcoholic beverages, since both the Claimant and Lynx could obtain the necessary invoices from their suppliers due to their ability to purchase alcoholic beverages directly from the Mexican manufacturers and function as eligible taxpayers, and the different IEPS tax structure applicable to alcoholic beverages.[FN17] Thus, the decision had considerable practical benefit for the Claimant at the time even without addressing or resolving the Article 4 question which the Claimant had not raised in the proceeding. In this Tribunal's view, that court decision did not resolve the Claimant's problems with obtaining tax rebates on cigarette exports because the Claimant failed to challenge Article 4 of the IEPS law.

123. The documentation and testimony regarding what transpired subsequently between the Claimant and the Respondent concerning the IEPS requirements is unfortunately ambiguous and often conflicting, making it difficult for this Tribunal to determine exactly what occurred. For example, a letter was provided to the Claimant by SHCP on March 12, 1992, in response to a written request from the Claimant - before the *Amparo* decision but after the 1992 changes in the IEPS law. It is unclear whether the request was treated by SHCP as a formal ruling under Article 34 of the Fiscal Code; SHCP officials subsequently have asserted that the letter was general and did not relate to a specific situation, and thus was not treated as a formal, binding ruling under Article 34. (See witness statement of Jose Riquer, May 17, 2001, para. 7). That letter refers to Article 2 of the IEPS law and Articles 22, 34 and 42 of the Fiscal Code, but does not mention Article 4 of the IEPS law.[FN18] However, this letter may have been issued at a time when the invoices stating the taxes separately were not yet at issue, as the Claimant's statement of facts suggests (see memorial, para. 14-18, discussing the problem in the context of denial of IEPS rebates to resellers).

124. Other than this 1992 letter and an even more ambiguous May 10, 1994, letter confirming the obligation of tobacco and alcoholic beverage *sellers* to show the transfer of the tax amount separately on the invoice, there are no other written communications that could reasonably be treated as formal rulings, and none at all that specifically address the Article 4 requirement. SHCP officials state that they have been unwilling to provide written rulings to the Claimant on the issues raised by the Claimant informally, and that only a written ruling pursuant to Article 34 of the Fiscal Code would be binding. (See testimony of Fernando Heftye Etienne, paras. 8-11.) Officials explain this on the not unreasonable ground that the Claimant did not follow proper administrative procedures under Article 34 of the Fiscal Code in requesting such determinations. Insofar as the Tribunal has been able to determine, at no time before 1998 did the Claimant present the Article 4 issue to a Mexican court, or seek a formal,

binding administrative ruling from SHCP.

125. The Claimant also contends that, in accordance with the Claimant's interpretation of the *Amparo* decision, SHCP effectively concluded an oral agreement with the Claimant to permit the rebates, and then refused to carry out the agreement. Such a failure, if proven, could be evidence of a denial of due process or fair and equitable treatment, and support a conclusion that the IEPS law was intentionally being administered in a manner designed to destroy CEMSA's export operations. There is considerable evidence in the record of some sort of an informal agreement or understanding between the Claimant and SHCP in 1995, based on a number of meetings and correspondence. The Claimant suggests that the agreement was to provide rebates without the invoices, with the understanding that SHCP would then not have to seek the invoices from Carlos Slim/Cigatam as may be required of SHCP by Mexican law (first Feldman Statement, paras. 40-42). Perhaps the best evidence for some sort of understanding is the fact that a high profile taxpayer such as the Claimant was granted the rebates for a sixteen month period in 1996-1997, even though SHCP officials were well aware that it was impossible for the Claimant to obtain invoices with the IEPS tax amounts separately stated. On the other hand, given SHCP's authority to audit rebates after the event, and the fact that it is a large organization with various offices accepting IEPS and other tax rebate applications in significant numbers, it is possible that the Claimant's applications did in fact receive routine treatment/approval.

126. Unfortunately for the Claimant, however, even if there was some sort of oral understanding, there is little persuasive evidence as to its scope, i.e., whether it was limited to assuring the availability of the 0% tax rate as required by the 1993 *Amparo* Supreme Court decision, or whether it also authorized the Claimant to obtain rebates notwithstanding the lack of invoices stating the tax amounts separately, or even authorized the Claimant to obtain rebate amounts in excess of those otherwise permitted. Not only has no written document from SHCP been made available to the Tribunal, but apparently neither the Claimant nor his counsel prepared any contemporaneous memoranda reflecting such an agreement, despite the many meetings with SHCP officials.

127. SHCP flatly denies the existence of an oral agreement (testimony of Fernando Heftye Etienne, para. 3). While SHCP contends it has not violated the *Amparo* decision requiring the 0% tax rate (counter-memorial, paras.112-113), it also takes position that the decision applied only to the 1990 law, not to subsequent versions of the IEPS law, and in any event that the law at all relevant times required the Claimant to possess invoices stating the tax amounts separately, since SHCP had no authority to exempt the Claimant from the requirements of Article 4(III) of the IEPS law (*Id.*, paras. 6, 12). Thus, even if the Claimant has met his burden of proof with regard to the existence of an oral agreement or understanding, he has not met that burden with regard to demonstrating the precise subject matter of such an undertaking. SHCP's inconsistent actions (or inactions) belie any clear understanding between the Claimant and SHCP, beyond compliance with the application of the 0% tax rate to CEMSA's exports.

128. As noted above, a finding of expropriation here depends in significant part on whether under the circumstances the Article 4 invoice requirements are inconsistent with the Claimant's rights under NAFTA Article 1110. On the basis of the evidence presented to the Tribunal, the Tribunal is not persuaded that they are. The Article 4 invoice requirements have been part of the IEPS law at least since 1987, that is, for at least three years *before* CEMSA was first registered as an export company in 1991. Since the operation of its export business depended substantially on the terms of the IEPS law, the Claimant was or should have been aware at all relevant times that the separate invoice requirement existed, as there has been no *de jure* change in it at any time relevant to this dispute.

Equally important, the Tribunal is reluctant to find an expropriation based largely on the failure of Mexican government officials to comply with an agreement in which those officials allegedly waived an explicit requirement of a tax law, even though there is some evidence, albeit contested by the Respondent, that the requirement was *de facto* ignored at some times both for the Claimant and for other cigarette resellers, including but not limited to members of the [so-called] Poblano group.[FN19] This, however, is not in the view of the Tribunal evidence of expropriatory action and will be dealt with below in the section on national treatment.

129. If the IEPS law, Article 4, obligation to possess invoices stating the tax amounts separately was simply a technical requirement of the IEPS law, the result here might be considered formalistic and unreasonable. As noted earlier (para. 114, note 11), it is under challenge as unconstitutional discrimination between taxpayers in Mexico, according to the still pending 1999 Fiscal Court proceedings. However, the Tribunal does not consider the invoicing requirements to be a mere formality or patently unreasonable, to be waived easily by officials based on their discretion. The obvious and legitimate purpose of the requirement that the IEPS tax amounts be stated separately on invoices to be submitted to SHCP authorities on demand as the basis of a tax rebate is to make it possible for the tax authorities to determine in a straightforward manner whether the tax amounts on exported products for which a rebate is sought are accurate and not overstated. This is clearly a rational tax policy and a reasonable legal requirement.

130. The Claimant himself is an excellent example of why this requirement is necessary to protect the revenue. Without invoices, it was of course impossible for the Claimant to know the precise amount of the IEPS taxes included in the selling price of the cigarettes he purchased from Walmart or Sam's Club, for his exports in 1996 and 1997. However, a very close approximation of the IEPS tax amounts could have been made by the Claimant for these years, just as it was in 1992 (see Zaga-Hadid affidavit, annex A) based on the IEPS tax rate for cigarettes applicable in 1996 and 1997 (85%), by dividing the selling price (inclusive of tax) by 1.85 to determine the price net of taxes, and then subtracting that amount from the selling price to determine the tax amounts. For example, if as the Claimant alleges, he paid US$7.40 per carton for cigarettes, and the tax rate specified in the IEPS law was 85%, the tax included in the US$7.40 price was approximately US$3.40.[FN20]

131. The Claimant apparently used this formula in 1992, and received the rebates. He used a somewhat different formula in 1996, which over-stated the rebate amounts.[FN21] Then, in 1997, he used a completely different formula, which had the effect of grossly overstating the tax amounts, US$6.55 instead of US$3.40 per carton, an overstatement of 93%.[FN22] The Claimant asserts that this methodology was explicitly approved by Director of Major Taxpayers Jose Riquer Ramos (Feldman affidavit, Mar. 28, 2001, para. 70). Mr. Riquer has denied this (Riquer statement, May 17, 2001, paras. 19-25). In the final analysis, the Tribunal does not find the Claimant's testimony on this issue to be credible. It is inconceivable to the Tribunal that even if SHCP officials were prepared to forego the invoice requirement informally during some periods, as appears to be the case, they would have given the Claimant or any other taxpayer carte blanche to over-estimate the amount of the rebates, in flagrant violation of the IEPS law.[FN23]

132. The Claimant also argues that notwithstanding the Respondent's (and this Tribunal's) interpretation of the scope of the 1993 *Amparo* decision, SHCP's actions between 1993 and 1997, particularly certain oral and written communications, were so arbitrary as to constitute expropriatory action. The Tribunal, as noted earlier (para. 125), has some sympathy with the Claimant's position here. The various written and oral communications from SHCP to the Claimant are at best ambiguous and misleading, perhaps intentionally so in some instances, as were

SHCP's actions in permitting rebates during some periods and denying them in others. However, a reasonable person, given the complex and exacting nature of tax laws and regulations, and the ambiguity of statements by and correspondence with SHCP officials, should have sought expert tax counsel if it was not already available to him. Had this occurred, the Tribunal doubts than any competent tax attorney would have confirmed the Claimant's right to rebates in the absence of proper invoices showing the tax amounts separately, given the text of Article 4 of the IEPS law and the lack of apparent legal authority on part of SHCP officials to waive this requirement.

133. While the transparency in some of the actions of SHCP may be questioned, it is doubtful that lack of transparency alone rises to the level of violation of NAFTA and international law, particularly given the complexities not only of Mexican but most other tax laws. The British Columbia Supreme Court held in its review of the *Metalclad* decision that Section A of Chapter 11, which establishes the obligations of host governments to foreign investors, nowhere mentions an obligation of transparency to such investors, and that a denial of transparency alone thus does not constitute a violation of Chapter 11 (*United Mexican States v. Metalclad,* Supreme Court of British Columbia, Reasons for Judgment of the Honorable Mr. Justice Tysoe, May 2, 2001, paras. 70-74, http://www.naftalaw.org.; transparency is a general NAFTA obligation of the NAFTA Parties under Chapter 18). While this Tribunal is not required to reach the same result as the British Columbia Supreme Court, it finds this aspect of their decision instructive.

134. Under the circumstances, therefore, the Claimant would have been wise to seek a formal administrative ruling on the applicability of Article 4 of the IEPS, and court review if the ruling were adverse, far before he was forced to do so in 1998, but for whatever reason he chose not to do so. Formal administrative procedures and the courts, according to the record, were at all times available to him, and have not been challenged here as being inconsistent with Mexico's international law obligations. Moreover, in Mexico, as in the United States and most other countries, oral or informal opinions are not binding on the tax authorities (see Article 34 of Fiscal Code, counter-memorial, paras. 18-20). Regardless of the results of the ruling process the Claimant would have been better off. If he had received a favorable ruling on Article 4, it would have been much easier for him to defend his rights under Mexican law and before this Tribunal. If he had lost, he could have at least avoided the uncertainties of his alleged right to rebates during much of the 1992-1997 period, and could have brought a NAFTA claim under Chapter 11 much earlier.

H.3.4 Public Purpose

135. As noted earlier, in the absence of a finding of expropriation and in view of the Restatement comments the Tribunal is reluctant to give excessive weight to the public purpose, non-discrimination and due process criteria in Article 1110(1). However, in this instance even if they are considered significant the Tribunal believes that they do not contradict an otherwise negative finding. The Claimant suggests, accurately in the view of this Tribunal, that Mexican government policy is designed to prevent cigarette resellers including CEMSA from exporting cigarettes from Mexico to other countries. He attributes this to political pressures from Carlos Slim, a major owner of Mexico's largest cigarette producer, Cigatam. He alleges that this policy is in conflict with normal Mexican policies that promote exports, and cites such policies as evidence that the restrictions do not have a valid public purpose (see memorial, paras. 31, 188, 189).

136. However, the Tribunal has already indicated its view that there are rational public purposes for this policy. These include, *inter alia,* discouraging »grey« market exports and seeking to control illegal re-exportation of Mexican cigarettes into Mexico. There is ample evidence on the record to suggest that cigarette smuggling is a significant problem for

Mexico, even if that evidence does not effectively link the Claimant with the illegal imports.[FN24] It may be that Mexican authorities feel they have greater control over cigarette producers who export (or that such producers are constrained by licensing agreements, such as the one that presumably exists between Philip Morris of the United States and Cigatam, the Marlboro producer, in Mexico), than they do over independent resellers. Also, as noted above, there are valid public policy reasons for requiring invoices that separately state the IEPS tax amounts as a condition of receiving the refunds, i.e., to prevent inaccurate or excessive claims for rebates.[FN25]

H.3.5 Non-Discrimination

137. The Chapter 11 scheme establishes a right to national treatment for investors (and damages for breach thereof) that is distinct from the right to damages from acts of expropriation.[FN26] In this respect, the Tribunal notes that the *S.D. Myers* tribunal, having weighed the allegations of expropriation and finding no violation of Article 1110, nevertheless found Canada in violation of its obligations under Article 1102 and Article 1105 (*S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 256, 268, http://www.state.gov/documents/organization/3992.pdf), violations that also constituted discrimination under Article 1110(1)(b) and denial of fair and equitable treatment under Article 1110(1)(c). This issue is examined below: see the section I on Article 1102.

H.3.6 Due Process/Fair and Equitable Treatment/ Denial of Justice

138. Regarding the possible claim of a denial of due process or a denial of justice, the Tribunal notes that the Claimant actually alleges a denial of justice primarily with regard to SHCP's failure - the failure of the Executive Branch - to implement the 1993 *Amparo* decision (memorial, p. 8). The Claimant only suggests in passing that the nullification decision of the circuit court may rely on a provision of the 1998 IEPS law to deny rebates that the Claimant sought for 1997 (reply, p. 16). In April 1998, the Claimant was effectively forced to seek »injunctive, declaratory or other extraordinary relief« before the Mexican Fiscal Court, as permitted under Article 1121. In that first case, CEMSA sought a declaratory judgment confirming CEMSA's right to receive tax rebates. This was necessary because of a determination of the tax authorities that CEMSA was not entitled to the rebates for exports made in October-November 1997, since CEMSA could not present invoices that complied with the Article 4 requirement that the IEPS tax amounts be stated separately, and was not a taxpayer entitled to claim IEPS rebates under Article 11 (the latter applied only to the situation under the amended IEPS law effective January 1, 1998). In that action the Mexican courts ultimately decided, *inter alia*, that CEMSA was subject to the invoice requirements of Article 4 (proceeding related to the negative response to a request presented to the tax authority referred above in paragraph 84). The Tribunal notes that this decision is in obvious conflict with the Claimant's interpretation of the 1993 *Amparo* decision as guaranteeing the Claimant's right to obtain IEPS rebates notwithstanding the Article 4 invoice requirement. In a separate action challenging SHCP's decision to audit CEMSA and ultimately to demand return of the rebate amounts paid to CEMSA between April 1996 and September 1997, discussed *supra* at paras. 82-83, the issue of whether the invoice requirements under Article 4 of the IEPS law are legal under Mexican law and the Mexican constitution remains pending.

139. Assuming that Article 1110 must be interpreted in accordance with international law, as Article 1131(1) states, not just any denial of due process or of fair and equitable treatment (the latter through the cross-reference in Article 1110(1)(c) to Article 1105) constitutes a violation of international law. In this instance, the allegations of denial of due process or denial of justice are weakened by several factors. Here, as in *Azinian*, the Claimant does not effectively contend that there was a denial of justice by Mexican courts, either with regard to

the Supreme Court's *Amparo* decision or the various lower courts' subsequent determinations in the nullification and assessment cases. Rather, in the instant case the Claimant's assertions of denial of justice relate to actions of SHCP rather than the courts. (See Claimant's May 8, 2002 submission, para. 9, stating that »the Claimant maintains that Respondent's insistence on such discrimination [between producers and exporters] in disregard of both the Supreme Court decision and the agreement Mexican officials made with the Claimant in 1995-96 constitutes discrimination and denial of justice under international law.«) *Azinian* states that »A governmental authority surely cannot be faulted for acting in a manner validated by its own courts *unless the courts themselves are disavowed at the international level.*« *Azinian* further suggests that there must be a showing that the court decision itself is a violation of NAFTA, or that the relevant courts have not accepted the suit, or there is »a clear and malicious misapplication of the law« (*Robert Azinian and Others v. The United Mexican States*, Award, November 1, 1999, paras. 97, 102, 103, 14 ICSID Review. FILJ 2, 1999.).

140. This is a standard that the nullity and assessment decisions almost certainly do not meet.[FN27] Given as noted earlier that Mexican courts and administrative procedures at all relevant times have been open to the Claimant, the Claimant's victory in the 1993 *Amparo* decision, and the availability of court review in the nullity and assessment decisions filed by the Claimant in 1998, there appears to have been no denial of due process or denial of justice there as would rise to the level of a violation of international law. As the Respondent concedes, this Tribunal could find a NAFTA violation even if Mexican courts uphold Mexican law (counter-memorial, para. 364); this Tribunal is not bound by a decision of a local court if that decision violates international law. Also, as discussed in Section G2, NAFTA does not require a claimant to exhaust local court remedies before submitting a claim to arbitration. The Claimant is limited only by the requirements of Article 1121(2)(b).

141. While there may be an argument for a violation of Article 1105 under the facts of this case (a denial of fair and equitable treatment), this Tribunal has no jurisdiction to decide that issue directly. As noted earlier, Article 1105 is not available in tax cases, but may be relevant in the cross-reference of Article 1110(1)(c). The Tribunal does not need to decide whether this cross-reference makes a full Article 1105 consideration appropriate in a tax matter. Even assuming, *arguendo*, that the Respondents' actions in the aggregate do constitute a denial of fair and equitable treatment that reaches the relatively egregious level of a violation of international law, this alone does not establish the existence of an illegal expropriation under Article 1110. As *S.D. Myers* indicates, it may be appropriate for a NAFTA tribunal to find a violation of Article 1105 and at the same time decline to find a violation of Article 1110(1)(c).

H.3.7 The Claimant in Control of CEMSA

142. Although the Tribunal does not consider this a controlling argument, the regulatory action has not deprived the Claimant of control of his company, CEMSA, interfered directly in the internal operations of CEMSA or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity, such as exporting alcoholic beverages or photographic supplies, as in the past, or other products for which he can obtain from Mexico the invoices required under Article 4. Of course, he was effectively precluded from exporting cigarettes, certainly by the IEPS law amendments, that went into force in 1998 making the IEPS rebates available only to producers, and in the Tribunal's view by the invoice requirements of Article 4(III), which were stated requirements of Mexican law at least since 1987, and did not change at any relevant time subsequently. However, this does not amount to Claimant's deprivation of control of his company.

H.3.8 Other NAFTA Decisions

143. The Tribunal's conclusion that the actions by the Mexican government against the Claimant -

even though in some instances inconsistent, and arbitrary - should not be treated as expropriatory, is in the Tribunal's view consistent with earlier NAFTA Chapter 11 decisions that have sought to interpret Article 1110, including not only *Metalclad*, *Azinian* and *S.D. Myers*, discussed above, but also *Pope & Talbot.*

144. *Metalclad v. United Mexican States* is the only NAFTA decision to date in which a violation of Article 1110 has been found. Metalclad was granted a federal government permit for a hazardous waste disposal facility in January 1993, and began construction shortly thereafter. However, despite early support, opposition arose from the state and municipal governments, apparently because of the usual »NIMBY« (not in my back yard) concerns. Work on the new facility, which included a clean up of the residues left by the previous operators, was completed in March 1995, but opposition from local interests intensified, despite efforts of Metalclad and the federal government to satisfy them.[FN28]

145. Ultimately, the municipality denied Metalclad's construction permit, in a process which was closed to Metalclad, and the governor of San Luis Potosi issued an »Ecological Decree« declaring the area of the landfill to be a »Natural Area for the protection of rare cactus« (see Metalclad Corporation v. United Mexican States, Award, August 30, 2000, paras. 50, 54, 57, 59-60, 16 ICSID Review. FILJ 1, 2001). Based on these actions, the *Metalclad* Tribunal opined that Article 1110,

includes not only open, deliberate and acknowledged takings of property... but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of the property even if not necessarily to the obvious benefit of the host state. (*Id*, para. 103.)

146. The tribunal, in reaching its finding of indirect expropriation, not only cited »reasonably-to-be-expected economic benefit,« but found it important that Metalclad had relied on the representations of the Mexican federal government of its exclusive authority to issue permits for hazardous waste disposal facilities. It also faulted the lack of transparency in the Mexican legal system for siting of hazardous waste facilities. Separately, without much discussion, the Tribunal found that the state government's decree fixing Metalclad's site as an »ecological preserve« effectively barring the landfill operation permanently, was a »further ground for a finding of expropriation.«[FN29]

147. The *Metalclad* Tribunal's finding of an expropriation based on transparency and, implicitly, on reliance by the Claimant, was effectively vacated by the British Columbia Supreme Court (British Columbia was the »seat« of the arbitration), responding to a challenge by the Government of Mexico. However, the tribunal's determination that the Mexican state's decision to make Metalclad's site into an ecological preserve was expropriatory was confirmed by the British Columbia Court. (*United Mexican States v. Metalclad*, Supreme Court of British Columbia, Reasons for Judgment of the Honorable Mr. Justice Tysoe, May 2, 2001, para. 84, http://www.naftalaw.org.)

148. The facts, and the reasonableness of the Claimant's reliance in *Metalclad*, are thus quite different from the instant case. The assurances received by the investor from the Mexican government in *Metalclad* were definitive, unambiguous and repeated, in stating that the federal government had the authority to authorize construction and operation of hazardous waste landfills, and that Metalclad had obtained all necessary federal and other permits for the facility. (See *ibid.*, paras. 28-41.) Nor is there any indication that the assurances received by Metalclad, despite some ambiguities, were inconsistent with Mexican law on its face. Finally, Metalclad was deprived of all beneficial use of its property, which was incorporated into an »ecological preserve.«

149. In contrast, in the present case, the Mexican government essentially opposed the Claimant's

business activities at every step of the way, notwithstanding a few periods when the rebates were granted. Also, in the present case the assurances allegedly relied on by the Claimant (which assurances are disputed by Mexico) were at best ambiguous and largely informal (since the Claimant never sought a formal written tax ruling on the Article 4 issue, or litigated the issue until 1998). They were also in direct conflict with Article 4(III) of Mexico's IEPS law requiring the possession of invoices stating the taxes separately as a condition of receiving tax rebates.[FN30]

150. *S.D. Myers v. Canada* involved a government action barring exports (hazardous waste). There, the tribunal noted that expropriation normally constitutes a taking of »property« with a view toward transfer of ownership,[FN31] a situation that did not occur in that case or in this one. No expropriation was found in *S.D. Myers*, although the Tribunal did find violations of Articles 1102, 1105 and 1106 (see paras. 123, 256, 280, 284).

151. Somewhat different issues arise in comparison with *Pope & Talbot* which again focused on the alleged denial of a right to export, in this instance, softwood lumber.[FN32] The *Pope & Talbot* Tribunal had opined (in what would be considered *dicta* in the US legal system) that regulatory measures could constitute expropriation under Article 1110, and found that the lumber export control regime came within Article 1110. However, it also noted that the investor was able to continue to export and to earn profit on those exports, and declined to find a violation of Article 1110, based on this consideration and on the ground that the investor »remains in control of the Investment, it directs the day-to-day operations of the Investment, and no officers or employees of the Investment have been detained.... Canada does not...take any other actions outing the Investor from full ownership and control of his investment.« The Tribunal suggested further that in determining »whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from its owner.« (*ibid.*, paras. 100, 102.)

152. Given that the Claimant here has lost the effective ability to export cigarettes, and any profits derived therefrom[FN33], application of the *Pope & Talbot* standard might suggest the possibility of an expropriation. However, as with *S.D. Myers*, it may be questioned as to whether the Claimant ever possessed a »right« to export that has been »taken« by the Mexican government. Also, here, as in *Pope & Talbot*, the regulatory action (enforcement of longstanding provisions of Mexican law) has not deprived the Claimant of control of the investment, CEMSA, interfered directly in the internal operations of CEMSA or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of export trading, such as exporting alcoholic beverages, photographic supplies, or other products for which he can obtain from Mexico the invoices required under Article 4, although he is effectively precluded from exporting cigarettes. Thus, this Tribunal believes there has been no »taking« under this standard articulated in *Pope & Talbot*, in the present case.

153. On the factual basis set out in the record, and this analysis, the Tribunal holds that the actions of Mexico with regard to the Claimant's investment do not constitute an expropriation under Article 1110 of NAFTA.

I NATIONAL TREATMENT (NAFTA ARTICLE 1102)

154. In the present case, there are only a handful of relevant investors, one foreign (the Claimant) and one domestic (the Poblano-Guemes Group), each engaged in the business of purchasing Mexican cigarettes and marketing those cigarettes abroad. These investors cannot purchase the cigarettes from Mexican cigarette producers because the producers (and their wholly owned distributors) refuse to sell to them. Therefore, the Claimant or the Poblano Group firms must purchase their cigarettes from volume retailers, Walmart and Sam's Club. Since

Walmart and Sam's Club are retailers and not IEPS taxpayers, they do not have available to them the precise amounts of the IEPS taxes included in the price paid first by the retailers in the transaction with the producers or distributors, and then by the Claimant and other reseller/exporters. Accordingly, neither the Claimant nor the Poblano Group companies can comply with the requirement of the IEPS law, Article 4(III), which makes it a condition of obtaining tax rebates upon export that the applicant be a taxpayer who possesses invoices showing the tax amount stated separately.

I.1 Views of the Disputing Parties

155. The essence of the Claimant's denial of national treatment argument is that Mexico discriminated against CEMSA in the 1998-2000 period. During that period, SHCP permitted at least three resellers of cigarettes (Mercados Regionales and Mercados Extranjeros - respectively Mercados I and Mercados II: the Poblano Group, and MEXCOBASA, ownership unknown) and possibly some others, to export cigarettes and to receive rebates, notwithstanding the fact that like the Claimant, they purchased their goods from retailers, are not formally taxpayers and thus could not have invoices stating the IEPS tax amounts separately (memorial, paras. 128-135, 225). The Claimant also objects to similar discriminatory treatment in the 1996 - 1997 period. The Claimant reports that the Respondent admits paying NP$ 91,000,000 to three cigarette exporter/trading companies after September 1996, a period when the Claimant was either denied rebates or an effort was made by SHCP to recoup rebate amounts originally granted (memorial, para. 134).

156. In addition, the Claimant's firm, CEMSA, was denied registration as an export trading company, while no similar denial occurred with regard to the members of the Poblano Group. There is no persuasive evidence that SHCP has made any parallel effort to recoup the rebates paid to the members of the Poblano Group during the relevant periods. Thus, according to the Claimant, CEMSA and the members of the Poblano group have been treated differently, and »there is a NAFTA violation under the ordinary meaning of the words used in Article 1102« (reply, para. 12).

157. The Claimant also argues that discrimination under Article 1102 is actionable whether it is *de jure* or *de facto.*In this case, even though the IEPS law is non-discriminatory on its face, it has been applied in a discriminatory manner. Nor is there any need to demonstrate that the reason for the discrimination is a result of the Claimant's nationality, if in fact the Claimant is being treated less favorably than a domestic investor in like circumstances (memorial, paras. 224-226).

158. The Respondent counters that the known domestic investors in the business of reselling/exporting cigarettes, the »Poblano-Gamez-Guemes network companies« were in fact related to CEMSA rather than competitors (counter-memorial, paras. 487-500). The Respondent asserts that the evidence shows that there were not really distinct entities, CEMSA and the Poblano Group. Rather, CEMSA and the Poblano Group companies were effectively part of the same corporate group, even if there was no common ownership of shares. They sold goods to each other; Poblano group members loaned money under favorable terms to CEMSA; and they engaged in a range of financial and business dealings which were not arms-length in nature. As a legal matter there cannot be discrimination under Article 1102 unless there exists a foreign investor and an unrelated domestic investor who are treated differently. If the foreign investor and the domestic firms in like circumstances are really one and the same, there can be no discrimination as between Mexican and foreign investors.

159. The Respondent also argues that there is no *de jure* discrimination in the IEPS law, in the sense that the law by its terms treats all re-sellers in the same manner. Also, because of the manner in which the law operates Mexican authorities do not know until after the fact who is seeking rebates on cigarettes and therefore, there can be no *de facto* dis-

crimination (counter-memorial, paras. 501-504). It was SHCP's policy to deny IEPS rebates to all cigarette reseller/exporters who lacked the requisite invoices, regardless of nationality (counter-memorial, para. 505). The Respondent has demonstrated that all resellers are being audited and will be assessed if there is evidence that they did not have the proper invoices (Díaz Guzman first and second statements, rejoinder, para. 184).

160. According to the Respondent, notwithstanding the fact that CEMSA is arguing *de facto* discrimination, because CEMSA cannot show *de jure* discrimination, it would be highly inappropriate for the Tribunal to find a violation of national treatment based on the failure of SHCP to provide a benefit which they had no authority under Mexican law to provide. Under Article 4(III) of the IEPS law, SHCP has no authority to provide IEPS rebates to persons claiming such rebates unless those claimants have invoices showing the tax amounts stated separately. Thus, a SHCP official would be acting *ultra vires* if he agreed that CEMSA could apply for and receive IEPS rebates without regard to the amounts or whether the correct formula for calculating the rebates was used by CEMSA. Moreover, the fact that the overstatement of the rebate amounts by CEMSA was discovered only after an audit reinforces the reasonableness of Mexican legislation (Article 4 of the IEPS law) which requires a taxpayer to have invoices with the correct tax amounts stated therein as a condition of receiving the rebates.

161. Thus, according to the Respondent, there is simply no indication of discrimination between foreign investors and domestic investors in this instance. Evidence on the record indicates that the Poblano group, like CEMSA, even if unrelated, is also being audited with regard to irregularities in tax payments. SHCP conducts hundreds or thousands of audits each year and the fact that it audits one company (which happens to be foreign) sooner than it audits a company in like circumstances (which happens to be domestic) is not in itself evidence of discrimination. Administrative agencies must receive some latitude in carrying out their duties, as the tribunals in *Pope & Talbot v. Canada* and *S.D. Myers v. Canada* have stated.

162. According to Mexico, denial of CEMSA's registration as an export trading company - a separate but related issue - was not a denial of national treatment, because in this instance CEMSA and the Poblano Group were not in like circumstances. CEMSA was at the time under audit and SHCP had discovered discrepancies in the amounts of the IEPS rebates sought for 1996 and 1997. The Poblano Group was not at that time under audit. Thus, it was reasonable for SHCP to deny export registration to CEMSA until the irregularities discovered in the audit had been resolved.

163. Assuming, *arguendo*, that there is different treatment, Mexico argues that it is not sufficient under Article 1102 just to show different treatment for there to be a violation of Article 1102. Rather, any discrimination shown between the Claimant and domestically owned cigarette seller/exporters must be shown to be a result of the fact that the Claimant is a foreign national. (rejoinder, para. 174; see transcript, July 10, 2002, pp. 107-109.)

164. Neither Canada nor the United States has exercised its right under Article 1128 to express views on the proper interpretation of Article 1102 in its Article 1128 submission, and the Tribunal for that reason is left to consider only the views of the Claimant and Mexico. [FN34]

I.2 Analysis by the Tribunal

165. The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11. [FN35] The concept is not new with NAFTA. Analogous language in Article III of the GATT has applied as between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods. Article 1602 of the United States - Canada Free Trade Agreement, with regard to investment, applied between those two NAFTA Parties from 1989-1993. NAFTA's Article 1102(2)

provides that

»Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.«

(Article 1102(1) is the same except that it refers to »investors« rather than to »investments of investors;« under Article 1102(3), the obligation applies to state/provincial governments as well, but this is not relevant here.)

166. Despite its deceptively simple language, the interpretative hurdles for Article 1102 are several. They include (a) which domestic investors, if any, are in »like circumstances« with the foreign investor; (b) whether there has been discrimination against foreign investors, either *de jure* or *de facto*; (c) the extent to which differential treatment must be demonstrated to be *a result of* the foreign investor's nationality; and (d) whether a foreign investor must receive the most favorable treatment given to *any* domestic investor or to just some of them.[FN36]

167. Analysis of these issues in the present case is complicated by the fact that only a limited amount of relevant factual information has been presented to the Tribunal, particularly with regard to the various domestic companies which may be in the business of reselling and exporting cigarettes from Mexico, and the treatment by SHCP of those resellers other than the Claimant. Neither party suggests that there are any foreign owned reseller/exporters other than the Claimant. One of the Respondent's witnesses indicated under questioning that there might be 5-10 or more other firms registered in Mexico for exporting cigarettes. There is agreement between the parties that there is at least one Mexican owned reseller/exporter, the so-called »Poblano Group,« consisting of Mercados Regionales and Mercados Extranjeros (»Mercados I« and »Mercados II«) and possibly other entities. A third company, MEXCOBASA, was mentioned by the Claimant but the ownership is not indicated in the record (first Feldman statement, para. 94). A Mexican official, Enrique Díaz Guzman, has confirmed that at least three trading companies (i.e., not producers) received IEPS rebates for cigarette exports at various times between September 1996 and May 2000, in the total amount of approximately NP$ 91,000,000 (first Diaz Guzman statement, App. 0506, 0515). Many of those rebates were authorized and paid after January 1, 1998, when amendments to the IEPS law effectively made the 0% tax rate and IEPS rebates on cigarette exports legally unavailable to *anyone* other than producers (by limiting the payment of the tax rebates to the first sale) (1998 IEPS law, Article 11).

168. There is disagreement as to how these trading companies (presumably the Poblano Group companies) were treated in comparison to the Claimant, that is, whether the Poblano Group was provided IEPS tax rebates denied during some periods to the Claimant, notwithstanding the same lack of invoices stating the tax amounts separately, as required by Article 4 and, after January 1, 1998, notwithstanding the bar to rebates except on the first sale. There is also a lack of detailed information as to whether SHCP has made effective efforts to recoup the rebates provided to the Poblano Group for the 1996-1997 period, as it has with respect to the Claimant, or for IEPS payments made in 1998 to 2000. On the grounds that there is an ongoing audit of Caesar Poblano, the principal owner of the Poblano Group companies, SHCP has declined to provide any detailed information on the treatment of the Poblano Group and how that treatment compares to treatment by SHCP of the Claimant. One of SHCP's witnesses, Mr. Diaz Guzman, did, however, state that only one of the three trading companies he identified was in the process of audit (as of March 2001), so presumably there are two others which have not been audited, despite being in like circumstances with the Claimant.

169. Also, given that this is a case of likely *de facto* discrimination, it does not matter for purposes of Article 1102 whether in fact Mexican law authorizes SHCP to provide IEPS rebates to persons who are not formally IEPS taxpayers and do not have invoices setting out the tax amounts separately, as has been required by the IEPS law consistently since at least 1987 and perhaps earlier. The question, rather, is whether rebates have *in fact* been provided for domestically owned cigarette exporters while denied to a foreign re-seller, CEMSA. Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors. Thus, if the IEPS Article 4 invoice requirement is ignored or waived for domestic cigarette reseller/exporters, but not for foreign owned cigarette reseller/exporters, that *de facto* difference in treatment is sufficient to establish a denial of national treatment under Article 1102.

I.2.1 In Like Circumstances

170. In the investment context, the concept of discrimination has been defined to imply *unreasonable* distinctions between foreign and domestic investors in like circumstances (Restatement, Sec. 712, Comment f). As discussed in the Article 1110 section (*supra*, paras. 115, 129), there are at least some rational bases for treating producers and re-sellers differently, *e.g.*, better control over tax revenues, discourage smuggling, protect intellectual property rights, and prohibit gray market sales, even if some of these may be anti-competitive.[FN37] Thus, as discussed in the expropriation section, the Tribunal does not believe that such producer - reseller discrimination is a violation of international law.

171. In this instance, the disputing parties agree that CEMSA is in »like circumstances« with Mexican owned resellers of cigarettes for export, including the two members of the Poblano Group, Mercados Regionales and Mercados Extranjeros (see memorial, para. 222; counter-memorial, para. 486), although Mexico of course denies that there has been any discrimination largely on the ground that CEMSA and the Poblano Group are effectively the same entity. In the Tribunal's view, the »universe« of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes. Other Mexican firms that may also export cigarettes, such as Mexican cigarette producers, are not in like circumstances. While the Claimant's *Amparo* decision held discrimination between producers and resellers of alcohol and tobacco products (at least as to the availability of the 0% tax rate for exported goods) to be unconstitutional, such discrimination is effectively reinstated by the 1998 IEPS law that limits IEPS tax rebates to the first sale, excluding any subsequent purchaser/exporter from the benefit, and has effectively been upheld in the other litigation brought by the Claimant in 1998, also discussed earlier. The Tribunal also notes that Article 1102 says nothing regarding discrimination among different classes of a Party's own investors.

172. Accordingly, the Tribunal holds that the companies which are in like circumstances, domestic and foreign, are the trading companies, those in the business of purchasing Mexican cigarettes for export, which for purposes of this case are CEMSA and the corporate members of the Poblano Group.

I.2.2 Existence of Discrimination

173. The limited facts made available to the Tribunal demonstrate on balance to a majority of the Tribunal that CEMSA has been treated in a less favorable manner than domestically owned reseller/exporters of cigarettes, a *de facto* discrimination by SHCP, which is inconsistent with Mexico's obligations under Article 1102. The only confirmed cigarette exporters on the limited record before the tribunal are CEMSA, owned by U.S. citizen Marvin Roy Feldman Karpa, and the Mexican corporate members of the Poblano Group, Mercados I and Mercados II. According to the available evidence, CEMSA was denied the rebates for October-November 1997 and subsequently; SHCP also demanded that CEMSA repay rebate amounts initially allowed from June 1996 through September 1997.

Thus, CEMSA was denied IEPS rebates during periods when members of the Poblano Group were receiving them (see *supra* para. 167, memorial, p. 3 *).*

174. Even if Mexico is auditing Mr. Poblano, the process was begun long after the audit of CEMSA, and according to the files provided to the Tribunal concerning this audit, there is no documentation that the audit continued after approximately March 2000, or that it even involved IEPS rebates (transcript, July 11, 2001, p. 2). CEMSA's rebates (before and after audits) have already been denied, and several years later no such action has been taken with regard to the Poblano Group. Arguably, the fact that CEMSA has been audited well before any other domestic reseller/exporters is in itself evidence of discrimination, even if SHCP is legally authorized to audit all taxpayers. If Mexican authorities are auditing or intend to audit other taxpayers who are in like circumstances with CEMSA, the Government of Mexico, as the only party with access to such information, has not been particularly forthcoming in presenting the necessary evidence. The two files presented to the Tribunal during the hearing (designated nos. 328 and 333) are incomplete, indicating no final or even continuing audit action (transcript, July 11, 2001, p. 2). The only clear knowledge that Mr. Poblano is subject to some sort of audit was supplied by the Claimant (first Feldman affidavit, para. 92), and counsel for the Claimant asserts that the evidence in the record demonstrates only that Mr. Poblano is subject to a personal audit for 1997 (transcript, July 13, 2001, p. 155). The Mexican Government has declined to provide any specific information as to the number of other possible taxpayers in like circumstances (resellers). The government's witness, Mr. Obregon-Castellanos, admitted that there were more than five, and likely more than ten firms registered as cigarette exporters (transcript, July 9, 2001, p.141), but was evasive with regard to tobacco exporter numbers even though he testified confidently and explicitly that there were 400 registered exporters of alcoholic beverages (transcript, July 11, 2001, p. 10).

175. The evidence also shows that CEMSA was denied registration as an export trading company, apparently in part because this action was filed, and in part as a result of the ongoing audit of the rebates for exports during 1996 and 1997, even though, as Mr. Diaz Guzman indicated, three other cigarette export trading companies had been granted registration. An unsigned memorandum which reasonably could have been generated only in SHCP indicates that registration was being denied on the basis of the audit of the Claimant's rebate payments. There is no evidence that any domestic reseller/exporter has been denied export privileges in this manner. Moreover, there appears to have been differential treatment between CEMSA and Mr. Poblano with regard to registration issues as well. According to the Claimant's witness, Mr. Carvajal, taxpayer CEMSA filed its application for export registration status on June 30, 1998; information was still being requested in writing seven months later. For taxpayer Mr. Poblano, information was requested by SHCP orally within 14 days of the date of Poblano's application, and any questions were apparently resolved (transcript, July 11, 2001, p. 3).

176. The extent of the evidence of discrimination on the record is admittedly limited. There are only a few documents in the record bearing directly on the existence of differing treatment, particularly the statement of Mr. Diaz Guzman, the »mystery« memorandum from SHCP's files, and the tax registration statement for Mercados Regionales, owned by the Poblano Group. One member of this Tribunal believes that this evidence on the record is insufficient to prove discrimination (see dissent). The majority's view is based first on the conclusion that the burden of proof was shifted from the Claimant to the Respondent, with the Respondent then failing to meet its new burden, and on an assessment of the record as a whole. But it is also based on a very simple two-pronged conclusion, as neither point was ever effectively challenged by the Respondent:

a. No cigarette reseller-exporter (the Claimant, Poblano Group member or otherwise) could legally have qualified for the IEPS rebates, since none under the facts established in this case would have been able to obtain the necessary invoices stating the tax amounts separately.

b. The Claimant was denied the rebates at a time when at least three other companies in like circumstances, i.e. resellers and exporters (see *supra* para. 171) apparently including at least two members of the Poblano Group, were granted them.

177. On the question of burden of proof, the majority finds the following statement of the international law standard helpful, as stated by the Appellate Body of the WTO:

... various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence. *If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.*(Emphasis supplied.)[FN38]

Here, the Claimant in our view has established a presumption and a *prima facie* case that the Claimant has been treated in a different and less favorable manner than several Mexican owned cigarette resellers, and the Respondent has failed to introduce any credible evidence into the record to rebut that presumption.

178. In weighing the evidence, including the record of the five day hearing, the majority is also affected by the Respondent's approach to the issue of discrimination. If the Respondent had had available to it evidence showing that the Poblano Group companies had not been treated in a more favorable fashion than CEMSA with regard to receiving IEPS rebates, it has never been explained why it was not introduced. Instead, the Respondent spent a substantial amount of its time during the hearing and in its memorials seeking (unsuccessfully in the Tribunal's view) to demonstrate that CEMSA and the Poblano Group were related companies (as there could be no discrimination, presumably within a single company group)[FN39]. Yet, if the Poblano Group firms had not received the rebates, that evidence of relationship would have been totally irrelevant. Why would any rational party have taken this approach at the hearing and in the briefs if it had information in its possession that would have shown that the Mexican owned cigarette exporters were being treated in the same manner as the Claimant, that is, denied IEPS rebates for cigarette exports where proper invoices were not available? Thus, it is entirely reasonable for the majority of this Tribunal to make an inference based on the Respondent's failure to present evidence on the discrimination issue. It is also notable that despite the lengthy presentation of evidence by the Respondent seeking (unsuccessfully in the Tribunal's view) to link the Claimant with an alleged smuggling operation *operated by or on behalf of Mr. Poblano*, export registration was nevertheless granted for Mr. Poblano's companies. This occurred at approximately the same time as registration was being denied for CEMSA, apparently because of the pending CEMSA audit. Again, the differing treatment of CEMSA and the Poblano Group is obvious.

179. There is also evidence in the record to suggest that Lynx, an earlier Poblano Group company, was treated somewhat more favorably by Mexico, as the Federal Fiscal Tribunal decided in February 1996 that Lynx was entitled to IEPS rebates on cigarette exports, despite the likely absence of invoices stating the tax amounts separately (*e.g.* memorial, para. 36; App. 1047-1070). As a result of this decision and Lynx' *Amparo* victory (which applied specifically only to alcoholic beverage exports), SHCP also

paid rebates to Lynx for IEPS taxes applicable to cigarette exports in 1992, along with substantial additional amounts for interest and inflation.[FN40] This was a period during which CEMSA faced uncertainty over the availability of rebates for cigarette exports, despite the fact that limited exports were made in 1992 by CEMSA. However, by 1996, when SHCP recognized Lynx' right to the rebates, SHCP had denied rebates to CEMSA for test shipments for several years.

180. All of this confirms a further weakness in the Respondent's argument that there can be no *de facto* discrimination under circumstances where rebates are essentially granted initially on the basis of a ministerial decision, with the detailed analysis coming later in the event of questions or an audit. Given the Claimant's notoriety at SHCP over the years, the newspaper articles and threats of litigation against SHCP officials, the audit that was initiated and then abruptly terminated in 1995, the multiple meetings with SHCP officials, etc., it is difficult for the Tribunal to believe that the Claimant's requests and actions were not well-known to and carefully monitored by SHCP officials. Those factors certainly created the necessary conditions for discrimination.

I.2.3 Discrimination as a Result of Nationality

181. It is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality, or »by reason of nationality.« (U.S. Statement of Administrative Action, Article 1102.) However, it is not self-evident, as the Respondent argues, that any departure from national treatment must be *explicitly* shown to be a result of the investor's nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances. In this instance, the evidence on the record demonstrates that there is only one U.S. citizen/investor, the Claimant, that alleges a violation of national treatment under NAFTA Article 1102 (transcript, July 13, 2001, p. 178), and at least one domestic investor (Mr. Poblano) who has been treated more favorably. For practical as well as legal reasons, the Tribunal is prepared to assume that the differential treatment is a result of the Claimant's nationality, at least in the absence of any evidence to the contrary.

182. However, in this case there is evidence of a nexus between the discrimination and the Claimant's status as a foreign investor. In the first place, there does not appear to be any rational justification in the record for SHCP's less favorable *de facto* treatment of CEMSA other than the obvious fact that CEMSA was owned by a very outspoken foreigner, who had, prior to the initiation of the audit, filed a NAFTA Chapter 11 claim against the Government of Mexico. Certainly, the action of filing a request for arbitration under Chapter 11 could *only* have been taken by a person who was a citizen of the United States or Canada (rather than Mexico), i.e., as a result of his (foreign) nationality. While a tax audit in itself is not, of course, evidence of a denial of national treatment, the fact that the audit was initiated shortly after the Notice of Arbitration (first Feldman affidavit, paras. 85-86) and the existence of the unsigned memo at SHCP noting the filing of the Chapter 11 claim in the context of the Claimant's export registration efforts, at minimum raise a very strong suspicion that the events were related, given that no similar audit action was taken against domestic reseller/exporter taxpayers at the time.

183. More generally, requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government's motivation for discrimination is nationality rather than some other reason. Also, as the Respondent argues, if the motives for a government's actions should not be examined, there is effectively no way for the Claimant or this Tribunal

to make the subjective determination that the discriminatory action of the government is a result of the Claimant's nationality, again in the absence of credible evidence from the Respondent of a different motivation. If Article 1102 violations are limited to those where there is explicit (presumably *de jure*) discrimination against foreigners, e.g., through a law that treats foreign investors and domestic investors differently, it would greatly limit the effectiveness of the national treatment concept in protecting foreign investors.

184. This conclusion is consistent with that reached in an earlier Chapter 11 proceeding, *Pope & Talbot v. Government of Canada*.The *Pope & Talbot* tribunal indicated its inclination to presume that discriminatory treatment of foreign investors in like circumstances would be in violation of Article 1102. According to that tribunal such differences between domestic and foreign investors would »presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.« One of that tribunal's concerns was that if there had to be a showing that the discrimination was based on nationality, it would »tend to excuse discrimination that is not facially directed at foreign owned investments« (*Pope & Talbot v. Government of Canada*, Award on the Merits of Phase 2, April 10, 2001, paras. 78, 79, http://www.dfait-maeci.gc.ca/tna-nac/Award_Merits-e.pdf) (The *Pope & Talbot* tribunal, on the facts, ultimately declined to find a violation of national treatment). In the instant case, the treatment between the foreign investor and domestic investors in like circumstances is different on a *de facto* basis, and such discrimination is clearly in conflict with the investment liberalization objective found in Article 1102. This Tribunal sees no reason to disagree with the *Pope & Talbot* tribunal's articulation in this respect.

I.2.4 Most Favored Investor Requirement?

185. NAFTA is on its face unclear as to whether the foreign investor must be treated in the most favorable manner provided for *any* domestic investor, or only with regard to the treatment generally accorded to domestic investors, or even the least favorably treated domestic investor. There is no »most-favored investor« provision in Chapter 11, parallel to the most favored nation provision in Article 1103, that suggests that a foreign investor must be treated no less favorably than the most favorably treated national investor, if there are other national investors that are treated less favorably, that is, in the same manner as the foreign investor. At the same time, there is no language in Article 1102 that states that the foreign investor must receive treatment equal to that provided to the *most* favorably treated domestic investor, if there are multiple domestic investors receiving differing treatment by the respondent government.

186. It may well be that the size of the domestic investor class here is larger than two - one Mexican government witness stated that there might be 5-10 or more registered to export cigarettes - and it may also be that some of those other investors have been treated in a manner more similar to the Claimant's treatment than to the more favorable treatment afforded to the Poblano Group. However, in the absence of evidence to this effect presented by Mexico - the only party in a position to provide such information - the Tribunal need not decide whether Article 1102 requires treatment equivalent to the best treatment provided to *any* domestic investors. Presumably, if there was evidence that another domestic investor had been treated in a manner equivalent to the Claimant, in terms of export registration, audit, and granting or withholding of rebates, the Respondent would have provided that evidence to the Tribunal. In this case, the known »universe« of investors is only two, or at the most three, one foreign (the Claimant) and one domestic (the Poblano Group companies), and the Tribunal must make its decision on the evidence before it. Thus, the only relevant domestic investor is the Poblano Group and the comparison must be between the Po-

blano Group and Claimant.

187. On the basis of this analysis, a majority of the Tribunal concludes that Mexico has violated the Claimant's rights to non-discrimination under Article 1102 of NAFTA. The Claimant has made a *prima facie* case for differential and less favorable treatment of the Claimant, compared with treatment by SHCP of the Poblano Group. For the Poblano Group and for other likely cigarette reseller/exporters, the Respondent has asserted that audits are or will be conducted in the same manner as for the Claimant, and implied that they will ultimately be treated in the same way as the Claimant. However, the evidence that this has occurred is weak and unpersuasive. The inescapable fact is that the Claimant has been effectively denied IEPS rebates for the April 1996 through November 1997 period, while domestic export trading companies have been given rebates not only for much of that period but through at least May 2000, suggesting that Article 4(III) of the law has been *de facto* waived for some if not all domestic firms. While the Claimant has also been effectively precluded from exporting cigarettes from 1998 to 2000, there is evidence that the Poblano Group companies have apparently been allowed to do so, notwithstanding Article 11 of the IEPS law. Finally, the Claimant has not been permitted to register as an exporting trading company, while the Poblano Group firms have been granted this registration. All of these results are inconsistent with the Respondent's obligations under Article 1102, and the Respondent has failed to meet its burden of adducing evidence to show otherwise.

188. In reaching the conclusion that the Respondent has breached its obligations to the Claimant under Article 1102, the majority observes that the cigarette exports by the Claimant and other similar situated resellers may be economically unsustainable, if IEPS rebates are unavailable, but there is nothing in the IEPS law during the relevant period (after the 1993 *Amparo* decision and before the 1998 amendments) that legally precludes the exports per se. The majority is also of the view that the factual pattern in this case reveals more than a minor error or two by the Respondent. Rather, it demonstrates a pattern of official action (or inaction) over a number of years, as well as de facto discrimination that is actionable under Article 1102. That being said, there is no disagreement that Chapter 11 jurisdiction over tax matters is carefully circumscribed by Article 2103, or that this Tribunal would be derelict in its duties if it either expanded or reduced that jurisdiction.

J DAMAGES

189. Concerning the quantum of damages to be awarded to the Claimant, the Tribunal observes at the outset that the appropriate measure and amount of damages is only generally and cursorily discussed by the Parties. Still more limited is the amount of evidence presented to the Arbitral Tribunal in this respect.

190. The Claimant assumes that CEMSA's damages for the Respondent's unlawful discrimination under Article 1102 are identical to those claimed for the unlawful expropriation, without either allowing for any divergence in both cases or taking into account the particular case of only *de facto* discrimination (memorial, para. 233). Regarding the valuation of damages, the Claimant asks for three elements of compensation (memorial, paras. 236-246):

(1) $64,582,645 Mexican pesos (or US$6,458,264) for IEPS due in the period of October-December 1997; (2) $90,350,605 Mexican pesos (or US$9,035,060) for lost profits in the period of January 1, 1994 - May 1996, calculated on the expected exports applying a profit margin of 62.4% and (3) $148,886,141 Mexican pesos(or US$14,888,614), requesting CEMSA's »going concern value« on the basis of the present discounted value of the future cash flow. The sum of the three elements amounts to $303, 819, 391 Mexican pesos (or US$30,381,938).

191. In his reply of June 11, 2001, the Claimant asserted that his calculation of IEPS, even if erroneous, was never challenged by the Respondent

(reply, paras. 72-75). He adds a claim for lost profits after December 1, 1997, without specifying any amounts (reply, para. 76(3)). He concludes by alleging that, even if CEMSA claimed more IEPS than Cigatam already paid, it would »still be entitled to damages in the order of twenty million dollars« (reply, para. 78).

192. The Respondent, on the other hand, alleges that CEMSA's financial records in the critical period were either inadequate or missing altogether. In addition, it is asserted that CEMSA's cigarette export business was not profitable (counter-memorial, paras. 513-517). Further, the Respondent denies that CEMSA was »a normal trading company« (countermemorial, para. 560) or had any fair market value at all material times (counter-memorial, paras. 532-539, 564).

193. In its rejoinder, the Respondent objects to the calculation of damages by the Claimant (rejoinder, paras. 202-262). In particular, the Respondent challenges the new claim for lost profits and concludes that the gross profit on each carton sold could be, at best, only five cents (rejoinder, para. 258).

194. The Tribunal, first, observes that under NAFTA Article 1117(1) *in f.* (as well as Article 1116(1) *in f.*) an investor of a Party on behalf of an enterprise may submit to arbitration a claim that the other Party violated, among other provisions, the obligation to accord national treatment under NAFTA Article 1102 and, therefore, »that the enterprise has incurred loss or damage by reason of, or arising out of, that breach«. NAFTA provides no further guidance as to the proper measure of damages or compensation for situations that do not fall under Article 1110 (expropriation); the only detailed measure of damages specifically provided in Chapter 11 is in Article 1110(2-3), »fair market value,« which necessarily applies only to situations that fall within that Article 1110. It follows that, in case of discrimination that constitutes a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discrimination that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to the full market value of the investment which is granted by NAFTA Article 1110. Thus, if loss or damage is the requirement for the submission of a claim, it arguably follows that the Tribunal may direct compensation in the amount of the loss or damage actually incurred.

195. To date only two other NAFTA tribunals, in *S.D. Myers* and *Pope & Talbot*, have found a compensable violation, of Articles 1102 and 1105 (respectively). The damages phase of *S.D. Myers* has not been completed. However, in outlining its intended approach to damages, that tribunal concluded that in the absence of a special provision, the drafters of the NAFTA intended to leave it open to tribunals to determine a measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of NAFTA. (*S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 303-319, http://www.state.gov/documents/organization/3992.pdf.)

196. In *Pope & Talbot*, the tribunal found only a relatively minor breach of Article 1105; claims of Article 1102 and Article 1110 violations and additional alleged Article 1105 violations, among others, were rejected. In its opinion of May 31, 2002, that tribunal did not explain its rationale for damages in detail, emphasizing only the rejection of the claimed damages for the cost of management time to deal with the respondent's breach of Article 1105, and of lost profits for a short period of time during which the firm's mills were shut down by the respondent, again in breach of Article 1105(the latter were rejected not in principle, but because the tribunal, after considering the claimant's assertions, determined that there had been no loss of profits). The only damages that were allowed were out-of-pocket expenses relating to the respondent's violation, incurred by the Claimant in defending itself. (These were items such as legal and accounting,

and lobbyist fees.) (*Pope & Talbot v. Government of Canada*, Award in Respect of Damages, May 31, 2002, paras. 81-90, http://www.naftalaw.org).

197. It is obvious that in both of these earlier cases, which as here involved nonexpropriation 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.

198. On this rationale, the Tribunal focuses on the most recent articulation of damages asked for by the Claimant in his reply (see *supra*, para. 191). For reasons stated earlier, of the three elements of damages sought for by the Claimant, the third one representing CEMSA's »going concern value« is to be dismissed because this item requires a finding of expropriation, which is not the present case (see *supra*, paras. 108-114).[FN41]

199. The second element of damages seeks lost profits in the period of January 1, 1994 - May 1996 and, therefore, is covered by the three-year limitation period under NAFTA Article 1117(2), as explained in paras. 39-47 of the Interim Decision on Preliminary Jurisdictional Issues of December 6, 2000. In that Interim Decision we held that the cut-off date of the three-year limitation period is April 30, 1996. Even if the Claimant asks, under the element under discussion, for lost profits for one month (May 1996) coming immediately after the cut-off date, the claim does not specify its amount with regard to that particular month and, in any case, has not convinced the Tribunal with respect to both existence and extent.

200. Again, even had there been greater specificity on the part of the Claimant, the Tribunal is not convinced on the basis of the evidence in the record that CEMSA's operations would have been profitable, should CEMSA had received the IEPS rebates during the relevant time in the proper amounts. As discussed earlier, when the IEPS tax rate was 85%, the Claimant erroneously treated 85% of the invoice price as taxes subject to rebate. (In fact, only approximately 45.95% of the invoice price was properly attributable to taxes.) If the gross price to Sam's was US$7.40, and it is assumed that the IEPS rebate is 85% of the gross price, the net price (less the rebates) would be US$4.00 (7.40/1.85). This produces a gross margin of only US$0.05 from an export selling price of US$4.05, which could not possibly cover the Claimant's expenses, including but not limited to the 14% interest on his loans from the Poblano Group (see Feldman affidavit, paras. 6, 72). Even if these approximations are slightly off, there is simply insufficient gross margin to cover normal operating expenses, let alone profit, unless of course, the Claimant can obtain IEPS tax rebates from SHCP, as he did in 1996 and 1997.

201. Assertions that the Claimant, had he been aware of the correct amount of the rebates, would have simply raised his US$4.05 per carton selling price, are totally unpersuasive from a business or economic point of view. Any reasonable businessman would set his prices based on supply and demand. If the Claimant could have obtained US$5.00 or US$6.00 or more per carton, he undoubtedly would have done so, as the Respondent contends (see rejoinder, paras. 216-221). Moreover, the Claimant had no significant customer base. All of his sales in his best year, 1997, were either to members of the Poblano Group, or to an apparently fictitious company, Dilosa, S.A. which may have been allegedly doing business in Honduras, a low tax jurisdiction for which IEPS rebates were not legally available (IEPS Law, 1997, Article 2(III)). In short, the Tribunal is convinced that the Claimant did not have a viable business exporting cigarettes purchased from retailers in Mexico, and could not have made a profit regardless of whether SHCP provided the IEPS rebates, assuming of course that the rebates sought and provided approximated the actual amount of IEPS taxes originally assessed on the cigarettes.

202. There remains only the first element of damages, concerning IEPS rebates due in the period of

October - December 1997. According to the Claimant, their amount is $64, 582,645 Mexican pesos (or US$ 6,458,264). In the record there are customs documents that reasonably reflect the relevant exportations during that period (pp. 3057 to 3199 of volume 8 that is annexed to the memorial).

203. Notwithstanding this assertion, the record demonstrates that during the three months of the relevant period, the Claimant filed only three requests for IEPS rebates for a total amount of $18,978,361 Mexican pesos as follows:

On November 3, 1997, he requested $10,134,669 Mexican pesos

On December 1, 1997, he requested $8,841,061 Mexican pesos

On January 5, 1998, he requested $2,631 Mexican pesos

To calculate the correct amount of the tax, the value of the exported merchandise should be divided by 1.85. The result, the value of the cigarettes, is subtracted from the gross invoice price, to arrive at the correctly estimated tax amounts. Thus, beginning with the $18,978,361 Mexican pesos, specified by the Claimant, according to the applications presented November 3, December 1, both of 1997, and January 5, 1998, and assuming that this number results from the erroneous calculation of the tax amounts that was made by the Claimant (applying simply the 85% against the gross invoice price, as discussed earlier (para. 131) and dividing that number by 85 and multipliying it by 100), the gross selling price for the cigarettes on the basis of which CEMSA requested the payment of IEPS is $22,327,483 Mexican pesos. This amount coincides with the invoices presented by the Claimant, that related to the relevant period.

204. As the gross invoice price is $22,327,483 Mexican pesos, the tax that corresponds to that amount is $10,258,573.5 Mexican pesos. This is the result of the following operation:

$22,327,483 / 1.85 = $12,068,909.73 Mexican pesos (This is the price of the cigarettes net of the IEPS)

$22,327,483 - $12,068,909.73 = $10,258,573.5 Mexican pesos (This is the approximate correct IEPS amount assuming an 85% tax rate.)

205. However, the Tribunal believes it appropriate to exclude the IEPS that correspond to an exportation to Honduras made in the relevant period. As Honduras is a tax haven jurisdiction (jurisdicción de baja imposición fiscal), this export was not legally subject to an IEPS rebate under Article 2(III) of the IEPS law. Thus, the total IEPS amount of $10,258,573.50 Mexican pesos should be reduced by the amount of $793,946.00 Mexican pesos (the rebate amount for the Honduran sale). Thus, the revised total award is $9,464, 627.50 Mexican pesos. (This amount of $793,946.00 Mexican pesos is obtained by dividing the price paid by CEMSA when it acquired the merchandise that it exported to Honduras, by 1.85%. CEMSA bought 27,000 Marlboro Flip Top from Sam's Club, for an amount of $1,728, 000.00 Mexican pesos, according to invoice 2060 dated September 29, 1997; that same merchandise was exported to Honduras on October 15, 1997 with export declaration 3465-7007533, also dated October 15, 1997, and with the invoice 2068 issued by CEMSA, which refers to 450 boxes or master cases of Marlboro Flip Top; one box or master case of Marlboro Flip Top contains 60 Flip Top packs). The total revised award indicated above of $9,464,627.50 Mexican pesos is increased by simple interest calculated from the date the rebates should have been paid (see below) to the date of this decision, in accordance with the interest rate paid on Federal Treasury Certificates or bonds issued by the Mexican Government, with a maturity of 28 days (see annex). The total interest so calculated is $7,496,428.47 Mexican pesos.

The amount of the rebates that should have been paid to Claimant is as follows:

on January 19, 1998, $4,684,253.45 Mexican pesos;

on February 16, 1998, $4,778, 951.89 Mexican pesos; and

on March 3, 1998, $1,422.16 Mexican pesos.

The interest should be calculated according to the law in force for the rebates requested in 1997 (payable 51 days after the request) and for the rebates requested in 1998 (payable 41 days after the request). Thus, as of the date of this decision, the total amount awarded by the tribunal is $16,961,056 Mexican pesos (principal amount of $9,464,627.50 plus interest of $7,496,428.47).

If the Respondent, for any reason, does not immediately pay the amount of compensation herein mentioned, at the time payment is made, the Respondent shall add the interest that continues to be generated on the original amount of $9,464,627.50 Mexican pesos, using the same calculation methodology as described above and in the annex of this award.

206. Thus, the correct amount for this (only proved) element of damages, based on the above analysis, is $9,464,627.50 Mexican pesos, plus simple interest at the rate calculated in conformity with the Mexican Government Federal Treasury Certificates interest rates (CETES) at maturity of 28 days.

207. Concerning the currency of the Award, the Tribunal observes that the Claimant in his Notice of Arbitration of April 30, 1999 asked for an »award of approximately 475 million pesos, which, assuming an exchange rate of $9.5 Mexican pesos to the U.S. dollar, equals U.S. 50 million dollars« (Notice of Arbitration, p. 11). Thus, it appears that, according to the Claimant, the principal currency of the Award should be the Mexican peso. Such currency also corresponds to the facts of the case since the monetary amount is requested by the Claimant in lieu of IEPS rebates due to him but not paid by the Respondent, such IEPS rebates being necessarily expressed in the Respondent's official currency. Therefore, the Tribunal considers that the Award should also be expressed in Mexican pesos, regardless of whether the Parties in subsequent communications may have referred also to U.S. dollar as a matter of convenience. It must be added that the parity between the Mexican peso and the U.S. dollar does not seem to have significantly changed in the last three years or so. In any event, even more significant changes must have been approximately reflected in the respective rates of interest. For reasons of consistency, then, the Tribunal will apply the Mexican Government bond interest rates to the award of damages expressed in Mexican pesos.

K COSTS AND FEES

208. Regarding the costs of this arbitration, the Tribunal recalls Article 59(1) of the Arbitration (Additional Facility) Rules. Under this provision, »[u]nless the parties otherwise agree, the Tribunal shall decide how and by whom the fees and expenses of the members of the Tribunal, the expenses and charges of the Secretariat and the expenses incurred by the parties in connection with the proceeding shall be borne«. In the absence of any agreement by the parties in this respect, the Tribunal takes into account that both parties have partly won and partly lost, and that the percentage of victory and loss did not have any measurable effect on the amount of costs. Accordingly, the Tribunal decides that each party bear half of the costs of the arbitration (fees and expenses of the members of the Tribunal as well as expenses and charges of the Secretariat), as billed by ICSID. In addition, each party bears its own legal fees and costs in connection with the arbitration.

L. DECISION

For these reasons, the Tribunal

209. Finds that the Respondent has not violated the Claimant's rights or acted inconsistently with the Respondent's obligations under NAFTA Article 1110;

210. Finds that the Respondent has acted inconsistently with the Claimant's rights and the Respondent's obligations under NAFTA Article 1102;

211. Orders the Respondent to pay immediately to

the Claimant the sum of $ 9,464,627.50 Mexican pesos as principal, plus interest generated at the time of signature of this award, in the amount of $7,496,428.47 Mexican pesos, which interest shall accrue until the date the payment is effectively made, pursuant to the last part of paragraph 205 of this award; the interest to be calculated shall be simple interest, for each month of the period of calculation at a rate equivalent to the yield for the month, of the Federal Treasury Certificates, issued by the Mexican Government, with a maturity of 28 days.

212. Denies all other claims for compensation;

213. Orders that each party be responsible for its own legal fees and related costs, and that the costs of the arbitration, as billed by ICSID, be shared equally by the parties.

Made as at Ottawa, Province of Ontario, Canada, in English and Spanish.

Professor Konstantinos D. Kerameus

Date:

Mr. Jorge Covarrubias Bravo

(subject to the attached dissenting opinion)

Date:

Professor David A. Gantz

Date:

FN1.1 *See* the Notice of Intent to Submit a Claim, submitted under NAFTA Article 1119, p. 2. The Notice of Intent also mentioned NAFTA Article 1106, on performance requirements, but the obligations of this provision were not invoked in the Notice of Claim.

FN2.2 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, opened for signature March 18, 1965, entered into force October 14, 1966.

FN3.3 The Claimant's Notice of Arbitration, p. 5 (submitted on April 30, 1999).

FN4.4 The Claimant subsequently submitted an additional request for a declaration that Mexico had breached its obligations to afford CEMSA national treatment under NAFTA Article 1102.

FN5.5 Emphasis added. Paras. 2-6 provide for compensation »equivalent to the fair market value of the expropriated investment immediately before the expropriation took place;« that compensation be paid without delay and be fully realizable; include interest in a hard currency; and be freely transferable. *Id.* Article 1110(1) (2-6).

FN6.6 Memorial, paras. 151 ff.; counter-memorial, paras. 335 ff. (with some qualifications). It is important to note that the language used by the Restatement, section 712, differs significantly from that used in NAFTA, even though the concepts are similar.

FN7.7 The Tribunal notes that the *S.D. Myers* tribunal (citing *Pope & Talbot*) effectively concluded that the words »tantamount to expropriation« were designed to embrace the concept of »creeping« expropriation rather than to »expand the internationally accepted scope of the term expropriation.« *See S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, para. 286, http://www.state.gov/documents/organization/3992.pdf .

FN8.8As discussed in the »Damages« section of this Award (paras. 189-207), there is a serious question as to whether the Claimant's business would have been economically viable even had SHCP consistently granted the rebates in the proper amount, given the very low gross profit, based on the gross profit of less than US$0.10 between CEMSA's net-of-tax cost of the cigarettes and the selling prices realized from CEMSA's customers.

FN9.9 First, NAFTA Article 2103 generally excludes tax measures from coverage under NAFTA:

»Except as set out in this Article, nothing in this Agreement shall apply to tax measures.« However, this exclusion is not absolute. Article 2103(3)(b) makes Article 1102 applicable to tax measures, and Article 2103(6) makes Article 1110 applicable under certain conditions. Article 1105 is not mentioned among the exceptions to the exclusion; therefore, it does not apply to tax measures, other than in a situation in which an expropriation under Article 1110 has been found, and there is an analysis as to whether the expropriatory action met the requirements of due process and Article 1105 as provided in Article 1110(1)(c).

FN10.10 *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 87-88, http://www.state.gov/documents/organization/3989.pdf. Canada also asserted that »tantamount« simply means »equivalent,« and that this language was not intended to expand Article 1110's coverage beyond creeping expropriation to cover regulatory action. *Id.* para. 89.

FN11.11 Also, although the Tribunal is aware, as indicated earlier, that the 1999 Fiscal Court proceedings challenging SHCP's efforts to recoup tax rebates from the Claimant are not final, the most recent decision has upheld the Claimant's position that the requirements of the IEPS law for invoices stating the tax amounts separately and precluding rebates for exports to low tax jurisdictions, are unconstitutional under Mexican law. The significance of this court decision is somewhat offset by the fact that in a separate, 1998 proceeding challenging denials of tax rebates from October 1997 through January 1998, which is final, another Mexican court determining essentially the same issues found in favor of SHCP (*see* Amparo decision of August 24, 2000).

FN12.12 See, *e.g.*, Annex 6 of the Claimant's reply memorial, providing copies of recent newspaper reports regarding the smuggling of U.S. cigarettes to Canada and several European countries; indications that cigarette producers in Mexico have reduced cigarette prices by 25% in order to compete more effectively with smuggled cigarettes (transcript, July 12, 2001, p. 148); and documentation provided by the Respondent suggesting that some cigarettes exported from Mexico to the United States are being re-imported into Mexico from El Paso.

FN13.13 Technically, the *Amparo* appears to apply only to the IEPS law challenged, i.e. the 1990 version. However, Article 2(III) of the law was further amended in 1992 to provide the 0% tax rate to reseller/exporters as well as producer/exporters, so long as the destination nation was not a low tax (tax haven) jurisdiction.

FN14.14 Although the tax base for the IEPS cigarette tax was the retail sale price, under the IEPS law the party responsible for paying the tax was the producer or its controlled distributor, not the retailer, presumably to assure that the full amount of the taxes would be paid in a distribution system where many of the retailers were small kiosk operators who apparently were not trusted to remit the proper tax amounts to SHCP, or to maintain records adequate to assure SHCP that the full taxes were being paid. See IEPS Law, Article 11 (1991).

FN15.15 The record is largely devoid of any statement of CEMSA's physical assets. The Claimant asserts that the initial capitalization of CEMSA upon its formation in 1998 was a total of $ 510,000 Mexican pesos, but there is no indication as to what percentage of this was paid in capital. Feldman declaration of March 28, 2001, para. 1. Moreover, the Claimant's claim for compensation is based almost entirely on a calculation of lost profits and its value as a going business [concern], plus a demand for the rebates anticipated but not paid for October - November 1997. See memorial, para. 231.

FN16.16 Several possible reasons emerged during the hearing. It was suggested that Article 4 of the IEPS law could only have been challenged within 15 days of the enactment of the provision, which occurred in 1984 or 1985, well before CEMSA was incorporated, or tbecause at the time the Article 4 requirements had not been applied to the Claimant

(transcript, July 12, 2001, pp. 127-135, testimony of Oscar Enriquez Enriquez).

FN17. 17 The IEPS applied to alcoholic beverages appears to function in a manner similar to normal value added taxes, with each succeeding seller being treated as a taxpayer. The special rules using the retail price as the tax base but making the producer or distributor the person responsible for paying the taxes for cigarettes apparently apply only to tobacco products, gasoline and diesel fuel. See IEPS law, Article 11 (1992 and other years).

FN18. 18 It states in operative part that »you are hereby confirmed your opinion in the sense that you are entitled to request the return of the balance in your favor resulting from the crediting of the special tax on production and services paid on the acquisition of alcoholic beverages and processed tobacco exported as from January 1st, 1992, provided such exports are made to countries with an Income Tax rate applicable to legal entities exceeding 30%.« (Letter from Jose Antonio Riquer Ramos to CEMSA, March 12, 1992, App. 0062-0069.) SHCP reserved the rights of surveillance and verification. It is also unfortunate that neither the Claimant nor the Respondent were able to produce a copy of the February 6, 1992, letter to which SHCP's letter was a response, so it is impossible for the Tribunal to know whether this response was in the context of a letter raising the Article 4 invoice issue, or, equally likely, raising only the 0% tax rate issue which was then before the Supreme Court.

FN19. 19 As discussed more fully in the section of this award on discrimination, evidence in the record suggests that there are 5-10 or more firms registered under Mexican law as cigarette exporters. (Obregon-Castellanos testimony, transcript, July 9, 2001, p. 141). It may well be that the requirements of Article 4 have been waived from time to time for them as well given the practical impossibility for resellers to export without the tax rebates, although the Mexican government has unfortunately been unwilling or unable to enlighten the Tribunal on this fact.

FN20. 20 Using the formula 7.40 = 1.85 X, where X is the price net of tax, X = 7.40/1.85 = 4.00. (*See* Feldman affidavit, Mar. 28, 2001, para. 6.) The remaining amount is the tax, US$7.40 - US$4.00 = US$3.40. See IEPS law, Article 2(1)(H).

FN21. 21 Although the methodology used in 1996 is relatively obscure (see Zaga-Hadid affidavit, annex A, exh. 3 of memorial), the result of the methodology used was to increase the portion of the purchase price treated as IEPS taxes subject to rebates from 45.95% to 55.95% of the purchase price.

FN22. 22 He arrived at this figure by simply multiplying the price of US$7.40 by 85%, in other words, treating 85% of the purchase price as tax amounts subject to government rebate upon exportation. (Zaga-Hadid affidavit, annex 3; first Feldman statement, para. 70.) This increased the tax amounts, in an unwarranted way, from 45.95% to 85% of the gross sales price.

FN23. 23 There was considerable discussion in the testimony of the parties regarding whether one of the Poblano Group companies, Lynx, had received excess IEPS rebates for 1991 as a result of Lynx's *Amparo* suit. (*See* third statement of Enrique Diaz Guzman, paras. 7-8, App. 6455-6456; declaration of Oscar Enriquez Enriquez, Jun. 8, 1991, paras. 3 bis - 14 bis.) However, the Tribunal believes that the Claimant failed to demonstrate that the amounts received on behalf of Lynx were excessive, once interest and an inflation factor for the five year period between accrual and payment are factored in.

FN24. 24 Respondent made an extensive effort in its briefs and during the hearing to document a series of export transactions by the Claimant, and to link those exports with re-entry of the cigarettes into Mexico. While Respondent was unable to demonstrate that the Claimant was aware of any such illegal practices, or that any of the cigarettes the Claimant exported were reentered into Mexico, Respondent did demonstrate evidence of a serious

problem. Countermemorial, pp. 104-116, and transcript, July 12, 2001, pp. 148 ff.

FN25. 25 See *supra*, paras. 130, 131, and Respondent's exhibits for cross-examination of the Claimant, Vol. II, tab 6.

FN26. 26 Moreover, under international law, there is considerable doubt whether the discrimination provision of Article 1110 covers discrimination other than that between nationals and foreign investors, i.e., it is not applicable to discrimination among different classes of investors, such as between producers and resellers of tobacco products, at least unless all producers are nationals and all resellers are aliens. Thus, under the Restatement, the relevant comment states that »a program of taking that singles out aliens generally, or aliens of a particular nationality, or particular aliens, would violate international law.« The comment does not refer to discrimination between national producers and resellers (whether national or foreign) operating under somewhat different circumstances, particularly under the tax laws. Also, there is an implication in the NAFTA Parties' interpretation of Article 1105 of July 31, 2001, that a breach of one substantive provision of Section A should not in itself be considered a breach of a separate provision (NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, July 31, 2001, consulted on the web site of the Department of Foreign Affairs and International Trade of the Government of Canada. See NAFTA Articles 1131(2) and 2001).

FN27. 27 Moreover, the Mexican courts have been deciding issues of national law which it is inappropriate for the Tribunal to review, except and unless those determinations (or of Mexican administrative agencies such as SHCP) are themselves denials of justice or otherwise in violation of NAFTA or international law.

FN28. 28 See Metalclad Corporation v. United Mexican States, Award, August 30, 2000, paras. 1, 32, 38, 40, 45-46, 16 ICSID Review. FILJ 1, 2001. Metalclad and Mexican federal environmental authorities entered into an agreement in which Metalclad agreed, *inter alia*, to make certain modifications in the site, take specified conservation steps, recognize the participation of a Technical Scientific Committee and a Citizen Supervision Committee, employ local manual labor, and make regular contributions toward the social welfare of the municipality, including limited free medical advice. *Id.*, para. 48.

FN29. 29 This is rather strangely characterized as an act »tantamount to expropriation,« although it probably was more accurately described as a direct expropriation. *Id.* paras. 109-111. Ultimately, the tribunal awarded Metalclad compensation of US$16,685,000 for the loss of its investment in Mexico (more than US$90 million in damages was sought) based on violations of NAFTA Articles 1105 (fair and equitable treatment) and 1110 (expropriation). See *Metalclad, Id., paras.* 76-92, 103-105, 123-125, 128, 131.

FN30. 30 Here, as in *Metalclad*, there was without doubt a lack of transparency with regard to some actions by Mexican government officials. Yet, if the British Columbia Supreme Court is correct that lack of transparency is not in itself a violation of Chapter 11 of NAFTA, the fact that SHCP communications and other actions after the 1993 *Amparo* decision were inconsistent and ambiguous, and difficult for the Claimant to assess, are insufficient to justify a finding of expropriation under Article 1110.

FN31. 31 *S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, para. 280, http://www.state.gov/documents/organization/3992.pdf .

FN32. 32 The Claimant had argued that the Canadian lumber export control regime had »deprived the Investment of its ordinary ability to alienate its product to its traditional and natural market,« and that by reducing the claimant's quota of lumber that could be exported to the United States without pay-

ing a fee, Canada violated Article 1110. *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, para. 81, http://www.state.gov/documents/organization/3989.pdf .

FN33.33 For a discussion of the profitability of the Claimant's cigarette exporting business (or lack thereof), see Section J, *infra.*

FN34.34 Mexico has provided excerpts from United States submissions in other cases, which imply that there must be a showing that the reason for differential treatment is nationality. See, *e.g.*, U.S. Submission of April 7, 2000, in *Pope & Talbot*, http://www.state.gov/documents/organization/4097.pdf. However, such statements were made in the context of cases with different fact situations and, possibly, legal and policy considerations. Under those circumstances, this Tribunal chooses not to consider them.

FN35.35 See Daniel M. Price & P. Brian Christy, *An Overview of the NAFTA Investment Chapter, in* The North American Free Trade Agreement: A New Frontier in International Trade and Investment in the Americas 165, 174 (Judith H. Bello, Allan F. Holmer & Joseph J. Norton, eds., 1994).

FN36.36 The issue of whether the size of the »universe« of foreign investors, and of domestic investors, matters has been an issue in other NAFTA Chapter 11 cases, including *S.D. Myers* (see *S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 93, 112, 256, http://www.state.gov/documents/organization/3992.pdf) and particularly in *Pope & Talbot* (see *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 11, 24, 36, 38, http://www.state.gov/documents/organization/3989.pdf). However, the Respondent here has not raised that issue, and the Tribunal accordingly does not address it (see *infra* paras. 185, 186).

FN37.37 With minor exceptions, NAFTA does not regulate the creation and maintenance of monopolies. »Nothing in this Agreement shall be construed to prevent a Party from designating a monopoly.« Article 1502(1). Thus, affording cigarette producers a monopoly on exports would not appear to be an article 1102 violation, as long as all non-producers, both domestic and foreign, are treated in the same manner.

FN38.38 *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Adopted 23 May 1997, WT/DS33/AB/R, p. 14. Accordingly, *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Reports, pp. 246, 272, 1990. (»In case a party adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent.«).

FN39.39 Counter-memorial, para. 488; see, *e.g.*, transcript, July 10, 2001, pp. 110-113. It is undeniable that CEMSA and the Poblano Group maintained a business relationship; CEMSA, *inter alia*, was a seller of cigarettes to several of the Poblano Group companies from time to time, and had borrowed working capital from Mr. Poblano (memorial, paras. 101-102). However, there is no evidence of any common stock ownership, common membership on corporate boards of directors or any of the normal indices of common ownership and control. Moreover, SHCP has treated the two as completely separate taxpayers, audited CEMSA early on, while more than three years later no final action has been taken against the Poblano Group. Clearly, there is no evidence that the Mexican government considered CEMSA and the Poblano Group companies to be a common enterprise prior to this proceeding. Accordingly, this Tribunal would not be inclined to treat them as such so as to defeat the Claimant's assertion of discrimination.

FN40.40 See Zaga-Hadid testimony, transcript, July 13, 2001, p. 142, tables introduced into evidence during the hearing. Allegations that Lynx had been intentionally paid excessive rebates by SHCP were denied (third witness statement of Diaz-Guzman, App. 06455-06456) and further disputed at the hearing by both parties. The evidence on this issue

before the Tribunal is conflicting, and the Tribunal is not convinced that the amounts paid, including interest paid and the inflation adjustment for the 1993-1996 period, were in fact excessive.

FN41. 41 We observe, without deciding, that even if there had been an expropriation, there is inadequate proof in the record to demonstrate that CEMSA had more than negligible going concern value. As noted in footnote 15, there is no statement of CEMSA's physical assets in the record, other than an assertion of an initial capitalization of 510,000 Mexican pesos at the time of formation in 1988, without any indication as to what percentage of this was paid in. The going concern value of an enterprise which earns 90% of its alleged revenues from gray market sales of cigarettes is also suspect. As discussed in para. 201, *infra*, after selling and financing costs, this operation could not have been profitable, and a money losing business seldom has significant value as a going concern.

Commentary citations:

Cited documents:

Cited Court Decisions

- ICJ, "Case Concerning Elettronica Sicula S.P.A. (ELSI) (United States of America v. Italy)"
- Supreme Court of British Columbia, "United Mexican States v. Metalclad"

Cited Awards

- ICSID Case No. ARB(AF)/97/1, "Metalclad Corp. v. United Mexican States"
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- NAFTA/UNCITRAL Award, "S.D. Myers, Inc. v. Government of Canada"
- NAFTA/UNCITRAL, Interim Award, "Pope & Talbot Inc. v. Government of Canada"

Cited Rules

- ICSID Arbitration Additional Facility Rules, Art. 6
- ICSID Arbitration Additional Facility Rules, Art. 59
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- Mexican Fiscal Code, Art. 34
- Mexican Impuesto Especial Sobre Producción y Servicios Law, Art. 2
- Mexican Impuesto Especial Sobre Producción y Servicios Law, Art. 4
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Cited Treaties

- Bilateral Investment Treaty (USA-Canada)
- North American Free Trade Agreement, Chapter 11
- North American Free Trade Agreement, Art. 1102
- North American Free Trade Agreement, Art. 1103
- North American Free Trade Agreement, Art. 1105
- North American Free Trade Agreement, Art. 1110
- North American Free Trade Agreement, Art. 1116
- North American Free Trade Agreement, Art. 1117
- North American Free Trade Agreement, Art. 1120
- North American Free Trade Agreement, Art. 1121
- North American Free Trade Agreement, Art. 1122
- North American Free Trade Agreement, Art. 1128
- North American Free Trade Agreement, Art. 1134
- North American Free Trade Agreement, Art. 1136
- North American Free Trade Agreement, Art. 1139
- North American Free Trade Agreement, Art. 2103
- North American Free Trade Agreement, Annex 1120.1

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