COURTESY TRANSLATION[*]

IN THE ARBITRAL PROCEEDING UNDER CHAPTER ELEVEN OF THE NORTH AMERICAN FREE TRADE AGREEMENT

GAMI INVESTMENT, INC.,
CLAIMANT

VS.

UNITED MEXICAN STATES,
RESPONDENT

STATEMENT OF DEFENSE

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[*] Translation is provided as a courtesy only. The only official text is the original signed in Spanish.

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I. FACTS

1. Mexico will respond to the Claimant's allegations of fact, first, by placing this claim in its proper factual context. It is important that the Tribunal understand the nature of the sugar industry, its complexity, the substantial distortions that exist in the international sugar market, and the difficulties encountered in other countries in the implementation and administration of their sugar programs. The Tribunal will see that Mexico is not unique in encountering a surplus in sugar production.

2. After reviewing the salient facts, Mexico will then turn to the specific allegations of fact made in the Statement of Claim. To assist the Tribunal, Section I.B. of this Statement incorporates the Claimant's allegations verbatim and then provides Mexico's response to each allegation.

A. The Claim In Its Proper Factual Context

3. The company in which GAMI chose to invest was a newly created company in a sector that --in Mexico, the United States, Canada and elsewhere-- has always been characterized by trade distortions, high risk, and uncertainty.

4. Between NAFTA's entry into force on 1 January 1994 and the expropriations, those trade distortions, risks and uncertainties were amply demonstrated in all three NAFTA Parties as well as in the world sugar market. The Statement of Claim notably omits any significant discussion of the declines in the U.S. and world sugar markets that paralleled Mexico's market problems. To read the Statement of Claim, one would think that the Mexican sugar policies were abysmally administered in comparison to the rest of the world. Nothing could be further from the truth. The fact is that most countries struggle with the administration of their sugar policies, in seeking to reconcile irreconcilable competing demands of interested groups, and governments' struggles are exacerbated by events and measures that are beyond their control.

1. The World-Wide Sugar Industry is Characterized by Trade Distortions, High Risk and Uncertainty

5. Agriculture differs from other forms of production because weather, pestilence, the desire for food security, governmental production incentives, and other factors play a much greater role in determining what crops will be grown and where, whether there will be production shortfalls or surpluses, and so on.

6. The sugar industry is a particularly difficult agricultural sector for States to manage because, in addition to factors common to all sectors of agricultural production, the trade policies of the major sugar-producing states have led to enormous distortions in international sugar trade. The Statement of Claim adverts to this but fails to give the Tribunal a full sense of the magnitude of the problem.[1] States heavily regulate the production of sugar throughout the world through

[1] Statement of Claim, ¶ 29.

measures such as import and export tariffs, government subsidies, and other measures designed to promote and protect domestic producers of sugarcane and sugar beets.[2]

7. There are over 120 sugar producing countries in the world and approximately 70 percent of world sugar sales are made at each country's regulated domestic price. As a consequence of this widespread government intervention, the world sugar market is a "residual" market.[3] Many States restrict access to their national markets in order to provide for support domestic prices. High prices spur production, which then leads to surpluses that must then be disposed of in the world market at distress prices. It has been calculated that from 1983-84 through 1998-99, the world average cost of producing sugar was 16.3 cents/lb. but the world market price was only slightly more than half of the cost of production: 9.5 cents/lb.[4]

8. The sugar trade is also notorious among international commodities for its price volatility.[5] It is an extremely challenging market in which to participate, even in countries that have well functioning commodities markets that convey data on supply and demand instantaneously.[6] To understand the nature of this volatility, it is necessary to understand the basic elements of the production and sale of raw, standard and refined sugar. While each product faces similar trade distortions, risks and uncertainties, the pricing, cost, and risk reducing strategies of each are distinct. GAM only produced and sold standard and refined sugar.[7]

9. Raw cane sugar is minimally processed sugar containing some impurities that is extracted from harvested sugarcane in a sugar mill. It is a stable, inert product that does not rapidly deteriorate and can be stored for lengthy periods of time before being refined. It is the most widely traded type of sugar. Refined cane sugar is processed so as to remove all impurities. Finally, standard sugar (known in Mexico as "*estandar*") is a semi-refined sugar that falls between raw cane sugar and refined sugar in terms of processing.

10. Sugar millers and refiners make their profit from what is known in the trade as the "refiner's margin". With respect to the production of raw cane sugar, where the miller and sugarcane growers are not vertically integrated, as was the case with GAM, the miller obtains a gross return equal to the difference between the selling price of the raw cane sugar and the cost of the sugarcane. Deducting from this amount all milling and other costs associated with the production, sale and delivery of the raw cane sugar yields the "miller's net margin". A similar

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2 This is the case for two of the three NAFTA countries; Mexico and the United States both have support programs for their growers. Although Western Canada produces sugar from sugar beets, there are no support programs. Most refined sugar in Canada is produced from raw sugar purchased on the world market and imported for refining.

3 Testimony of Jack Roney on Behalf of the American Sugar Alliance on "The Future of U.S. Sugar Policy", Committee on Agriculture, United States Senate, Washington D.C., July 17, 2001 ("Roney Testimony"), p.6. Exhibit R-1.

4 Ibid.

5 See price graphs for raw cane sugar prices on the world market, U.S. raw cane sugar prices, U.S. refined sugar prices, world refined sugar prices and Mexican standard sugar prices in USDA, *Sugar & Sweetener Situation and Outlook Yearbook*, May 2001. "S&SSO Yearbook", p. 8. Exhibit R-2

6 As demonstrated by the experience in the United States over the 1995-2001 period, described in detail in this Statement.

7 Statement of Claim, ¶ 22.

relationship exists in the production of refined cane sugar. In situations where a refinery is included as part of a sugar mill, as was the case with GAM's Benito Juárez facility, the refiner obtains a gross return equal to the difference between the selling price of the refined sugar and the cost of the sugar cane.[8] Deducting from this amount all milling, refining and other costs associated with the production, sale and delivery of the refined sugar yields the refiner's net margin.[9] With respect to standard sugar, in situations were the refiner and sugar cane growers are not vertically integrated, as was the case with GAM, the economics of producing sugar are similar to those described previously. The principal difference is that the processing costs are lower because standard sugar is less processed than refined sugar. In all three cases, the net margin for the production of the sugar is affected by fluctuations in sugar cane costs and, in particular, sugar prices.[10]

11. The risk associated with price fluctuations can be reduced for raw cane sugar and refined cane sugar sold in certain markets. Raw cane sugar is traded internationally under the New York Board of Trade (NYBOT) Sugar No. 11 (World) Futures Contract ("No.11 Contract").[11] In the U.S. market, raw cane sugar is traded under the NYBOT Sugar No. 14 (Domestic) Futures Contract ("No. 14 Contract").[12] Finally, refined sugar is traded internationally under the London International Financial Futures and Options Exchange (LIFFE) No. 5 White Sugar Futures Contract ("No. 5 Contract").[13] Futures exchanges enable market participants to comprehend precisely what the supply/demand position is for a sugar product at any particular time and, through the buying and selling of future contracts, reduce price volatility risk. [14] There is no futures exchange for standard sugar.

12. There is no futures exchange for sugar in Mexico. After the sugar mills were privatized, Mexico sought to create its own domestic futures exchange for sugar so that market participants could obtain precise information on pricing, supply and demand conditions and hedge against price fluctuations. In May 1993, the Fideicomiso para el Mercado de Azúcar ("FORMA") was created.[15] Unfortunately, this did not succeed. Market participants preferred the established way

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8 Internationally, many cane sugar refineries are stand-alone refineries unconnected to raw sugar mills. These refineries purchase raw cane sugar either on the domestic market (*e.g.*, the U.S. market) or on the world market (depending on whether the refiner is legally authorized to import the raw sugar for refining and sale in the particular national market in which it is situated) and process it into refined sugar. A "stand alone" refiner obtains a gross return equal to the difference between the selling price of the refined sugar and the cost of the raw cane sugar. Deducting from this amount all refining and other costs associated with the production, sale and delivery of refined sugar yields the refiner's net margin or profit. The refiner's net margin is affected by fluctuations in raw sugar costs and refined sugar prices. This was the common situation for U.S. cane sugar refiners during the relevant period.

9 This relationship is recognized by GAMI. See Statement of Claim, ¶ 27.

10 Unlike raw and refined sugar, standard sugar is not traded by means of a uniform contract (like Contract No. 11 or Contract No. 5) in the commodity market.

11 The NYBOT is the predecessor of the Coffee Sugar and Cocoa Exchange (CSCE) referred to in the Antonius Report (Exhibit C-3). The terms of the No. 11 Contract are set out in Exhibit R-3.

12 The terms of the No. 14 Contract are set out in Exhibit R-4.

13 The terms of the No. 5 Contract are set out in Exhibit R-5.

14 See *Sugar Futures and Options Trading*, Exhibit R-6.

15 FORMA stands for "Fideicomiso para el Mercado de Azúcar" and was created under the contract "Contrato de Fideicomiso No. 725-8" of 11 June, 1993 between sugar producing companies as trustors and the

of setting prices through daily commercial transactions without the assistance of a central market.[16]

13. The trade distortions, high risk and uncertainty characterizing the sugar industry world-wide is illustrated by fluctuations in world refined sugar prices (*i.e.,* No. 5 Contract prices). Over the period at issue in this case, there was a substantial downturn in the world market. No. 5 Contract prices, declined from an average of 17.41 cents/lb. in fiscal year 1996 to 9.10 cents/lb. in fiscal year 2000 and world raw sugar prices (the No. 11 Contract price) declined from 12.40 cents/lb. to 7.53 cents/lb.[17] The refiner's margin inherent in these figures dropped from 5.01 cents/lb. in fiscal 1996 to 1.57 cents/lb. in fiscal 2000.[18] In the first quarter of 2001, it dropped to 0.55 cents/lb.[19]

14. These declines in the world price of refined sugar are of more than academic interest to this case. They had a direct causal effect on the Mexican market. As GAM noted in its 1998 Form F-4 SEC filing:

> "[b]oth the world sugar price and tariffs for non-US sugar imports into Mexico are dollar-denominated. As a result, the Company believes that Mexican sugar prices subject to competitive pressures will generally tend to track the sum of the world price plus the Mexican import tariff".[20]

15. It was during this period that the Mexican sugar producers were seeking to export the surplus sugar from the domestic market. There were abundant and very cheap high quality whites in the world market.[21]

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development bank, "Banco Nacional de Comercio Interior S.N.C." (BNCI), as trustee. FORMA's main goal was to uncover and publish, through trustor's transctions, the market price of all types of traded sugar. FORMA's rules of operation: http://www.sagarpa.gob.mx/Forma/documentos/reglas.htm .

16 As the USDA noted in its report "*Sugar: Sugar Annual Report 1996*", 28 March 1996 (Exhibit R-7), "In March 1994, the Mexican Government initiated FORMA essentially due to a lack of experience with such a market. Now, alter price liberalization, FORMA is in a much better position to service as a price discovery mechanism for the industry." One year later, the USDA reported further in "*Sugar: Mexican Sugar Production / Export Forecast Up*", 30 January 1997 (Exhibit R-8): "FORMA was to register the amount of sugar produced, sold and its quality. It was also entended as a first step towards the creation of a futures market. However, these expectations have yet to be realizad. FORMA currently operates as a sugar exchange for Esther immediate delivery or 6-month deferred delivery. FORMA also reports on sugar market conditions and helps the milling/refining industry get access to U.S. bank credit through FORMA-backed sugar deposit certificates. These actions have been significant in stabilizing market prices, although some mills still do not participate." Finally, in its report No. MX8113 dated 30 September, 1998 "*Mexican Sugar Exports Increased for MY1997/98*" under the heading "Policy" (p.4), the USDA stated "As reported in MX7017, the Mexican government opened a Sugar Market Commission (FORMA) in March 1994. The main objective of FORMA was to create a stable marketplace for all domestic sugar transactions. This intitution, however, could not fulfill the expectations and currently only reports on sugar market conditions, production, sales, and quality". Exhibit R-8

17 S&SSO Yearbook, p. 42, Tables 2 and 3. Exhibit R-2

18 *Ibid.*

19 *Ibid.*

20 SEC Form F-4 Registration Statement Filed by GAM, 26 March 1998, p. 54. Exhibit R-9

21 The USDA reported in *"Sugar: Mexico to Export Sugar Again in MY 1999"*, 10 April 1999, that: "The sugar export forecast for Mexico in MY 1999 is 900,000 MT which is almost 6 percent lower than in MY

2. Mexico

a. The Profile of the Sugar Cane Growing and Milling Industry in Mexico

16. The Mexican sugarcane agricultural territoryis comprised of relatively small parcels of land compared to international standards.[22] Parcels of less than 8 hectares represented approximately 66% of total harvested area for harvest year 2001/2002 (in 1970 they represented 50% of total harvested area). Cane growers with that amount of land accounted for 91% of the total number of cane growers. This situation does not allow for an efficient use of resources, cost reduction, and results in *cañeros* pressuring mills ito pay higher prices for sugarcane. [23]

17. Sugarcane growers are grouped in two nation-wide unions: one associated with the National Confederation of Agricultural Workers (the UNPCA-CNC), which represents 60% of sugrcane growers and accounts for 52% of the total harvested area, and the second, associated with the National Confederation of Rural Property Owners (UNC-CNPR), which represents 35% of sugarcane growers and 41.5% of the total harvested area. There are a small number of independent sugarcane producers that are not part of either union. [24]

18. The milling sector spans 15 of Mexico's 32 states and it is a key component of economic and social development in many rural areas of the country. The milling sector is also fragemented compared to international standards. It is characterized by a relatively large number of small and medium size mills. Thirty-eight mills have a milling capacity between 4,000 and 8,000 tonnes; sixteen between 8,000 and 12,000 tonnes and only three have a milling capacity over 12,000 tonnes. [25]

19. There is a mutually dependant relationship between sugar mills and cane growers; the mill requires a feed of sugar cane from nearby producers and, due to the rapid degradation of the

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1998. This outlook, however, is tempered by the final results of actual sugar production and substitution by alternative domestic and imported sweeteners. It is important to note that domestic prices for sugar are higher than international prices. Therefore, the sugar industry considers exports a double-edged sword – they are necessary to reduce storage costs, but unprofitable due to low international prices. Also, the Mexican industry agreed on exporting excess sugar on a per mill quota basis in order to prevent downturns in domestic sugar prices. Domestic sugar is priced between US$400 to US$500 MT, while it is exported at approximately US$300 MT. Sugar exports under the U.S. quota for MY 1999 will be approximately 27,000 MT, including both raw and refined sugar. The Mexican sugar industry, however, keeps pressing the Mexican government for more access to the U.S. market, equivalent to a relatively free access to the Mexican market for HFCS (prior to the imposition of antidumping duties). The sugar industry claims there is danger of having to close 15 to 20 mills, resulting in layoff of about 100,000 workers, due to the high levels of imported HFCS, higher levels of sugar production and a flat sugar consumption. According to the industry, there are approximately 149,000 sugar cane growers, 32,000 blue collar workers and 5,500 employees.". Exhibit R-10.

22 Sparks Companies, Inc., "Tomorrow's North American Sweetener Industry: Prospects and Challenges", October 1998, p. 122. Exhibit R-11

23 Expert Report of Luis Ramiro García, p. 17-18. Exhibit R-12.

24 Id, p. 16.

25 *Tomorrow's North American Sweetner Industry: Prospects and Challenges*, October 1998, p. 126. Exhibit R-11

cane's sucrose content after harvesting, growers must sell to nearby mills. Sugarcane itself cannot be traded across long distances because of sucrose loss. It must first be milled into "raw sugar" before it can be traded. Each mill owned by GAM purchased its main feedstock, sugarcane, from several sugarcane growers located in the vicinity of its mills. Such growers represented each mill's sole source of supply of sugarcane.

20. Sugarcane production in Mexico occurs under diverse geographical conditions and other factors that affect the profitability of the crop. Sugarcane is harvested in Mexico in areas of heavy rainfall. Only 44% of the total harvested area receives sufficient rainfall during the year to support the crop; 60% does not have the necessary irrigation systems; and, for the small proportion that has an irrigation system, they are usually insufficient. In contrast, the tropical area in Mexico encounters a problem of excess water supply, which causes the sucrose content of the sugarcane to diminish unless there is adequate drainage. [26]

21. Each region in Mexico has its own conditions regarding soil quality, temperature, water availability and agricultural practices that determine the profitability of sugarcane. The sugar mill's sugar extraction efficiency depends on the quality of the input (sugarcane) and the operating conditions of the equipment and machinery used. All these factors affect production costs.[27]

b. The Evolution of the Industry

22. Due to its importance as a staple source of calories (and a critically important source of daily nutritional intake of the population of a developing country), Mexican sugar prices were set by government decree for many years. In addition, the sugar industry was state-owned.

23. In 1989, the Government of Mexico began to privatize the industry. In 1992, during the NAFTA negotiations, Mexico and the United States agreed to move towards a common sweetner market by establishing a common external tariff and removing all tariffs and other barriers to bilateral trade.

24. Leading up to NAFTA's implementation on 1 January 1994, Mexico had been a net sugar importer and had consistently run a deficit in sugar trade. According to the bargain struck between the United States and Mexico with respect to trade in sweeteners (primarily sugar and high fructose corn syrup[28]), the United States agreed to gradually reduce its tariffs and quotas on imports of Mexican sugar and by 2008 trade in sugar would be unrestricted. During the transition period of six marketing years (October through September), Mexico had a minimum quota of 7,258 tonnes per year. Starting on the seventh marketing year, the United States would grant a quota of up to 150,000 tonnes. The quota for the next years would increase the limit of the previous year by 110 percent, and would be eliminated by 2008. If Mexico became a surplus producer for two consecutive years, it could increase its quota to 25,000 metric tonnes during the first six years and could export the total amount of its surplus starting on the seventh marketing

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26 Expert Report of Luis Ramiro Garcia, p. 17-19.

27 Id., p. 20.

28 HFCS is a subsitute for sugar in various industries.

year. Mexico would adopt the same tariff as the United States no later than the sixth marketing year.[29] Starting in 2008, the Mexican and U.S. sweetener markets would be fully integrated.

25. The privatization of Mexico's state-owned sugar mills had already started by 1991, just as the NAFTA negotiations began. It was widely anticipated that, as a result of privatization, Mexico would gradually increase its production levels, eventually generating surpluses that could be sold in export markets, including the U.S. market. It was also anticipated that, with the gradual elimination of tariffs (over a 10-year period starting with NAFTA's entry into force), U.S. HFCS would gradually increase its access to the Mexican market, —the U.S. industry was producing surpluses for many years-- which would contribute to the generation of sugar surpluses in Mexico.[30] Those surpluses could then be displaced to the U.S. market as the liberalization process moved forward.

26. The United States has historically regulated sugar production in such a way as to guarantee substantial returns to sugarcane growers and sugar beet processors (although not to sugarcane refiners). For ten years leading up to NAFTA's implementation, the U.S. support price was on average 1.5 to 2.5 times the prevailing world price for raw sugar and the refined price was correspondingly higher.[31] Under the regime established by the NAFTA, it was anticipated that prices of sugar in Mexico and the U.S. would converge. The Mexican industry considered the possibility of exporting to the US market as a great benefit under the NAFTA.

27. A number of factors led to the emergence of a sugar surplus in Mexico. First, the privatization of the mills led to new investment in their physical plant and consequent improvements in productivity.[32] Second, encouraged by new mill owners, the *cañeros* themselves sought to increase their own productivity and also increased the number of hectares cultivated.[33] Third, the growing access of HFCS to the domestic market started to displace sugar.[34] Fourth, there was a general expectation in the Mexican industry that it would be able to export the surpluses to the U.S. market.[35]

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29 Annex 703.2 of the NAFTA. Exhibit C-1.

30 Due to the distortions in the sugar markets, the price of HFCS was significantly lower than sugar both in the U.S. market and Mexican market.

31 S&SSO Yearbook, pp.42-43, Tables 3 and 4. Exhibit R-2.

32 The USDA noted in 1996 that the industry was increasing its output due to better harvesting and post-harvest technology as well as higher factory yields. See USDA, "Mexican Sugar Output Forecast to Decrease", September 17, 1996. Exhibit R-13.

33 The USDA noted in its report entitled "Mexican Sugar Exports to Increase", April 10, 1998, p. 3, that the cañeros had been making technical improvements. Sugarcane yields per hectare increased from an average of 68MT/ha in 1990 to about 72 MT/ha in 1997 due to technical improvements. Exhibit R-14.

34 The U.S. HFCS industry has, to use the USDA's words, "been plagued with excess capacity" and the Mexican market was seen as an attractive nearby market in which to export excess production. See USDA Economic Research Service, *Agricultural Outlook*, September 1999, p. 18. Exhibit R-15. The USDA noted that although HFCS sales in the United States increased by 13% in the 1994-1997 period, the increase was not large enough to absorb the production surplus. "As a result, the sector faced tough adjustments, with some smaller operations leaving the business and others selling to or attracting investors from among larger companies."

35 After the NAFTA was signed, but prior to its implementation, Mexico and the United States discussed a request made by the sugar industries of both countries regarding the way in which HFCS was to be

28. In a very short period of time, Mexico moved from being a deficit to a surplus producer.[36] Mexico has generated a surplus of sugar every year since 1995. In 1999, after analyzing the Mexico-U.S. sweetener trade dispute, (of which more will be said below), the United States Department of Agriculture (USDA) commented:

> Behind the Mexican sugar industry's interest in this dispute is the remarkable rebound in Mexican sugar production since implementation of NAFTA. As recently as the November-October marketing year 1994, Mexico produced only 3.8 million MTRV (metric tons, raw value) of sugar. By marketing-year 1998, Mexico produced a record of nearly 5.5 million. Although USDA forecasts a decrease to 5.04 million for marketing-year 1999, the year's production would still be the second highest on record.[37]

29. Contrary to the impression given in the Statement of Claim, in the latter half of the 1990's, the price of sugar in Mexico increased (in peso terms but declined in dollar terms due to downward pressure on the exchange rate after the 1995 Mexican financial crisis). Indeed, at one point, Mexican sugar commanded a higher price than sugar in the U.S. market, which itself was experiencing a severe crisis in the late 1990s.[38] Nevertheless, Mexican producers were concerned because sugar surpluses were putting downward pressure on the domestic price and during that period only a small amount (25,000 tonnes) could be exported to the U.S. market. The alternative was to sell in the world market at significantly lower prices.

30. The sugar milling companies, already heavily indebted from acquiring the mills from the federal government, had huge debt servicing problems due to very high interest rates resulting from the 1995 Mexican financial crisis.[39]

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incorporated in the calculation of the net production surplus (to determine if Mexico was a net surplus producer in accordance with the Treaty and to calculate the size of the exportable surplus). The two countries did not reach an agreement and each country's understanding of the agreement differed. However, the United States used the formula it had proposed. Their understanding also implied imposing a limit on the Mexican sugar surplus exported into the United States during the transition period, which is a breach of the Treaty. Mexico agreed to take HFCS into account for the calculation of the net sugar production surplus, but applied a different formula. However, Mexico did not agree to allow restrictions to access to the U.S. market granted by the NAFTA. In March 1998, anticipating that the United States would maintain its position and prevent Mexico from exporting the total amount of its surplus, Mexico initiated, proceedings to resolve the dispute under Chapter Twenty of the NAFTA by requesting a consultation with the United States in accordance with Article 2006. In August 2000, when the United States effectively restricted access to its market for Mexico's sugar, Mexico requested the establishment of an arbitral panel. However, the United States opposed the establishment of a panel, effectively depriving Mexico of the opportunity to resolve the dispute under the NAFTA

36 From 1985 to 1988, Mexico had a sugar surplus; subsequently from 1989 to 1994 there was a deficit and then it returned to a surplus from 1995 until 2002. See "Resumen Anualizado de Balance Azucarero de México", *Evolución histórica por año calendario of the CAA.* Exhibit R-17.

37 *Agricultural Outlook*, September 1999, p. 17. Exhibit R-15

38 During the late 1990s, Mexican prices increased, coming closer to matching the U.S. price and the U.S. price declined, approximating the Mexican price. This occurred together with a precipitous drop in world sugar prices. See S&SSO *Yearbook,* p. 11. Exhibit R-2.

39 The financial crisis struck in December 1994. By August 1995, interest rates in Mexico ranged between 50 and 80%. This led the federal government to implement debt-relief to permit the sugar industry to restructure its debts.

31. GAM was one of ten "*grupos*" that, together with fourteen independent mills, collectively owned sixty two Mexican sugar mills. Like every other company, GAM contributed to and was affected by the rapid changes in the Mexican sugar market, including the generation of the surplus. As shall be seen, many factors, most of which are not attributable to the Mexican State, combined to create the surplus. The federal government took a series of actions to alleviate the situation affecting the sector:

- With the consensus of the industry and *cañeros*, it facilitiated the 1997 and 1998 *acuerdos* which required the exporting of surpluses to the world market and encouraged production limits.

- It provided refinancing to companies operating under the heavy debt load incurred in the privatization process, a load that increased due to the financial crisis.[40]

- It paid the storage costs of taking 600,000 MT of sugar off the domestic market in order to reduce the surplus.[41]

- It requested consultations with the United States and the establishment of an arbitral panel with a view to resolving the disagreement between the Parties as to the terms of Mexico's negotiated access to the U.S. market.[42]

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[40] The USDA report entitled: "Sugar: Mexico to Export Sugar Again in MY 1999", dated 10 April 1998, p. 3 noted: "*The principal factor affecting the industry's ability to improve efficiency continues to be financial problems, and the non-availability of credit. In fact, in November 1998 the government and FINAZA (Mexican Sugar Financing Institution) initiated a plan to restructure most sugar mills' debt which has increased to approximately US$2.0 billion… The industry insists that the debt growth and the inability to repay is due to a decrease in domestic sugar consumption and low international sugar prices compared to domestic production and low international sugar prices compared to domestic production costs, all of which contributed to the industry's petition for antidumping protection against imports of U.S. high fructose corn syrup (HFCS).*" Exhibit R-10.

[41] The USDA report entitled "*Mexican Sugar Exports to Increase*", 10 April 1998, p. 10, noted that: "*The industry agreed to hold approximately 600,000 metric tonnes of sugar off the market during MY 1997/98, 1998/99 and 1999/2000 to prevent a downturn in prices. The government will finance storage costs*." Exhibit R-14.

[42] On 13 March, 1998, Mexico requested consultations with the United States in accordance with Article 2006. On 15 April, 1998, consultations took place but did not reach an agreement regarding the dispute. On 13 November, 1998, Mexico requested a meeting of the Free Trade Commission (comprised of the Foreign Trade Ministers of the NAFTA Parties) in accordance with Article 2008. After exchanging their views and negotiating without reaching a solution, on 3 November 1999, Mexico requested a meeting of the Free Trade Commission. The Commission met on 17 November, 1999 in Washington D.C. On 17 August, 2000, Mexico formally requested the establishment of an arbitral panel in accordance with Article 2008. On 17 October of the same year, Mexico sent a communiqué to the United States suggesting a candidate preside over the panel. The United States rejected Mexico's proposal and stated that it would put forward a candidate of its own. During the following months, the United States stated that it required more time to finalize its proposed candidate. No candidate was ever proposed by the United States. Subsequently, Mexico attempted to compel the NAFTA Secretariat to designate the panelists. However, the United States opposed this (unlike the WTO dispute settlement mechanism, there are no independent arbitrators without both parties' cooperation). The United States officially lists this case as pending. See Exhibit R-18.

32. It is important to note that well before GAMI acquired its shares in GAM in 1996, the Mexican sugar market had encountered problems. A USDA annual report on Mexico ("Annual Report of 1996"), listed a number of problems:

- Mexico was already in surplus (for MY 1995/96 production was estimated to be 4.68 MMT, while domestic consumption was constrained due to the economic recession and estimated to be 4.38 MMT);[43]

- Financial conditions of sugar mills had deteriorated with the 1994 peso devaluation and resulting economic crisis, which produced higher interest, rates, greater debt burden and higher import costs.[44] This had already led the government to implement debt-relief to restructure overdue loans and would lead it to liberalize sugar prices to generate higher returns for the industry;[45]

- Even with debt restructuring, the sugar industry, was unable to pay the new lower interest rates on loans and, as a result, requested more flexible repayment terms;[46]

- Since the peso devaluation, commercial banks had largely discontinued credits for growers due to existing debt burdens;[47]

- Consumption was growing at a very slow rate due to the deterioration of consumer purchasing power;[48] and

- Some industrial consumers were beginning to test HFCS as a sugar substitute.[49]

3. The United States

33. Even in the highly regulated U.S. sugar market, there have been bankruptcies of major sugar companies and many exits in refining and beet processing capacity. In the period 1996-2001, *seventeen* sugar beet and sugarcane processing mills either closed or announced their closure in United States.[50] By 2001, other mills were threatening closure and the nation's largest seller of refined sugar was in bankruptcy due to the disarray in the U.S. sugar market.[51]

34. The United States Department of Agriculture regulates the U.S. sugar market. The U.S. Sugar Program was designed to provide a high support price to growers of sugarcane and sugar

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To this date, Mexico and the United States continue to negotiate intermittently without yet resolving the dispute.

43 *Sugar: Sugar Annual Report 1996*, 28 March 1996, p. 2. Exhibit R-7

44 Id., p.3.

45 Ibid.

46 Id., p.4.

47 Ibid.

48 Id., p.5.

49 Id., p. 12.

50 Roney Testimony, p. 2. Exhibit R-1

51 Ibid.

beets. The price-supporting policy mechanisms consist of: (i) the price support "non-recourse" loan program; and (ii) the restrictive tariff rate quotas (TRQ's) import control system.[52]

35. A loan program for sugar processors administered by the USDA's Commodity Credit Corporation (CCC) supports the U.S. price for sugar. Although aimed at supporting prices for growers (*i.e*., producers), sugar loans are made to refiners/processors and not directly to growers. This is because sugarcane and sugar beets, being bulky and very perishable, must be processed into raw or refined sugar before they can be traded and stored. To qualify for loans, processors must agree to provide a part of the loan payment to the producers in proportion to the amount of the loan value accounted for by the sugar beets and sugarcane that the growers deliver.[53] In 1995, it was observed that this payment to sugarcane growers in the U.S. State of Louisiana amounted to 60% of the U.S. raw cane sugar price.[54]

36. Historically, the USDA has sought to maintain a balanced sugar market. However, since it is the U.S. producers, and not USDA, who determine production levels, the market balance could not be maintained in the latter part of the 1990s.[55] The USDA's control over the size of the surplus was limited to its ability to reduce imports of raw cane sugar into the United States market. However, such reductions could not go below the minimum access levels mandated by U.S. commitments under the WTO and other international trade agreements.[56] By 2000, record U.S. sugar production pushed inventories to very high levels.[57]

37. The U.S. loan program is non-recourse; that is, the growers pledge their crops as collateral for the loans and, other than paying a small financial penalty if they forfeit in repaying the loan, they can walk away from their collateral and the U.S. government has no recourse against them. Thus, if the price of refined sugar declines, producers may find it more profitable to forfeit their crops and take the loan proceeds rather than the sum that the processors can afford to pay them. Although Congress instructed the USDA to administer the Sugar Program to avoid

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52 See USDA *Economic Research Service*, *Farm Commodity Policy: 1996-2001 Program Provisions*, http:/ /www.ers.usda.gov/Briefing/FarmPolicy/1996sugar.htm .Exhibit R-17.

53 Ibid.

54 See Expert Report of Luis Ramiro Garcia. In order to compare this percentage to the 54 percent of standard sugar price paid to Mexican sugarcane growers in 1995, it is necessary to convert the U.S. raw sugar price into a standard sugar "equivalent". This can be done by using the 6 percent adjustment to the raw sugar price used in the reference price formula in the 1997 *Acuerdo*. Using this conversion, 60 percent of the raw sugar price equates to 57 percent of the standard sugar price. Accordingly, the proportion of the selling price shared with growers in the United States compared to Mexico was higher in 1995 and, subsequent to December 1996, was the same. As also noted in the report, sugarcane growers in other countries receive a significantly greater share of the selling price. Exhibit R-12

55 Roney Testimony. Exhibit R-1.

56 The purpose of the United State's quota is to restrict imported sugar supply in order to maintain the base price. However, the United States cannot block all sugar imports: in addition to its obligations under NAFTA, the United States muest allow raw sugar imports of 1,117,195 tons and refined sugar imports of 22,00 tons in accordance with the WTO. List XX –United States of America, Chapter 17 (*Sugars and Sugar Confectionary*), item 2 and tariff 1701.11. Exhibit R-21.

57 USDA, *Sugar and Sweeteners – Summary*, 20 January 2000, 18 May 2000 and 21 September 2000. Exhibit R-20.

forfeitures, this turned out to be impossible to do.[58] In 2000, there were significant forfeitures due to a substantial drop in refined sugar market prices.[59]

38. Refined sugar prices in the United States began to drop in 1996 and then plunged in mid-1999. A U.S. surplus in 1999 caused U.S. prices to decline in 2000 to levels not seen in more than a decade and a half.[60]

39. The U.S. Sugar Program's diminishing effectiveness in protecting sugar producers during the 1997-2001 period was summed up in testimony of Mr. Jack Roney, a representative of the American Sugar Alliance (a growers and producers group), to the United States' Senate Committee on Agriculture in July, 2001. His testimony reads, in part:

> American sugar producers face economic, domestic policy and trade policy crises that profoundly threaten their existence.
>
> Producer prices for sugar began falling in 1997 and 1998 and plummeted in 1999 and 2000. American sugar producers, both beet and cane, have been facing sugar price at or near 22-year lows for most of the past two years. Raw cane and refined beet sugar producers' lost income on the 1996 through 2000 crops, relative to 1995-crop prices, has been ruinous and will likely total more than $2.2 billion...
>
> Since 1996, 17 beet and cane processing mills have closed or announced their closure… Other mills threaten closure. The nation's largest seller of refined sugar is in bankruptcy. Both this company and the nation's second biggest seller are attempting to sell their beet processing and cane refining operations, but are hard pressed to find buyers or complete sales because of the financial uncertainty. Buyers of last resort have tended to be the growers themselves, desperate to find a way to stay in business. Failure to sell these operations could lead to additional mill closures.
>
> Last year, for the first time in nearly two decades, sugar producers forfeited a significant quantity of sugar to the government… Wholesale refined sugar prices remain well below forfeiture levels… raw cane prices are barely above the forfeiture range…[61]

40. Thus, even in the protected U.S. market, sugar producers faced substantial trade distortions, risks and uncertainties. These are recognized risks in the sugar business.

41. The substantial fluctuations in U.S. raw cane sugar and refined sugar prices over the same period warrant notice. Both dropped substantially between 1996 and 2000, and particularly in mid-1999. The price of No. 14 Contract raw sugar fell from an average of 22.56 cents/lb. in July

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58 Roney Testimony, p. 2 (Exhibit R-1) and *Sugar and Sweeteners – Summary* (Exhibit R-83).

59 For the first time in two decades, in 2000, sugar producers forfeited a significant quantity to the U.S. government. Cane and beet sugar 1999 crop forfeitures totaled 949,080 tons raw value. According to one U.S. sugar industry representative, the 793,000 tons of sugar that the U.S. government possessed absorbed a large amount of producers' storage capacity and was overhanging the market in 2001 with a price-depressing effect. Wholesale refined sugar prices remained well below forfeiture levels and raw cane prices were barely above the forfeiture range. Testimony of Jack Roney at p. 2. Exhibit R-1.

60 S&SSO Yearbook, p. 43. Exhibit R-2.

61 Roney Testimony, pp. 1-2. Exhibit R-1.

1999 to 17.24 cents/lb. in February 2000 --a 24% decrease. Prices rebounded to the mid-19 cent range in mid-June 1999 and then plunged to 17-18 cents by mid-July, even though USDA intervened in the market to purchase 132,000 tons of refined sugar.[62] More importantly, the refiner's margin dropped almost by half, from approximately 6.34 cents/lb. to 3.50 cents/lb.[63] In the first quarter of 2001, the refiners' margin dropped to 1.5 cents/lb.[64]

42. This substantial reduction in refining margins and disarray in the U.S. market led to the concerns expressed by Mr. Roney. His evidence before the Senate Committee indicated that for brief periods in 2000 and 2001, refined beet sugar prices dropped below raw cane sugar prices. In such circumstances, the U.S. refiners' margins would be negative.

43. The downturn in U.S. refined sugar prices in 1996-2001 led the U.S. industry to increase their pressure on the Clinton Administration to resist Mexico's efforts to clarify its NAFTA market access rights. A typical statement was that of Mr. Roney made in July 2001:

> The U.S. is abiding by its NAFTA sugar commitments. However, the U.S. sugar market is oversupplied, financially depressed, and does not need an additional pound of Mexican sugar. Furthermore, the Mexican sugar surplus that it seeks to unload on the U.S. market is the result of Mexican government subsidies so generous that, since the NAFTA began, production has increased far in excess of Mexican needs.
>
> …
>
> *Unless the Mexican access problems are resolved, no long-term sugar policy that we propose here today could possibly be effective*.[65] [Emphasis in original.]

44. Mexico considers that while the sentiments and conclusions set forth in this statement are wholly incorrect, it nevertheless reveals the very strong opposition within the U.S. sugar industry to the liberalization of the sugar market agreed to by the United States and Mexico. This opposition predated NAFTA's entry into force and has persisted to the present day.

4. Canada

45. Due to its northern climate, Canada does not produce sugarcane. Although there is a sugar beet industry in western Canada, approximately 85 percent of its refined sugar is produced by sugar refineries that import raw sugar from the world market. As a result of the small size of its sugar beet processing industry, Canada does not have a support program for sugar beet growers. During the relevant period, there were three sugar producers in Canada. Only one of the producers, B.C. Sugar and its successor, had production facilities in Western Canada.[66]

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62 USDA Economic Research Service, *Agricultural Outlook*, September 2000, at p. 8-9. Exhibit R-22.

63 Ibid. These figures were calculated by deducting the average raw sugar prices from the average wholesale refined beet sugar prices for fiscal years 1996 and 2000.

64 Ibid.

65 Roney Testimony, p. 15. Exhibit R-1.

66 *The Dumping in Canada of Refined Sugar Originating in or Exported from the United States of America, Denmark, The Federal Republic of Germany, The Netherlands, The United Kingdom and The Republic of Korea, and the Subsidizing of Refined Sugar Originating in or Exported from the European Union*, CITT

46. Canada maintains an MFN rate of duty on imports of refined sugar of CDN $30.86 per metric tonne. This duty applies to imports of refined sugar from Mexico. The duty on imports of refined sugar from the United States was eliminated under the *Canada-United States Free Trade Agreement*.

47. In the early stages of the decline in the U.S. and world markets in 1995, imports of U.S. and EU sugar began to enter the Canadian market at significant discounts as American and European producers sought to dispose of their surpluses in Canada. Upon the complaint of its domestic sugar refining industry, Canada initiated a trade remedy action against imports of U.S. and European sugar. The investigation found substantial margins of dumping with respect to imports from United States and EU and substantial subsidization of EU exports.[67] Significant import duties were thus imposed in order to protect the Canadian sugar industry.[68]

48. Due to the continued existence of these distortions –and further market deterioration in the United States in 1995-- in 2000 Canada extended its protective duties for an additionalfive-year period.[69]

5. Conclusions

49. GAMI invested in a sector characterized by trade distortions, high risk and uncertainty:

- it invested in a new company involved in the production of an agricultural product that was subject to the inherent risks associated with all agricultural products;
- it invested in a particularly difficult agricultural sector in which there is high price volatility;
- the sector in question had been recently privatized, price supports had been removed, and there was no futures exchange to provide precise information on pricing, supply and demand conditions, further increasing the risk;
- there was no ability for GAM to hedge against price fluctuations by buying and selling future contracts; and
- GAM, like other Mexican sugar companies, incurred heavy debt to acquire the mills. Debt servicing required substantial cash flow, which was difficult to generate in a commodity market in a country experiencing a financial crisis.

Inquiry No. NQ-95-002, Finding issued 6 November 1995 ("CITT Refined Sugar Injury Finding"), p. 6. Exhibit R-23.

67 The EU provides extremely high export subsidies in order to maintain market equilibrium; they can amount as high as US 20 cents/lb., sometimes higher than the price of a pound of sugar on the world market.

68 CITT Refined Sugar Injury Finding, Exhibit R-23.

69 *The Dumping in Canada of Refined Sugar Originating in or Exported from the United States of America, Denmark, The Federal* Republic *of Germany, The Netherlands, The United Kingdom and The Republic of Korea, and the Subsidizing of Refined Sugar Originating in or Exported from the European Union*, CITT Review No. RR-99-006, Order issued 3 November 2000. Exhibit R-24.

50. As noted above at paragraph 32, these risks were reported by the USDA's Foreign Agricultural Service before GAMI invested in GAM. The risks and uncertainties that arose in Mexico's domestic market when it began experiencing surpluses were not exclusive to it. Also affected were sugar industries in protected markets like the United States and other countries exposed to the world market such as Canada.

51. By 2000, the situation in Mexico was serious. The nation's sugar mills had a combined indebtedness of $2 billion U.S. Many mills, including GAM's, could not pay their growers or other creditors. The growers, in turn, could not finance the planting of next year's crops.[70]

52. In May 2001, the USDA, who publishes the most complete analysis of the US and world sugar markets, commented on the Mexican situation and its own projections for "insignificant growth" in the Mexican market in 2001:

> …these projections indicate insignificant growth and are premised on the sugar industry's continuing financial crisis (accumulated debt load of an estimated $1.5 billion), low world sugar prices, and limits on exports into the U.S. market.[71]

53. To read the Statement of Claim's rhetoric ("deplorable and unlawful" implementation of the laws, a "bloated, rather than market-determined" price for sugarcane, *etc*.), it would appear that Mexico is the only State to ever encounter a sugar surplus and that simple changes in policy and administration would have cured the problem. This was clearly not the case. The existence of a sugar surplus was a private, rather than a public problem as noted by Juan Gallardo, who was GAM's General Director and Chairman of the Board at that time.[72]

54. With this proper factual context in place, Mexico will now respond to the specific factual allegations made in the Statement of Claim.

B. Response To Factual Allegations Of The Claimant

55. As noted at the outset, Mexico has reproduced the relevant paragraphs from the Statement of Claim verbatim (excluding footnotes) and provides its response immediately after each (some paragraphs are not reproduced because they do not relate to facts, and therefore cannot be accepted or denied). The Respondent follows the order and structure of the Statement of Claim. For ease of reference, it will reproduce in this section the sub-titles of the corresponding sections of the Statement of Claim.

1. Summary

Statement of Claim, paragraph 17

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70 In accordance with Article 12(b) of the Sugarcane Decree, the most significant payment to be made by the mills to the sugarcane growers is the pre-prayment made prior to the harvest, which is equivalent to 80% of the net sugarcane received by the mill. However, at the beginning of the harvest season, the mills have not yet received income derived from sales of sugar.

71 S&SSO Yearbook, p. 9. Exhibit R-2

72 Interview with Juan Gallardo, Newspaper Article from *El Financiero*, 29 May, 2000. Exhibit R-25.

Statement of Claim	**Admissions & Denials**
The core facts underlying GAMI's claim can be summarized as follows. GAMI owns shares in GAM, a company whose productive assets consisted of five sugar mills, which Mexico expropriated without compensation on 3 September 2001. At the same time, Mexico expropriated 22 other sugar mills, while leaving 34 sugar mills in private hands. Prior to the formal seizure of the mills, Mexico's conduct in the implementation – and non-implementation – of its sugar laws had significantly damaged GAMI's investment.	Second sentence admitted, except for the phrase "expropriated without compensation". Third sentence admitted. Last sentence denied.

Response:

56. It is false that Mexico has expropriated sugar mills without compensation. The Expropriation Decree (Decreto por el que se expropian por causa de utilidad pública, a favor de la Nación, las acciones, los cupones y/o los títulos representativos del capital o partes sociales de las empresas que adelante se enlistan) expressly states:

> The corresponding indemnity payment for the expropriated goods will be paid by SAGARPA, in accordance with Article 27 of the Constitution, the Expropriation Law and other applicable regulations, once the stock coupons and/or equity titles are submitted. [73]

The Sugarcane Decree adds:

> The Federal Government, through the Commission for the Valuation of National Assets (CABIN), will determine the compensation payment to those who have a legitimate claim in accordance with the law.[74]

57. The Federal Law states:

> The price to be set as an indemnity for the expropriated property will equal the commercial value…[75]

58. Notwithstanding the clear and precise language of the law and the Expropriation Decree, GAM has chosen not to proceed with its claim for indemnity, but to challenge the legality of the expropriation through an *amparo* proceeding in an attempt to overturn the expropriation of 3 of its mills (GAM desisted from the amparos concerning the other 2 mills, but has not yet claimed the indemnity payment).

59. GAM cannot, at the same time, make an indemnity claim and impugn the Expropriation Decree by means of an *amparo*, because it faces an important legal restriction. In accordance with the Amparo Law, the *amparo* proceeding is inadmissible, and therefore, the claim must be

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73 Expropriation Decree, Article 3. Exhibit C-15.

74 Ibid.

75 Federal Expropriation Law, Article 10. Exhibit C-34.

rejected when the act, which is the basis of the claim –in this case the Expropriation Decree—has been accepted by the claimant. The challenge of the expropiatory act necessarily entails the right to receive compensation. In other words, to request the payment for compensation implies the consent to the expropriatory act. GAM chose to request an *amparo* proceeding.[76]

2. History Of GAM And GAMI's Investment In GAM

Statement of Claim, paragraph 19

Statement of Claim	**Admissions & Denials**
GAM is a Mexican corporation. Mr. Juan Gallardo, a Mexican citizen, directly or indirectly owns or controls approximately 65 percent of the company's stock. Mr. Juan Cortina currently serves as GAM's Chairman and Chief Executive Officer.	Admitted.

Statement of Claim, paragraph 20

Statement of Claim	**Admissions & Denials**
Prior to the expropriation, GAM's assets consisted almost entirely of five Mexican sugar mills wholly owned as incorporated subsidiaries of GAM: *Subsidiary* *Location of Mill* *Ingenio Presidente Benito Juárez, S.A. de C.V. ("Benito Juárez")* *Cárdenas, Tabasco* *Ingenio José María Martínez, S.A. de C.V. ("Tala")* *Tala, Jalisco* *Ingenio Lázaro Cárdenas, S.A. de C.V. ("Lázaro Cárdenas")* *Lázaro Cárdenas, Michoacán* *Ingenio San Francisco el Naranjal, S.A. de C.V. ("San Francisco")* *Lerdo, Veracruz* *Compañía Industrial Azucarera San Pedro, S.A. de C.V. ("San Pedro")* *Lerdo, Veracruz*	Admitted.

[76] Amparo Law, Article 73(XI) and (XII). C-40.

Statement of Claim, paragraph 21

Statement of Claim	**Admissions & Denials**
The GAM group also included four subsidiaries, of which two were devoted to marketing activities. *Corporación Azucarera de Tala* ("Tala Trading"), was responsible for purchasing and reselling the sugar produced by GAM's mills. *Proveedora de Alimentos México, S.A. de C.V.* ("PAMSA") is a packaging company that prepared sugar for retail sale.	Admitted.

Statement of Claim, paragraph 22

Statement of Claim	**Admissions & Denials**
Prior to the expropriation, GAM was the fourth largest producer of sugar in Mexico, producing 433,833 metric tons of sugar during the 2000/2001 harvest, constituting approximately 8.81% of Mexico's total production for that harvest. GAM's principal activities were production of standard ("*azúcar estándar*") and refined sugar from sugarcane. Refined sugar ("*azúcar refinada*"), which is generally marketed to industrial consumers that require greater quality sugar, such as soft-drink bottlers, sells at a higher price than standard sugar ("*azúcar estándar*"), which is consumed by domestic households, and is the primary sugar consumed in Mexico.	Admitted.

Statement of Claim, paragraph 23

Statement of Claim	**Admissions & Denials**
In December 1996, GAMI acquired a minority position in GAM, pursuant to a private placement. The following year, in conjunction with GAM becoming a publicly traded company listed on the *Bolsa Mexicana de Valores* ("Mexican Stock Exchange"), GAM issued US$145 million in public debt in the United States to raise further capital and reduce its outstanding long-term Government debt. This was part of a strategy to position GAM as an internationally recognized, investment-grade	Admitted with the exception of the last sentence. The Respondent cannot confirm or deny GAM's strategy.

company.	

Statement of Claim, paragraph 24

Statement of Claim	Admissions & Denials
GAM has been a publicly held company since 1997 and has filed disclosures with the U.S. Securities and Exchange Commission ("SEC") since 1998. Outside auditors have reviewed and certified its books and records since its inception.	Admitted except for the last sentence. Mexico cannot confirm or deny GAM's auditors report.

3. The Mexican Sugar Industry

Statement of Claim, paragraph 25

Statement of Claim	Admissions & Denials
Sugar is the most important sweetener worldwide and its production has an important impact both socially and economically in Mexico. A variety of factors characterize the Mexican sugar economy, some due to the nature of the crop, some due to unique social, economic, and political features of the Mexican industry, and some due to the long history of economic regulation of sugar production by Mexico. The expert report of Andrés Antonius González, attached as Exhibit C-19, describes the economics of the Mexican sugar industry in substantial detail. We summarize salient points here.	First two sentences are admitted.

Response:

60. Regarding the characteristics of the sugar industry and the economic factors affecting this sector, see the Expert Report of Luis Ramiro García. (Exhibit R-12).

Statement of Claim, paragraph 26

Statement of Claim	Admissions & Denials
Sugarcane is a semi-perennial crop, requiring 12-18 months to mature from planting to first harvest, and then producing for a period of 4-8 years, after which the crop must be replanted. This makes sugarcane supply slow to react to price signals because farmers are reluctant to convert sugarcane fields to other crops early in the cycle. Because sugarcane loses its sucrose content quickly after cutting, it must be	Admitted.

processed within 24-48 hours of the harvest. As a result, it is impractical to ship sugarcane any significant distance for processing, and mills must be located in close geographical proximity to sugarcane fields. This creates a relationship of mutual dependence between mills and *cañeros*. C*añeros* must have a nearby mill or their sugarcane is worthless, and the mills must have nearby *cañeros* to supply them sufficient sugarcane. Efficient production requires a high degree of coordination between mill operators and *cañeros* to ensure that mills have a steady supply of sugarcane during the harvest season. The harvest season for sugar mills typically runs from November to June. Between July and October, the mills are then refurbished in anticipation of the following harvest.	

Statement of Claim, paragraph 27

Statement of Claim	**Admissions & Denials**
The principle (sic) variables affecting the profitability of sugar mills are the price they pay for sugarcane and the price they receive for the sugar they produce. The difference between the price a mill receives for the sugar it sells and the price it pays for sugarcane is called the refining margin, and the size of that margin, as compared to the processing costs the mill incurs, determines the ultimate profitability of a sugar mill.	Admitted in part.

Response:

61. The cost of sugarcane is the principal component of a mill's operating costs. Labor is also an important component of the operating costs. The low profitability of mills is a result of high production costs, due to problems in the efficiency of the sugar extraction process.[77]

Statement of Claim, paragraph 28

Statement of Claim	**Admissions & Denials**
A sugar mill involves high levels of sunk costs for investment in mills, which creates barriers to entry and exit from sugar milling. In Mexico, ownership of the sugarcane fields is highly fragmented by global standards, as sugarcane is grown on thousands of small,	Admitted.

[77] Expert Report of Luis Ramiro García, pp. 36-40. Exhibit R-12.

generally inefficient plots. This phenomenon results partly from the legacy of the 1910 Revolution and the former Article 27 of the Mexican Constitution, which barred corporate ownership or leasing of agricultural land. During the 1970s and 1980s, the Mexican Government directly and indirectly encouraged the fragmentation of the sugarcane fields into successively smaller and smaller plots, partially through the Government's land redistribution program, but primarily through the establishment of a series of Government health and welfare benefit programs for *cañeros*. Farmers could qualify for these programs simply by dedicating a portion of their land to sugarcane production. The *cañeros* have their own unions: (1) the *Unión Nacional de Cañeros* ("National Union of Sugarcane Growers") from the umbrella group *Confederación Nacional Campesina* ("National Farmers' Confederation") and (2) the *Unión Nacional de Productores de Caña de Azúcar* ("National Union of Sugarcane Producers") from the umbrella group *Confederación Nacional de Productores Rurales* ("National Confederation of Rural Producers").	

Response:

62. The *cañeros* are well organized in production unions and have nation-wide representation.[78] It is necessary for the sugar milling industry and the Government to work with them on a consensual basis. Tripartite mechanisms have been created in Mexico in order to reconcile the competing interests of the *cañeros* and the milling companies.

Statement of Claim, paragraph 29

Statement of Claim	**Admissions & Denials**
In much of the world, including Mexico, there is a high degree of Government involvement in the sugar market, both through international trade measures and programs to support the price for farmers and processors. The European Union, the United States, Mexico and many other countries use restrictive trade policies and other forms of governmental intervention to support prices well above "world" sugar prices. Over the last 30 years,	Admitted in part.

[78] See ¶ 17.

sugar has faced increasing competition from other sweeteners, notably high fructose corn syrup ("HFCS"), which has also been the subject of governmental restrictions, especially in trade.	

Response:

63. There is a very high degree of government involvement in sugar markets throughout the world. The first sentence refers to "a high degree of government involvement… to support the price for farmers and processors". The Government of Mexico denies that it has supported the price for processors. Rather, it has provided price support for upstream agricultural producers—*i.e.*, growers of sugar cane. These programs commonly cause adverse effects on the processors of those primary agricultural products.

Statement of Claim, paragraph 30

Statement of Claim	**Admissions & Denials**
Mexican mills can obtain the highest prices by selling in the protected domestic market or in the U.S. market, but the United States restricts the quantity of sugar that can be imported from all sources, with tariff rate quotas allocated by country, including an allocation for Mexican sugar. The Mexican market generally has prices that are much higher than world prices but not quite as high as those in the United States. World prices for a number of years have been well below U.S. and Mexican prices. Therefore, exporting to the world market is the least desirable outlet for Mexican mills.	Admitted.

Response:

64. The situation regarding Mexican sugar access to the United States market is discussed above.[79]

Statement of Claim, paragraph 31

Statement of Claim	**Admissions & Denials**
To maintain prices above world levels for sugar requires Government intervention; otherwise, low-price imports would decrease local prices to the world level. For countries that are net importers of sweeteners, such as the United States, the domestic price can wholly or largely be supported by using import restrictions to	First sentence admitted. Second and third sentences denied.

[79] See footnote 35.

decrease supply. However, for countries with higher production than demand, sustaining high prices requires not only import restrictions but also government intervention to reduce domestic supplies, either through production controls or mandatory exports.	

Response:

65. As discussed above, in countries like the United States, which are net importers of sugar, the restrictions on imports are not enough to maintain high prices. The recent history of the U.S. sugar market confirms that prices dropped at the end of the 1990s, notwithstanding the restrictions that the government maintained on imports. Many companies went bankrupt or were acquired by larger companies.[80]

66. Mexico denies the implication that the government intervened to reduce the surplus by means of a production ceiling or export quotas. As will be explained in further detail below, the millers, the *cañeros* and the government agreed by consensus on mechanisms to limit production and export sugar surpluses to the international market to prevent domestic prices from declining.

4. Previous Economic Regulation Of The Mexican Sugar Industry

Statement of Claim, paragraph 32

Statement of Claim	Admissions & Denials
Between 1971 and 1980, the Mexican Government took over the majority of Mexican sugar mills as they defaulted on government-issued debt. These defaults largely were caused by the government's deliberate setting of input and output prices at levels that made mills insolvent. The milling industry continued under state control, while sugarcane production remained in the hands of *cañeros*. There were administered prices for sugarcane and for sugar, and a state marketing monopoly through the end of the 1980s.	First sentence admitted. Second sentence denied.

Response:

67. The Government of Mexico categorically denies that the mills' defaults were caused by the government's deliberate setting of input and output prices at levels that made the mills insolvent. In addition to being factually incorrect and unsubstantiated, it is legally irrelevant as it relates to events occurring long before NAFTA'simplementation.

[80] See Section I.A.3 of this Statement.

Statement of Claim, paragraph 33

Statement of Claim	Admissions & Denials
Beginning in the late 1980s, as part of an intended shift away from state-ownership and toward more market-oriented economic policy, Mexico began to privatize many of the government-owned sugar mills.	Admitted.

Statement of Claim, paragraph 34

Statement of Claim	Admissions & Denials
This newly privatized sugar industry was to operate under the legal framework created by the Decreto por el que se declaran de interés público la siembra, el cultivo, la cosecha y la industrialización de la caña de azúcar, published in the Diario Oficial de la Federación, on 31 May 1991 (the "Sugarcane Decree") and later amended in 1993 (the "Amendment to the Sugarcane Decree").	Admitted.

Statement of Claim, paragraph 35

Statement of Claim	Admissions & Denials
The Sugarcane Decree established a regime governing the economic relationship between the *cañeros* and the mills. The Decree declared the sowing, cultivation, harvest and industrialization of sugarcane to be "of public interest." Article 2 of the Sugarcane Decree created the *Comité de la Agroindustria Azucarera* ("CAA"), a committee chaired by the *Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y Alimentación* ("SAGARPA"), which casts the deciding vote, and includes participation by the *Secretaría de Economía*, to establish all implementing rules for the Sugarcane Decree and to "aid in the strict compliance" with the Decree and all implementing rules. The CAA includes representatives of *cañeros*, mills and mill workers.	Admitted in part.

Response:

68. The Sugarcane Decree was published in 1991 after the privatization of the sugar mills. It established new rules governing the relationship between sugar mills and sugar cane growers

regarding sugarcane trade.[81] The Sugarcane Decree declared the sowing, harvest and industrialization of sugarcane[82] of public interest and established the basis for the relationship between sugarcane growers and sugar mills.

69. The Sugarcane Decree established:

a. The Committee on the Sugar Agro-industry (CAA), which is responsible for facilitating the compliance with the Sugarcane Decree and developing guidelines for the relationships between the sugarcane growers and sugar mill owners. The CAA is comprised of two representatives of the *cañeros* (one from each union), two representatives of the industry (through the Camara Nacional de la Industria Azucarera y Alcoholera (CNIAA)) and two representatives of government (a representative of SAGARPA (the Secretary of Agriculture) and a representative of the Secretaria de Economia (formerly known as SECOFI)). The CAA is presided over by the representative of SAGARPA, who has the deciding vote.

b. Mills' Sugarcane Production Committees, which govern the relationship between the mills and the *cañeros* in all matters concerning the sowing, harvest, supply, and quality of the sugarcane are comprised of representatives of the mill and the sugarcane growers. The President or Secretary-General of the Executive Committees of the local sugarcane organizations represents the sugarcane growers and the mills are represented by their managers. The Sugarcane Production Committees are responsible for drafting the end-of-harvest report.

70. The CAA is a tripartite entity. The CAA acts by simple majority. In the event of a tie between the other voting members, the President has the deciding vote, although this vote has never been exercised. Since its creation, the CAA has always made its decisions by consensus.[83] In GAM's words, the CAA "is responsible for supervising the compliance with the Sugarcane Decree and developing guidelines for the relationships between the sugarcane growers and sugar mill owners, including the technical procedures to analyze the sucrose content of the sugarcane".[84] In accordance with the Sugarcane Decree, the purpose of the CAA is to facilitate agreements between the mills and *cañeros*. The government does not participate in the Production Committees.

71. The Decree also sets the rules for the determination of the price of sugarcane as a percentage of the price of sugar, as well as the basis for its payment.

72. The Decree requires uniform contracts between mills and *cañeros* regarding the sowing and harvesting of sugarcane.

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81 Witness Statement of Jose Pinto. Exhibit R-26.

82 The Sugarcane Decree of 1980 considered these activities to be in the public interest. Exhibit R-27. The Sugarcane Decree of 1991 abrogated the Decree of 1980. See second transitory article of the Sugarcane Decree. Exhibit C-20.

83 Witness Statement of Adalberto Gonzales. Exhibit R-28.

84 Initial Public Offering, 1 October, 1997, p. 53. Exhibit R-29.

Statement of Claim, paragraph 36

Statement of Claim	Admissions & Denials
In addition, Article 7 of the Sugarcane Decree designated the *Junta de Conciliación y Arbitraje de Controversias Azucareras* ("JCACA") as the competent authority to resolve all economic disputes between *cañeros* and mills.	Admitted in part.

Response:

73. The Sugarcane Decree established the JCACA as the entity in charge of resolving all disputes of an economic nature between mills and *cañeros* or between mills through arbitration. The parties to the dispute must accept and comply with the rulings of the JCACA.[85]

74. The JCACA is not a government authority. It is a tripartite collegiate entity comprised of two representatives of the *cañeros*, two representatives of the mills, and two of SAGARPA, one of which presides over the JCACA (each representative has an alternate). The JCACA makes its resolutions by the vote of the majority. In the event of a tie, the President has the deciding vote. The regulation of the JCACA was approved by the CAA with the unanimous participation of the representatives of the *cañeros*, mills and government.[86]

Statement of Claim, paragraph 37

Statement of Claim	Admissions & Denials
The Sugarcane Decree declared, inter alia, that: . . . it is necessary to promote the [sugar] industry by giving economic certainty to the different sectors that participate in production thereof, such that said production be profitable, and also be able to foment its own growth. That it is necessary for trade policies to allow for a permanent sugar supply, thus it is prudent to link the price of sugarcane to that of sugar so as to ensure equity to all participants in the production chain.	Admitted with the following qualification: It is denied that the Sugarcane Decree is designed to promote the sugar industry.

Response:

[85] In the five claims brought by *cañeros*' unions against GAM's mills, GAM's mills objected by challenging the jurisidiction of the JCACA. See the reply presented *ad cautelam* for the five GAM mills. Benito Juarez, El Naranjal, San Pedro, Tala, Lazaro Cardenas. Exhibit R-30.

[86] JCACA Regulation, approved on October 1, 1991. Exhibit R-31.

75. The Sugarcane Decree is not an instrument designed to protect the mills, but to promote the activity of sugar production as a whole. Its purpose is much broader. In its objectives, the Sugarcane Decree establishes:

a. The food supply, in adequate conditions of price and quality in accordance with the national development plan, as a priority (first and seventh considerations);

b. The need to promote sugar activity (not the industry) to improve efficiency of the *cañeros'* fields and sugar mills, giving economic certainty to the various sectors involved in the production, in such a way that it can be profitable and can generate its own growth, by virtue of the importance that such activity has in the economy, both because of the value of the production and the number of people that participate in it and for the importance of the sugar in the daily diet (second and eighth considerations);

c. Negotiations between social (workers and *cañeros*) and private (industrial) sectors -- who are directly responsible for production-- and their participation through the establishment of rules and guidelines that govern their commercial relationships as well as their intervention in the resolution of disputes derived from such relationships, the objective of procuring a healthy understanding between mills and *cañeros* to achieve higher productivity (third, fourth and fifth considerations);

d. That equity should exist between those participating in the production chain through the linking the price of sugarcane to sugar (seventh consideration);

e. The adequate protection of the sugar sector against world supply, as world market prices do not reflect production costs (sixth consideration).

76. The objectives of the Sugarcane Decree can be summarized as the need to increase field and factory efficiency, to achieve higher productivity, to ensure an adequate sugar supply, being a basic necessity. Negotiation was the basis of the relationships between the production sector and the participation of both sectors in the development of rules and guidelines governing their relationships as well as their disputes.

Statement of Claim, paragraph 38

Statement of Claim	**Admissions & Denials**
The stated objectives of certainty, profitability, and equity under the Sugarcane Decree require the intervention and direction of the Government, either directly, or through the CAA that it controls.	Denied.

Response:

77. The objectives of the Sugarcane Decree are broader. The Decree is based on negotiations between sugar mills and *cañeros.* In no way is it based on State guidance. In fact, the government is just another participant who acts as a mediator. The relationship between mills

and *cañeros* exists trhough the Sugarcane Production Comittees, in which the government does not intervene; and globally, within the CAA, (see paragraphs 68-76).

Statement of Claim, paragraph 39

Statement of Claim	Admissions & Denials
Article 5 of the Sugarcane Decree required uniform contracts between the *cañeros* and millers, subject to the rules issued by the CAA. Pursuant to the uniform contract, mills were required to purchase all sugarcane produced by *cañeros* in a certain tract of land. The Sugarcane Decree provided for payment of 54% of the price of sugar (or a price determined by the CAA if, as was the case, there was no official bulk price) to *cañeros* for their cane.	Admitted with the following elaboration:

Response:

78. The price of sugarcane is determined by reference to the KARBE per net tonne of cane. The standard recuperable base sugar is the standard sugar that can be extracted through the milling process. This KARBE-based calculation is done for each mill, at 54 percent of the official standard base sugar price FOB, which originally varied month-to-month. The income received by the *cañeros* depends on the price of sugar and the quantity of recuperable sugar in the sugarcane.[87]

Statement of Claim, paragraph 40

Statement of Claim	Admissions & Denials
To remedy perceived problems, especially in determining the price of sugar, the Sugarcane Decree was amended in 1993, notably to raise over time the percentage of the reference price paid to *cañeros* from 54% to 57%. The reference price continued to be determined by the CAA under the Government's control, despite the intent to track the market.	Denied with the exception that the Decree was reformed to gradually increase the sugarcane price from 54 percent to 57 percent.

Response**:**

79. The Sugarcane Decree was reformed because, until 1993, sugar mills were responsible for paying the *cañeros'* social security contributions to the IMSS, which increased over time. The *cañeros* are not mill employees and, because of their large number and the amount owed to IMSS, both the mills and *cañeros* agreed that the *cañeros* would take responsibility for their

[87] See Expert Report of Luis Ramiro Garcia, pp. 24-26. Exhibit R-12.

contributions. In exchange, there was an increase of 3 percent in the price of sugarcane over a three-year period. The Sugarcane Decree was reformed to give certainty to this agreement.[88]

80. The reform also allowed the relationships between *cañeros* and mills to be bound by the terms of their contracts by which they make joint investments, form associations, reach agreements to increase productivity and efficiency and achieve higher diversification of the *cañero* fields. Prior to this the benefits that stemmed from these associations had to be shared as established in the uniform contracts.

81. As for the CAA, see paragraphs 68-76.

Statement of Claim, paragraph 41

Statement of Claim	**Admissions & Denials**
Mexico had been a net deficit producer of sweeteners, but this had changed. Adoption of increased import protection pursuant to a NAFTA requirement to adopt a similar trade regime to that of the United States helped increase prices in Mexico, particularly after the Government dropped sugar price controls in 1995. The NAFTA also promised increased access over time into the U.S. market.	Admitted with the following elaboration.

Response:

82. One of the objectives of the privatization was to increase production. The Sugarcane Decree also states this objective (see paragraphs 75-76).

83. The text of NAFTA is also consistent with this goal. Under NAFTA, Mexico was expected to substantially increase its production and move from being a deficit producer to a surplus producer (see paragraph 24).

84. The Sugarcane Decree also states that the sugar sector must be adequately protected from the international supply. NAFTA is also consistent with this. Due to the harmonization of Mexico's MFN tariff with that of the United States pursuant to NAFTA, Mexican prices for refined sugar were expected to converge with those of the United States. As GAM noted in 1997:

> The Company's business plan, in part, assumes that (i) domestic refined sugar prices in Mexico will tend to converge with the U.S. Midwest Price, which generally has fluctuated between US$0.22/lb. and US$0.30/lb.over the last 10 years (the price of standard sugar has generally represented approximately 86% of the price of refined sugar and generally fluctuated in tandem), and (ii) the Company will be

[88] Witness Statemente of José Pinto. Exhibit R-26 and Acta No. 23/7/ORD/92 of CAA, 26 October 1992, Exhibit R-32.

> able to sell its sugar at generally prevailing market prices for sugar in Mexico without discounts.[89]

85. This assumption turned out to be incorrect in part. At certain points, due to the collapse of the U.S. market, the Mexican refined price was *higher* than the U.S. price.[90]

86. GAM's SEC report went on to state:

> There can be no assurance that, among other factors, competition from alternative sweeteners, including HFCS, changes in US or Mexican agricultural or trade policy, including the Federal Agriculture Improvement and Reform Act of 1996 ("FAIR"), or developments relating to international trade, including those under the World Trade Organization (the "WTO"), will not directly or indirectly result in lower domestic or U.S. sugar prices. The failure of domestic sugar prices to rise, substantially in accordance with the expectations contained in the Company's business plan, or any prolonged decrease in sugar prices, could have a material adverse effect on the Company. There can be no assurance that the Company will be able to maintain sales at generally prevailing market prices for sugar in Mexico without discounts and that sufficient exports will take place in order to assure a domestic market balance. Due in part to insufficient levels of exports during 1997, the domestic price of sugar was adverse effect in 1998.[91]

87. The USDA reports show that GAM's projections turned out to be incorrect:

> Until September 1999, the estandar [Mexican standard sugar] price was consistently below the U.S. raw sugar price (No. 14, New York contract). Since then, the U.S. raw sugar price at times dipped to (historically) low levels (e.g., 17.24 cents a pound in February 2000). It has regained some ground starting in October 2000 and is now in the 21-22 cents a pound range. Between 1998 and 2000, the estandar price has been variable in a range between 18 and 24 U.S. cents a pound. Since September 1999, it has been at times greater than the U.S. raw price. In 2001, however, the estandar price has dropped from the 21.52 cents a pound (4.634 pesos per kilogram) in January to 17.18 cents a pound (3.534 pesos per kilogram) in April. It is now well below the U.S. raw price by a margin of 4 cents a pound. Both Mexican and US prices have been well above comparable world prices.[92]

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89 See GAM's SEC filing *Form 20-F, Annual Report for 1999*, p. 15. Exhibit R-33.

90 See *S&SSO Yearbook*, p. 11. Exhibit R-2.

91 *Form 20-F, Annual Report for 1999,* p. 15. Exhibit R-33.

92 USDA *Sugar and Sweetener Outlook, Situation and Outlook Yearbook*, May 2001 at page 10. Exhibit R-2

Statement of Claim, paragraph 42

Statement of Claim	Admissions & Denials
Nevertheless, it was clear that if the Sugarcane Decree was to meet its objectives, reforms would be important to deal with the situation of a net surplus producer and to achieve the objective of making the prices in the system responsive to market conditions.	Denied.

Response:

88. The Sugarcane Decree does not refer to a situation in which Mexico would become a surplus producer, nor does it establish the foundation for sugar price determination. The Decree links the price of sugarcane to the price of sugar.

89. It is incorrect to assume that "the situation of a net surplus producer" was unexpected and that reforms would be required to deal with it. In fact, the NAFTA demonstrates that Mexico anticipated becoming a net surplus producer.

90. The need for a mathematical formula to determine the reference price in the future, so as to avoid the annual face-off between sugarcane growers and the industrial sector, was set out during the negotiations between the mills, *cañeros* and the federal government. [93]

5. The 1997 And 1998 Acuerdos

Statement of Claim, paragraph 43

Statement of Claim	Admissions & Denials
On 25 March 1997, the Mexican Government published the Acuerdo por el que se establecen reglas para la determinación del precio de referencia del azúcar para el pago de la caña de azúcar (the "1997 Acuerdo") setting forth several important reforms of the law. An "acuerdo" is a government measure, in this case issued at the ministerial level, which legally binds affected parties. A ministerial acuerdo is subordinate to a Presidential Decree or regulation, and in practice can be used to implement the terms of a Decree.	Denied.

[93] Initial Public Offering, October 1997, p. 54. Exhibit R-29.

Response:

91. On March 25, 1997, SECOFI published the Acuerdo por el que se establecen regals para la determinación del precio de referencia del azúcar para le patgo de la caña de azúcar (the "1997 Acuerdo") that established the rules for reference price deterimination. The 1997 Acuerdo is not law but an administrative agreement jointly issued by the Secretaries of Hacienda, SECOFI and SAGAR.

92. In the Mexican legal system, the administrative agreement is not a concept that is clearly defined nor regulated. There are many types of agreements that have diverse functions. For example, an officer may delegate certain matters concerning instructions issued by the President to a Secretary (submitted to the President for their resolution by the Secretaries of State) to his subordinates by transfering his powers to them through an agreement (and therefore for the acts of the subordinate to be valid the commission agreement must be published in the *Diario Oficial de la Federacion*). The administrative agreement is frequently the legal concept used for the creation of non-centralized entities that are incorporated to the public administration structure to attend specific matters. The resolutions issued by two or more government entities (*i.e.*, two or more Secretaries of State), also adopt the form of an administrative agreement. The administrative agreement also serves as an instrument to provide information, in other words, as a vehicle to inform the public on resolutions adopted by the executive officer of a government agency (*e.g.* the agreements regarding the structure and internal organization of agencies of the public administration)[94] Thus, an administrative agreement does not necessarily create obligations; and when it does, these obligations generally have no effect over individuals. Administrative agreements cannot stem from a decree or regulation.

93. The 1997 *Acuerdo* originated from a concern of mills and *cañeros*[95] and reflects the consensus reached between them, with the participation of the federal government within the CAA. According to the Sugarcane Decree, it is the CAA's responsibility to develop rules, definitions and guidelines to implement the Decree[96] that would contribute to promote the modernization and competitiveness of the sugar production chain. This is set out in the considerations of the 1997 *Acuerdo*.

Statement of Claim, paragraph 44

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94 Cf. "Acuerdo Administrativo" in *Diccionario Jurídico Mexicano*. 12 edition. Porrua and Universidad Nacional Autonoma de Mexico, Mexico, 1998, pp. 92 and 93. Exhibit R-35.

95 Witness Statement of Adalberto Gonzalez. Exhibit R-28.

96 Article 4.

Statement of Claim	**Admissions & Denials**
The 1997 *Acuerdo* provided two important modifications in the sugar program. First, it created a methodology and a formula for determining a national reference price for sugarcane that was to apply from the 1997/1998 harvest onward, and that would be responsive to actual market conditions. The reference price was to be determined by a weighted average of the prices received in the domestic market, the price for the exports to the United States market within the restricted U.S. quota, and finally, prices from exports of surpluses to the (low-priced) world market. Such a formula would in principle mean that, to the extent increased production required a higher proportion of that production to go to low-priced world markets, that would tend to lower the reference price and hence the return to *cañeros*, providing a first market "signal" to *cañeros* against continuous increases in sugarcane production.	Admitted with the following elaboration:

Response:

94. The 1997 Acuerdo established a new scheme for the calculation of the reference price for sugarcane and had the intention of providing the proper incentives to both, mills and sugarcane growers, in order to avoid a price decline in an oversupplied market.

95. The Sugarcane Decree required that the sugarcane be paid for in two stages: (1) a pre-liquidation ranging from 80% to 85% percent of the quantity of sugarcane supplied. This payment was required at the beginning of the harvest and was to be calculated based on the average factory yield or the percentage of recuperable base standard sugar obtained during the previous five harvests; and (2) a final payment equivalent to the difference between the quantity of recuperable standard base sugar obtained and the pre-liquidation payment.

96. Prior to the 1997 *Acuerdo*, the reference price used in the pre-liquidation was calculated based on the FOB price of a kilogram of standard base sugar.[97] When Mexico abolished the "official price" in August 1995 (as requested by the industry[98]), mills and *cañeros* entered into negotiations to determine the reference price used to determine the price of the sugarcane. This system generated conflicts between *cañeros* and industries every year.[99]

97. The formula devised in the 1997 *Acuerdo* reduced the rigidity of the price of sugarcane by subjecting it to market fluctuations. It also considered domestic market conditions and

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97 See Sugarcane Decree, Article 9. Exhibit C-20.

98 Expert Report of Luis Ramiro Garcia, pp. 38-39. Exhibit R-12.

99 Id., p. 25. The refrence price for the 95/96 and the 96/97 harvests was 2,650 and 3,339 pesos respectively. See Exhibit C-23.

included an export factor by which both *cañeros* and mills would assume part of the cost of selling in the world market and share the benefit of exporting to the U.S. market, otherwise the mill would take these benefits exclusively.

98. According to the 1997 *Acuerdo*, the reference price is calculated at the beginning of the harvest and is valid from October 1 to September 30 of the following year. It is equivalent to the weighted-average of domestic and export prices of standard sugar. It can be obtained by adding (1) the result of multiplying the reference price by the ratio of national consumption to total production, and (2) the result of multiplying the expected price of exports by the ratio of surplus to total production.

- The Secretary of Economia (then SECOFI) determined both expected production and expected domestic consumption (from which expected surplus can be derived) based on the data and the opinion provided by SAGARPA (then SAGAR), FINA, the CAA, the CNIAA and both *cañero* unions.

- The reference national price is calculated from the wholesale price of standard sugar in the central markets reported by the SNIIM from the previous two harvest years.

- The expected export price of sugar is the weighted average of the U.S. market prices and the world prices and can be calculated from NYBOT's data on No.11 Contracts and No. 14 Contracts.

99. The 1997 *Acuerdo* also establishes the rules for the adjustment of the final payment based on the real price obtained by each mill in its sales of sugar to the domestic market and its exports. The Sugarcane Production Committees are responsible for calculating the amount of the adjustment.

100. If the observed price is higher than the reference price the mills will pay the difference to the *cañeros*. If the observed price is lower than the reference price, the adjustment will be in favour of the mills. This mechanism allows for an adjustment based on the real prices obtained by the mill through its sales to the domestic, world and U.S. markets.

101. The 1997 *Acuerdo* also provided for an adjustment factor to the observed price in case the mill did not comply with its export quota.

Statement of Claim, paragraph 45

Statement of Claim	**Admissions & Denials**
The 1997 *Acuerdo* also required that sugar mills comply with export quota requirements set by SECOFI. Under the *Acuerdo*, any mill that did not comply with the export requirements had to pay a substantial penalty price, equal to 2.5 times the difference between Mexican and world prices for the deficit from the export requirement. If enforced, this would	Denied.

erase the temptation of sugar mills to sell their surplus on the domestic market.	

Response:

102. The Claimant incorrectly describes the nature of the 1997 *Acuerdo*. As it has been explained, the 1997 *Acuerdo* reflects an agreement in the CAA between mills and *cañeros* with the participation of the government (see paragraphs 91-93). In accordance with the Sugarcane Decree it is up to the CAA to formulate the basis that regulates the relationship between the mills and the *cañeros*, as well as the rules, definitions and provisions that implement the Sugarcane Decree.[100] The 1997 *Acuerdo* was issued in accordance with these provisions. It relates then to rules formulated by the CAA.[101]

103. The 1997 *Acuerdo* does not impose an export obligation on the mills. It contains a conventional sanction to adjust the price observed by the mills, where one of them has not complied with the export requirements. This Tribunal should note that the 1997 *Acuerdo* does not make the government responsible for its enforcement. The *Acuerdo* does not grant any power to the Secretaries that published it to require compliance through the application of administrative sanctions (fines and administrative arrest), which are the only kind of sanctions that the authorities may impose. The Tribunal should also note that the *Acuerdo* does not grant the government authorities any power to adjust the prices observed by the mills–in fact, the price adjustment is not considered an administrative sanction.

104. The Sugarcane Decree does not grant these powers (neither does the law or any other government measure). On the contrary, the Sugarcane Decree creates the JCACA to intervene and resolve all disputes of an economic nature between the mills and the *cañeros* or between the mills (see paras. 73-74). The Claimant admits that the JCACA was responsible for resolving disputes regarding export requirements.

105. Responsibility for the enforcement of the 1997 *Acuerdo* was conferred upon both sectors involved. The governmental authorities did not have the power to intervene if the *cañeros* did not claim the payment a result of a difference between the price paid by the mill and the reference price or the application of the adjustment factor for non-compliance with the export requirement. For the same reasons, the government was unable to intervene if the mills did not adjust the price of the sugarcane to their favour when the reference price was higher than the price obtained by the mills, as allegedly happened with GAM's mills. It was up to the mills and the *cañeros* to address these issues in the Sugar Production Committee and, if they could resolve a matter in the Committee, apply to the JCACA.

106. The CNIAA was responsible for determining the quota for each mill. This responsibility was later transmitted to SECOFI.[102] Each mill was informed about its corresponding export

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100 Sugarcane Decree, Article 4. See also paragraphs 68-77 of this Submission.

101 See third consideration of the 1997 *Acuerdo*. Exhibit C-23.

102 On 29 January, 1997 the CNIAA and SECOFI agreed on the "Procedimiento para el Comercio Exterior de Azúcar" (Exhibit R-36), which established the rules for the allocation of sugar export quotas. Almost all the mills, including GAM, subscribed this programme. In summary, the procedure consisted in:

quota every year, so that it could comply with this requirement. In fact GAMI has stated that GAM had complied with its quota every year. [103]

107. SECOFI took all the legal actions it could possibly take to promote the compliance of the mills with their export quotas. For example:

a. One of the consequences of the 1995 financial crisis was a strong devaluation of the peso. Because of the exchange rate, in 1995 the world market, notwithstanding its low prices, was a more attractive alternative than the Mexican market. To avoid a shortage of sugar in the domestic market, the President established a high tariff on this product. However, this generated a high financial cost to sugarmills related to inventory management. For this reason, SECOFI allocated tariff free export quotas to facilitate better inventory management through temporary exports of sugar, provided that the mills reimported it back at the same price. Otherwise, they would have to pay the export tariff [104]. This scheme was maintained until 1998, when the export tariff was eliminated.

b. As requested by the sugar industry, the government eliminated the official price in 1995, allowing it to respond to market conditions.

c. During 1998 and 1999 the federal government, through SECOFI, granted mills a subsidy to enable them to pay for the storage of 600,000 mt of sugar. [105] SECOFI conditioned the subsidy to the compliance of the export requirements. The subsidy was denied to those mills that did not comply with its export quotas [106].

- Every year in the month of October, the CNIAA integrated a proposal of the Sugar Balance Committee that reports the amounts of sugar for January 1st of each year and the estimates of consumption and production for the following twelve months;
- It was for SECOFI to authorize the Sugar Balance Committee, taking into account the opinion of that Committee;
- Guaranteeing the national sugar supply and certain volumes of exports, the CNIAA established the volumes to export for every mill and classified them as: (1) exports to the U.S. quota in accordance with the NAFTA; (2) substituted sugar under PITEX; (3) exports to the world market quota.
- The CNIAA notified SECOFI this figures.

The CNIAA maintained this system in place during the relevant period,

103 Statement of Claim, ¶ 52.

104 *Decreto* por *el que se reforma la Tarifa de la Ley del Impuesto General de Exportación en fracciones relativas al azúcar y demás productos que se indican*. Exhibit R38.

105 Acuerdos publicados en el Diario Oficial de la Federación el 16 de abril de 1998 y el 27 de diciembre de 1998. Exhibit R-39.

106 Witness Statement of Adalberto González. Exhibit R-28

d. SECOFI also conditioned the export quota allocation to the US Market to the compliance with the export requirement.[107] SECOFI allocated this quota considering the compliance level of each mill. [108]

Statement of Claim, paragraph 46

Statement of Claim	Admissions & Denials
In 1998, the Government amended the 1997 *Acuerdo*, most significantly to provide for maximum production ceilings, with penalties for mills that increased their sugar production over the ceiling and a reward for mills that reduced production below the ceiling. Thus, a sugar mill that reduced production levels below the ceiling would have its export quota requirement reduced by that amount. The 1998 *Acuerdo* stated that no later than the first of October of each year, SECOFI and SAGARPA would be responsible for determining a maximum production level for each sugar mill.	Admitted, subject to the following elaboration:

Response:

108. The 1998 *Acuerdo*, as does the 1997 *Acuerdo*, derives from an agreement reached between mills and *cañeros* in the CAA,[109] and, at the same time, originated from a request by the representatives of the sugar sector (mills and *cañeros*) to adjust the 1997 *Acuerdo*, in order to establish production levels for each mill and to modify the time over which to calculate the average price of sugar in the national market in accordance with the formula for the reference price.[110] Also, the 1998 *Acuerdo* amends the term to calculate the average price in the national market.

109. In accordance with the 1998 *Acuerdo*, SECOFI and SAGAR should have established the production levels for each mill, with the opinion of the CAA. This was, a joint work by the government with the mills and the *cañeros*[111]. This turned out to be a complicated task because

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107 Until 1999, the NAFTA quota was 25,000 mt. However the allocation of this quota, was a stronger incentive starting on 2000, when the USA extended this quota to 105,788 for that year, and 137,788 for 2001 (the quota assigned to Mexico was 116,000 mt. and 148,000 respectively).

108 Witness Statement of Adalberto González. Exhibit R-28. *Procedimiento Exterior de Azucar*, p. 18. Exhibit R-36. Comunique between CNIAA and SECOFI dated 23 March. 1998. Exhibit R-40. Letter from the CNIAA to SECOFI of 6 March, 2000. Exhibit R-41.

109 1998 *Acuerdo*, preamble, second and third considerations. Exhibit C-25.

110 Id., fifth consideration.

111 This is corroborated by an agreement subscribed January 10, 1998, between the Sugar Chamber and the two associations of the *cañeros*. Article 6 of this agreement establishes that "previous to the determination of the sugar balance of 1998/99, the Sugar Chamber and the national associations of the *cañeros* will request to SECOFI and the Secretary of Agriculture with the opinion of the CAA, in a coordinated fashion to establish the level of production for each mill". This agreement also refers to the sugar balance modification, because actual production level was higher than expected; establishes adjustments to the

of the lack of consensus between the mills and the *cañeros*, and defining production levels could trigger substantial problems between mills and *cañeros,* as expressed by the CAA.[112]

110. In accordance with the 1998 *Acuerdo*, the mills' base production level was to be determined considering the production levels of the harvest year of 1997/98. However, the production during that year was underestimated. [113] The government, *cañeros* and mills tried to find a method to define the base production levels for each mill with higher accuracy. For this reason the base production levels could not be determined. The CAA, the sugarcane growers' organizations, the CNIAA and SECOFI drafted a separate proposal. All of them were analyzed within the CAA.[114]

111. It was agreed that the base production levels would be established taking into account the harvested area of each mill. [115] This modification was agreed on and implemented through the 2000 *Acuerdo*. The CAA was responsible for calculating the base production level for each mill. Both SECOFI and the CAA informed each mill of its base production level in accordance with the 2000 *Acuerdo*. [116] Mr. Alejandro Hidalgo Prieto, representative of GAM's International Trade Department, went to SECOFI's premises to obtain it on GAM's behalf. [117]

112. On the same day that the 2000 Acuerdo was published, the CNIAA sent a circular to all its members informing them of the acuerdo. Four days after its publication, SECOFI met with representatives of various mills, including GAM's, to inform them of their production levels.[118] The compliance with the acuerdo was to be executed by the *cañeros* and the mills. CAA statistics show that GAM's mills, as well as the rest of the mills, reduced their harvested areas.[119]

Statement of Claim, paragraph 47

Statement of Claim	Admissions & Denials

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reference price for the harvest year 1997/98; establishes the rules governing the adjustments in accordance to the 1997 Acuerdo and the price for each mill; establishes the appropriate criteria for penalty deposits arising from export quotas' non-compliance; establishes the mills compromise to export the additional surplus; and the rules to account for the exports, among others. Exhibit R-42.

112 Preeliminary Report of the CAA, 16 December, 1999. Exhibit R-43.

113 Agreement between the CNIAA, la UNC-CNPR y la UNPCA-CNC dated 10 June 1998. Production was initially estimated at 4.75 million tones, however, the CNIAA and the production unions agreed to revise it to 5.094 million tonnes. Exhibit R-42.

114 Records from the CAA sessions No. 40/1/ORD./99. of December 16, 1999 (see item No. 6) an 41/1/ORD./2000 of February 7, 2000 (see item No. 5). Exhibit R-44.

115 Records of the CAA No. 41/1/ORD/2000, 7 February 2000. R-44.

116 Article 2.

117 Witness Statement of Adalberto González. Exhibit R-28.

118 Registry of persons attended in relation to the 2000 *Acuerdo*. Exhibit R-44.

119 For example, Tala maintained a harvest area of 24,297 hectares during the 1997/98 harvest. This area was reduced to 22,894 hectares; Lazaro Cardenas had a harvested area of 4,119 hectares during the 1998/99 harvest and reduced it to 3,848 hectares. In general, the harvested area of all sugar mills was reduced from 611,297 hectares in the 1999/2000 harvest to 603,453 hectares in the 2000/2001 harvest. Accordingly, sugar production was reduced during the 20001/2002 harvest. See "Desarollo Operativo Campo-Fabrica 1997-2002" from the CAA and table "Desarollo Agroindustrial Azucarero 1996-2002". Exhibit R-47.

The 1997 *Acuerdo,* as modified by the 1998 *Acuerdo,* remains in force. These *Acuerdos*, if implemented, would have provided for a system that protects the interests of *cañeros* and mills in an equitable way as called for in the Sugarcane Decree, implemented in the context of a net surplus of Mexican production. The Government had the authority and duty to implement the export controls and production limits, so that prices could be sustained at a level sufficient for mills, in the light of the price that had to be paid to *cañeros*.	Denied.

Response:

113. This paragraph does not contain a description of the facts. Instead, it is argument.

6. Failure To Implement The Regulatory Scheme

Statement of Claim, paragraph 48

Statement of Claim	Admissions & Denials
While the reforms of 1997 and 1998 should have made the system function as contemplated by the legal regime, the Government flagrantly and systematically failed to implement and enforce the law. First, as discussed below, the Government negated the benefit of the revised reference price by using unrealistic estimates that inflated what mills had to pay *cañeros*. Second, the benefit of the export requirement was nullified because the Government never took the steps necessary to enforce it. Third, the Government simply never implemented the production limitation requirement introduced in 1998.	Denied.

Response:

114. In paragraphs 68-112, the Respondent has explained in detail how the regulation of the sugar sector operates, and the context in which it emerged.

115. In paragraph 98, the Respondent explained in detail how the reference price is calculated and the source of the variables used in its calculation. It will come back to this point in the response to paragraph 49 of the Statement of Claim.

116. With regard to the export requirements and the base production levels, see paras 102-112.

a. The Government's Reference Price Calculation

Statement of Claim, paragraph 49

Statement of Claim	Admissions & Denials
Mexico altered the reference price formula by making unrealistic assumptions regarding its variables (*e.g.*, anticipated domestic production of sugar, NAFTA export quotas, expected domestic consumption and surplus to be exported) and utilizing statistics that overstated the price of sugar, with the effect that the reference price increased even as actual price decreased. As a result, prices GAM received for sugar in both the domestic and export markets were substantially below the government-set reference prices from which the price of sugarcane was derived.	Denied.

Response:

117. It is false that the Mexican authorities have made unrealistic assumptions regarding the variables for the calculation of the reference price for sugar:

- Economia (formerly known as SECOFI) determines the national production and consumption figures based on data provided by the government, the industry and the *cañeros*: the SAGARPA (formally known as SAGAR), FINA, the CAA, the CNIAA, the UNPCA-CNC and the UNC-CNPP. This is not about government "assumptions" nor arbitrarily determined values, instead the figures are estimated based on production and consumption data from past years, given by the producers (sugar and cane) as well as the competent authorities, and from the CAA in which the three sectors participate.

  In fact, the CNIAA participates in the Sugar Balance Working Group, where several administrative units of Economia (formerly known as SECOFI) and SAGARPA (formerly known as SAGAR), as well as FINA, FORMA and the CAA. This Working Group --which meets a number of times before presenting its conclusions-- is responsible for analyzing the information, the methodology and making projections.[120]

  These values can be rectified. For example, the production of sugar for the harvest 1997/98 was underestimated (contrary to the Claimant's assertion). It was initially estimated to be 4.75 million tons and then rectified to 5.094 million tons, through an agreement between the CNIAA and the *cañeros* unions.[121] As aresult, the surplus to be exported was also adjusted. There is

[120] Minutes of the Sugar Balance Working Group. Exhibit R-48.

[121] Agreement between the CNIAA, theUNC-CNPR and thatUNPCA-CNC of 10 June, 1998. Exhibit R-42.

no evidence on the record of the Secretariat that the CNIAA objected to any of the estimates.

- The surplus to be exported is established based on the same data: the difference between estimated consumption and production.

- The NAFTA export quota is established by the United States, not the Government of Mexico. This is the origin of the dispute between both countries.

- The information on national prices is reported by SNIM, as required by the 1997 *Acuerdo*, as modified by the 1998 *Acuerdo*.[122] The SNIM uses wholesale prices from all the central markets of the country. This is hard data. The Claimant does not suggest the contrary.

- Finally, the export prices are reported under the NYBOT No. 11 and No. 14 Contracts and the exchange rate is reported on the Chicago futures market.

118. In all cases, this is hard data published in the *Diario Oficial*. The reference price is the result of running this formula using this data. The government does not fix the price. The Respondent has no record that GAM or any other member of the industry had objected the reference price calculated in this way.

119. Moreover, the 1997 *Acuerdo* established a mechanism to adjust the KARBE price for the final liquidated payment, in accordance with the real prices given by each mill in its national and export markets. It is the mills and the *cañeros* that make the price adjustment in the Production Committees, prior to the final payment.[123] The government does not intervene.

120. If, as GAMI argues, GAM obtained lower prices than the reference price in the domestic market as well as the export market, it had a mechanism to adjust the cost of the sugarcane. The fact that it did not use the adjustment is not attributable to the government.

b. Failure To Enforce Export Requirements

Statement of Claim, paragraph 50

Statement of Claim	Admissions & Denials
To deal with the problem of price depressing surpluses of sugar production, the 1997 *Acuerdo* provided (and still provides) that each mill must export a certain percentage of its output so that surplus production would not be sold into the Mexican market, destabilizing the price.	Denied.

[122] 1997 *Acuerdo*, Article 3(III), as modified by the 1998 *Acuerdo.*

[123] 1997 *Acuerdo*, Articles 4 and 5(I).

Response:

121. See paragraphs 102-107.

Statement of Claim, paragraph 51

Statement of Claim	Admissions & Denials
Absent such a mechanism, even if the surplus sugar was stocked by the mills, it would overhang and depress prices below levels necessary for mills to be viable. The Government controlled the enforcement system in key respects. First, SECOFI was the official depository of the only reliable production and export data that would permit a determination whether there was non-compliance. Second, SAGARPA also controlled the JCACA, which was the entity in charge of enforcement of the export requirements in the event of a breach. *Cañeros* had the right to obtain the penalty price for non-compliance from a mill in an action before the JCACA. However, without access to reliable data, and expeditious adjudication by the JCACA, penalties could not be applied in a timely manner and the export requirement could not function.	Denied.

Response:

122. See paragraphs 73, 74, 102-107.

123. GAMI argues that the *cañeros* had the right to obtain a price that incorporates the penalty for non-compliance by the mill through the action of its Sugarcane Production Committee and the JCACA. It is important to note that when the *cañeros* of GAM's mills submitted to the JCACA their claims that GAM did not comply with the export requirements, GAM's mills objected on jurisdictional grounds.[124] In this way, GAM opposed the effective operation of the JCACA and the mechanism through which export requirements could effectively be enforced.

Statement of Claim, paragraph 52

Statement of Claim	Admissions & Denials
In fact, there were severe problems of non-compliance, but the Government failed to act and even contributed to the problem. GAM and other mills complied fully with their export requirements, but the system was undermined by non-compliance on the part of several mills, including mills operated by the Government	Denied.

[124] Reply to the Claim *Ad cautelam* of GAM's five sugar mills. Exhibit R-30.

itself.	

Response:

124. See response to paragraph 54 of the Statement of Claim.

Statement of Claim, paragraph 53

Statement of Claim	Admissions & Denials
Both of the government-owned mills, La Joya and Rosalía, failed, for example, to comply with their export obligations, thereby contributing to the domestic surplus while enabling the mills to avoid the need to accept lower prices for exports. In addition, numerous privately-held mills, such as those held by the CAZE and Jimenez Sainz groups, consistently failed to export the amounts that the law required of them. The following chart illustrates the degree of compliance of a sampling of mills, including all the mills of GAM, which fully complied:	Denied.

Mexican Sugar Mill Export Quota Compliance 1997 to 2001

Sugar Mill	Group	1997/98 harvest	1998/99 harvest	1999/2000 harvest	2000/01 harvest
La Joya	**FIDELIQ**	25.07%	60.10%	0.00%	0.0%
Santa Rosalía	**FIDELIQ**	21.03%	95.06%	5.76%	10.82%
Atencingo	**CAZE**	100.00%	4.94%	52.65%	0.00%
Casasano La Abeja	**CAZE**	100.00%	4.94%	51.60%	0.00%
El Modelo	**CAZE**	100.00%	4.94%	52.58%	0.00%
El Potrero	**CAZE**	100.00%	29.71%	68.76%	0.00%
Emiliano Zapata	**CAZE**	100.00%	13.05%	73.25%	20.14%
La Providencia	**CAZE**	100.00%	12.48%	53.79%	0.00%
Plan de San Luis	**CAZE**	100.00%	6.59%	52.13%	0.00%
San Cristobal	**CAZE**	100.00%	5.15%	48.90%	11.39%
San Miguelito	**CAZE**	100.00%	4.94%	53.27%	0.00%
Dos Patrias	**Jimenez Sainz**	2.44%	4.94%	4.68%	0.00%
Azsurmex (Tenosique)	**Jimenez Sainz**	2.44%	0.00%	4.68%	0.00%

Benito Juárez	**GAM**	100.00%	100.00%	100.00%	100.00%
Tala	**GAM**	100.00%	100.00%	100.00%	100.00%
Lázaro Cárdenas	**GAM**	100.00%	100.00%	100.00%	100.00%
San Francisco El Naranjal	**GAM**	100.00%	100.00%	100.00%	100.00%
San Pedro	**GAM**	100.00%	100.00%	100.00%	100.00%

Response:

125. See the responses to paragraph 54 of the Statement of Claim.

Statement of Claim, paragraph 54

Statement of Claim	Admissions & Denials
These trends of non-compliance became especially severe during the 2000/2001 harvest where mills that had previously been in, or close to, compliance, fell out of compliance. Thus during the 2000/2001 harvest, Grupo Machado only exported 56.4% of its requirements, Santos, 81.58%, AGA, 47.09%, Seoane, 85.72% and independent mills, 81.90%.	Denied.

Response:

126. GAMI alleged that the two mills administered by the government contributed to generating surpluses in the domestic market, because they did not comply with the export requirements. It does not say, however, that the volumes in question are insignificant. The export quota for both mills for the 2000/01 harvest represent only 2 percent of the export requirements for the whole industry. In terms of total production and consumption, the export requirements for the 2 mills represented 0.3 and 0.4 percent, respectively.

127. In paragraph 54, GAMI argues that during the 2000/01 harvest, several groups stopped complying with the export requirements: Machado, Santos, AGA, Seoane, and other independent mills. The export requirements of those mills represented only 1.5 percent of total national production and less than 2.0 percent of national consumption.

128. On the other hand, as it has been explained, the government did not have the power to require the mills to export the surplus that they produced nor to penalize them for the non-compliance. It was for the private parties, which had the mechanisms to make effective the penalties and make adjustments to the prices. GAM, among others, challenged those mechanisms when the *cañeros* triggered them against their mills (see paragraph 123).

Statement of Claim, paragraph 55

Statement of Claim	Admissions & Denials
The Government failed to perform the necessary actions to allow the *cañeros* to take timely enforcement action to stop these violations. In the case of the CAZE mills, the Government ignored repeated complaints, even from the *Cámara Nacional de las Industria Azucareras y Alcoholeras* ("CNIAA"), that CAZE had falsely claimed to have met its export requirements when it was quite apparent it had not. In October 1999, the CNIAA notified SECOFI that CAZE had tried to establish its compliance with its export requirement of 114,037 tons of sugar by presenting false official documents. Several communications were issued by the CNIAA denouncing CAZE's illegal behavior. Notwithstanding these efforts, the Government has never taken enforcement action against CAZE.	Denied.

Response:

129. See paragraphs 102-107.

130. It is false that the Mexican authorities did not take any action against the persons that allegedly committed illegal acts related to the mills' operation, including persons of CAZE. In fact, administrative and criminal actions are pending.[125]

131. The Mexican authorities do not have the power to require the mills to export nor penalize them for non-compliance. However, when private parties or government officials had allegedly violated the law in a manner that consisted in administrative or criminal liability, the government took action.

Statement of Claim, paragraph 56

Statement of Claim	Admissions & Denials
Cañeros did bring an action before the JCACA on 4 December 2000, but the JCACA, a Government-controlled organization, has taken no action on the case.	Denied.

Response:

[125] Letter from the office of the Attorney-General relating to Fiscal Matters dated 15 October 2003. The information relates to pending proceedings, it is therefore reserved in accordance with the applicable law. It is not possible to provide any further information or documents.

132. See paragraphs 73, 74, 102-107 and 123.

Statement of Claim, paragraph 57

Statement of Claim	Admissions & Denials
The effect of not enforcing the export requirements is that surplus sugar depressed prices in Mexico below remunerative levels for the mills. The non-complying mills benefited, in the sense that the Mexican prices, though depressed, were still well above world prices that would have been received if the mills had complied, and they faced no penalty despite the requirements of the *Acuerdos*.	Denied.

Response:

133. See paragraphs 102-107.

134. GAMI attributes the fluctuation in prices to the non-compliance of the mills with the export requirements, but ignores other factors affecting the market that, particularly given the circumstances of the Mexican sugar industry, had an important impact. The financial crisis in 1995 was still having adverse effects. [126] Sugar faced substantial competition from HFCS. It should not be ignored that most of the mills, including GAM's mills, were heavily in debt and encountered a severe liquidity crisis during the relevant period. The expert report of the Claimant, Andres Antonius, while analyzing the Mexican sugar industry, concludes that the companies which were heavily in debt had to lower their prices.

135. Many factors influenced the market and one cannot the attribute the price fluctuations solely to non-compliance with the export requirements.

c. Failure To Establish Maximum Production Ceilings To Encourage Reductions in Production

Statement of Claim, paragraph 58

Statement of Claim	Admissions & Denials
The Government similarly thwarted, rather than implemented, the production controls introduced as a requirement in the 1998 *Acuerdo*. The 1998 *Acuerdo* specifically required the CAA, SECOFI and SAGARPA to jointly issue the maximum production ceilings	Denied.

[126] For example, the CETES rate reached 74.75% in April 1995, and remained above 20% until January 1997. During the second quarter of 1998, as a consequence of the Asian crisis and lower oil prices, the CETES rate increased to 40.8% in September of 1998. The inflation rate reached its most critical level in 1995 (52%) and remained at a high level until 1998 (18.6%), at which point it began to decrease until it reached 4.4% in 2001.

for each mill by 1 October 1998. Notwithstanding this express requirement, the Government did not set production ceilings by the applicable deadline, or at any time since.	

Response:

136. See paragraphs 108-112.

Statement of Claim, paragraph 59

Statement of Claim	Admissions & Denials
On 9 March 2000, the Government published the Acuerdo por el que se ponen a disposición de los ingenios azucareros las cuotas de exportación por ingenio para la zafra 1999-2000 y los niveles de producción base por ingenio que surtirán efectos a partir de la zafra 2000-2001 (the "2000 Acuerdo"), which specified that SECOFI would provide the specific production ceilings to those mills that inquired. This information, however, was not made available at that time and, indeed, was never made available at any time before the expropriation in September 2001. The Government also never promulgated the regulations required by Article 2 of the 2000 Acuerdo. In the absence of any specified maximum production ceilings, no mill had any incentive or obligation to reduce production, and none ever did so.	Denied.

Response:

137. See paragraphs 108-112.

Statement of Claim, paragraph 60

Statement of Claim	Admissions & Denials
The consequence of all the Government's failure to comply with its own laws was twofold. First, the price paid to *cañeros* was too high relative to the domestic price of sugar because a high reference price inflated the cost of cane. Second, excess supplies depressed the domestic price of sugar as a result of the failure to implement export requirements and production controls.	Denied.

Response:

138. This paragraph does not contain a description of fact, instead it is simply argument. The evidence does not provide any support to the argument.

139. See paragraphs 98, 117-120 regarding the reference price.

140. See paragraphs 134-135 regarding the surplus.

7. Effects On GAM And GAMI

a. "Mexico's behavior reduced GAM's refiner's margin, which created the severe liquidity crisis during the spring of 2000"

Statement of Claim, paragraph 61

Statement of Claim	Admissions & Denials
The Government's failure to implement the 1997 and 1998 Acuerdos and enforce the export requirements was highly damaging to GAM's financial results. The average blended price GAM received for sugar (both standard and refined) on the Mexican market fell from M$ 4698 per metric ton in 1997 to M$ 4080 per metric ton in 2000, a decrease of 13.2 percent. This occurred over a period where the consumer price index in Mexico rose a cumulative 74 percent. Furthermore, the domestic component of the government mandated price of sugarcane rose during this same period from M$ 3339 per metric ton in the 1997/97 harvest to M$ 4633 in the 1999/00 harvest, a 38.8 percent increase.	Denied.

Response:

141. The Respondent has already explained in detail the 1997, 1998 and 2000 *Acuerdos* as well as the nature and scope of its intervention and that of the mill and *cañero* sectors.

142. This paragraph of the Statement of Claim incorrectly justifies the reasons for GAM's financial crisis. As it has been explained, there were many circumstances that compromised the financial condition of the industry and of GAM in particular:

- The mills were sold between 1988 and 1993 for 1 billion pesos (or approximately $500 million). In 1993, the industry had an accumulated moratorium debt with FINA of 900 million pesos. For 1995, the industry debt increased to 8,349 million pesos and FINA had to restructure the credit. In June 1997, the restructured debt with FINA increased to

13.235 billion pesos and in 2001 was around 25 billon pesos. GAM had high levels of debt. [127] GAM's total liabilities as of 31 December 1999 and 2000 were $2,421.4 and $3,385.3 million pesos, respectively. These liabilities represented 139.7% and 378% of GAM's stockholders equity in those years.[128]

- The financial crisis that was affecting Mexico was characterized by high levels of inflation, high interest rates, the devaluation of the peso, reduction of capital flows, negative growth (accumulated), a decline in consumption, unemployment, all of which had an adverse effect on the financial situation of GAM and its operating results.[129] The major part of GAM's debt was denominated in dollars. In 1996, 1997 and 1998, GAM suffered net exchange rate losses of 1.3 million, 6.5 million and 33.9 million dollars, respectively, by the effect of the devaluation of the peso in U.S. dollar debt. GAM did not protect itself against exchange rate fluctuations.[130]
- The characteristics of the harvesting and processing of sugarcane as well as the system of payment to the *cañeros*, also have an impact, because the mills required a lot of liquidity during the initial stage of the harvest but most of them were heavily indebted and had difficulties in securing additional credit. The Claimant's expert, also refers to this problem. He mentions that the Mexican capital market is an imperfect market characterized by credit rationing. Due to the fact that a mill bankruptcy not only affects the mill owners, but also a significant number of sugarcane producers, it is very difficult for banks to recover the securities in the credit. For this reason, the sugar industry seldom receives financing from private banks.[131] In relation to GAM's situation, the 20-F Report, at page 37 states: "As of December 31, 2000, the Company had no assurance and envisions that it is going to be very difficult to obtain working capital credit lines sufficient to meet expected capital needs during 2001."[132] Most of them, including GAM's mills, did not comply with their contracts with the *cañeros*.[133]
- The competition of substitute products, especially after the price of sugar was liberalized. In 1995, as a way to collect more economic resources and be able to pay their debts, the mills pressured the government to liberalize the price of sugar. However, this also had the effect that the sugar lost its competitiveness with substitute products.[134]
- High cost of production, associated with the financial requirements of the industry to modernize its plants, increase its productivity, reduce its costs of production and increase its profits. GAM's mills, one of them being San Francisco el Naranjal, had serious productivity problems in the field and in processing, with low profitability per unit of land and poor sugar content; and two of them, Benito Juárez and San Pedro, had medium

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127 Expert Report of Luis Ramiro García. Exhibit R-12.

128 Expert Report of Fausto García, p. 11. Exhibit R-16.

129 *Form20-F, Annual Report for the year 2000*, pp. 15 and 16. Exhibit R-57.

130 Ibid.

131 *Incentives and Performance in the Mexican Sugar Sector*. Antonius Gonzales, Andreas Constantin. Thesis to Obtain the Degree of Doctor of Economy, Harvard University, August, 1997, pp. 81-83. Exhibit R-51.

132 *Form20-F, Annual Report for the year 2000*, p. 49. Exhibit R-57.

133 Annex4 of the Administrative Record of the Expropriation (Minutes of 14 June, 2001.). Exhibit R-52.

134 Expert Report of Luis Ramiro Garcia, pp. 38-39. Exhibit R-12.

efficiency with problems with the productivity of the *cañeros*' fields.[135] The money that was given to the *cañeros* was also insufficient to enable them to modernize their production and reduce their own cost of production.

- The weather conditions affected the industry between 1997 and 1999, specifically with respect to GAM's mills which suffered frost damage (Tala and Lázaro Cárdenas), flooding (Benito Juárez), and drought (San Francisco)[136].
- The mills also suffered a surplus of offers in the market —anticipated by both the regulation of the sector in the context of the privatization of the industry as well as by the NAFTA— in a situation where the world market and the United States were heavily depressed and their prices at historic lows. This situation complicated the disposal of those surpluses and prompted the industry to try to sell their sugar in the domestic market, also at prices below the cost of production.[137] The excessive indebtedness of GAM, which made it difficult to have access to credit, also prompted its mills to sell at low prices.

143. In accordance with simple economic principles, a heavily indebted company will try to reduce prices in order to maintain liquidity.

Statement of Claim, paragraph 62

Statement of Claim	Admissions & Denials
The combination of the severe declines in the price it could obtain for its finished product and the simultaneous increase in the cost of its primary input – sugarcane – had a disastrous effect on GAM's financial performance. Adjusted for inflation, GAM's operating profits declined from a profit of over M$368 million in 1996 to an operating loss of over M$302 million in 2000.	Denied.

Response:

144. See paragraphs 117-120, 142-143 and Expert Report of Luis Ramiro García (Exhibit R-12)

b. Suspensión de pagos

Statement of Claim, paragraph 63

Statement of Claim	Admissions & Denials
This substantial decrease in revenues led to an acute cash flow crisis for GAM in 2000. Rather than allowing this cash shortage to force	First sentence admitted. Second sentence, the Respondent cannot admit or deny GAM's reasons for applying for *suspensión de pagos.*

135 Id., p. 34.

136 GAM's application for *suspensión de pagos*. Exhibit 53

137 Expert Report of Luis Ramiro Garcia, pp. 12 and 36. Exhibit R-12.

GAM to default on some of its obligations, and to protect the ongoing viability of GAM's operations for all interested parties, GAM instead filed for suspensión de pagos on 9 May 2000.	

Statement of Claim, paragraph 64

Statement of Claim	Admissions & Denials
Under the *Ley de Quiebras y Suspensión de Pagos* in effect at that time, a temporarily insolvent company could apply for suspensión de pagos, a judicial procedure to convene a company's debtors to negotiate and execute a general restructuring agreement, thereby allowing it to return to normal economic activity and avoid declaring bankruptcy. The purpose of this procedure was to enable companies in financial distress to pay their debts and continue operating. When a company is in suspensión de pagos, a judge appoints a trustee (síndico) to oversee its accounting and administration. The company continues to maintain control over its assets and operations under supervision of the trustee.	Admitted in part.

Response:

145. GAM applied for *suspensión de pagos* before the new law on commercial contests entered into force. As a consequence, the proceeding is ruled by the *Ley de Quiebras y Suspensión de Pagos*, which has been abrogated by the new law, except for judicial proceedings underway prior to its entry into force.

146. In accordance with the law, a company can be declared bankrupt if it has not complied, among other things, with its general liquidity obligations (Article 1). The law allows a company to enter into *suspensión de pagos* before being declared bankrupt (Article 394).

147. The *suspensión de pagos* proceeding has the purpose of bringing the creditors together in order to have their loans and priority recognized, as well as to meet in a *Junta de Acreedores* to negotiate an agreement to prevent bankruptcy, that can be approved or rejected by voting, in accordance with the majority that the law establishes in accordance with the type of agreement. In case the preventative agreement is approved by the creditors, it shall be sent to the judge who may approve or reject it. If the agreement is rejected by the creditors or the judge, the company is declared bankrupt.

Statement of Claim, paragraph 65

Statement of Claim	Admissions & Denials
Under suspensión de pagos, GAM was not	First sentence admitted. The rest is denied.

required to pay interest or principal on its debt. This provided significant relief from the liquidity crisis, and enabled GAM to make all required payments to its mill workers and cañeros. GAM promptly began negotiations with its senior creditor, Bancomext, on debt restructuring, and reached a tentative agreement within a few months. In September 2000, however, there was a change of administration and the new managing director of Bancomext declined to finalize the agreement. GAM sent numerous proposals to Bancomext during 2001, but Bancomext never provided a substantive response or counterproposal	

Response:

148. During the 1999/00 harvest, GAM only made a partial payment to the *cañeros* . For August 2000, GAM owed the *cañeros* almost 540 million pesos (approximately 54 millon dollars).[138] GAM reached an agreement with the unions to pay the debt. For that purpose, one of the *cañeros* unions authorized the *Fondo de Capitalización y Modernización del Campo Cañero* (FOCAM), a financial trust created for the *cañeros*, to give a loan to GAM in order to pay part of the debt owed to their own *cañeros* due to the "impossibility of obtaining credit" elsewhere because of the *suspension de pagos.*[139] The industry's situation did not improve and GAM encountered further difficulties in obtaining cash to pay its credit owing to FOCAM and it was in a situation of seeking modification of the payment schedule.[140]

149. GAM argued that, due to the liquidity crisis it was suffering during the 2000/01 harvest, it was not able to pay the *cañeros,* as required under the Sugarcane Decree and that it would try to negotiate a schedule for payment over 12 months with them. There was no certainty that it could reach an agreement.[141]

c. Expropriation Decree and Law

Statement of Claim, paragraph 66

Statement of Claim	Admissions & Denials
The Mexican Government formally expropriated GAM's five sugar mills, as	Admitted.

[138] Agreement between GAM, GAM's mills and the UNPC-CNC dated 18 August 2000 and Agreement between GAM and its mills and the UNC-CNPR dated 28 August 2000. Exhibit 58.

[139] Agreement between GAM and UNPC-CNC dated 18 August 2000 and Document No., 00/02 of the Trust for GAM *del Fideicomiso Fondo de Capitalización y Modernización del Campo Cañero* (FOCAM) dated 29 August 2000. Exhibit R-55.

[140] Letter from GAM to FOCAM dated 31 May, 2001. Exhibit R-56.

[141] *Form20-F, Annual Report for the year 1999*, pp. 19-20. Exhibit R-33.

well as 22 mills held by other investors, under the Expropriation Decree, a measure published in the Diario Oficial de la Federación on 3 September 2001 (the "Expropriation Decree")	

Statement of Claim, paragraph 67

Statement of Claim	Admissions & Denials
The Preamble to the Expropriation Decree listed seven criteria, five of which were substantive, purporting to explain the reason for expropriation of the 27 mills. The Expropriation Decree related to GAM states that the Government expropriated the sugar mills on the grounds of the public purpose listed in paragraphs V, VII, IX and X of Article 1 of the Ley de Expropiación ("Expropriation Law"). In addition, the Government created an Administrative Record ("Expediente Administrativo"), pursuant to Article 3 of the Expropriation Law, which under the law should contain evidence supporting the conclusion that each expropriated mill (or group of mills) satisfied the applicable criteria.	Denied.

Response:

150. The Expropriation Decree, in its preamble, states that the sowing, cultivation, harvest and processing of sugarcane are in the public interest, that sugar is a basic commodity for the low income community, and it characterizes the industry as one of high social impact because of its production and the employment that it generates. It declares that the owners of the expropriated mills caused them to lose their financial health by contracting high debts that caused them to be financially unviable and prevented them from operating with efficiency and complying with their requirements, which put at risk the assets of the field workers, the employment of the mill workers and external service providers and the economic activity of vast regions in the states where they are located, due to the fact that they did not have the necessary cash to guarantee the processing of more than 20 million tonnes of sugarcane for almost 50 percent of the *cañeros*. The Expropriation Decree specifies the reasons for public interest established in the expropriation law on which it is based.

151. The administrative file comprised by SAGARPA contains technical information that shows the suitability of the expropriated assets to satisfy the public interest upon which the Decree is based. The administrative file is available to interested parties.

152. The President did not publish a decree related to GAM or any other mill individually. The decree expropriates the assets and share of 27 mills including 5 which were owned by GAM.

153. The expropriated mills encountered a serious financial crisis that compromised the production and stability of the sector just before the harvest. GAM in particular was not able to obtain credit nor did it have access to credit. It did not have the necessary money to pay the *cañeros* for the early harvest, at such point that, due to its incapacity in obtaining credit, the *cañeros* were put in a position where they needed to loan a substantial amount of money to enable GAM to comply with its obligations. GAM encountered new difficulties with paying this credit and stated the impossibility of compliance with its sugarcane payment obligations for the harvest commencing in October 2001, in accordance with the requirements of the Sugarcane Decree. Additionally, GAM had debts with the Federal Government for approximately 450 million pesos as of 30 June, 2001.[142]

154. The federal government implemented the Financial Emergency Program to the System-Sugar Product in order to finance the payment of sugarcane to the mills before "la precaria situación financiera del sector, principalmente de aquellos grupos con un alta particiáción en la producción nacional.[143] GAM participated in this program. GAM, among other sugar corporations, held meetings with officials from SAGARPA and *cañeros*.[144] GAM argued that its debt with the *cañeros* was 463 million pesos. It also argued that it needed judicial authorization to obtain any kind of credit due to the *suspension de pagos* situation.[145] GAM and GAM's mills were labelled by Banco de Mexico as indicating that they were neither subject to any credit nor surety.[146]

Statement of Claim, paragraph 68

Statement of Claim	Admissions & Denials
The criteria purportedly justifying the expropriation, and their inapplicability to GAM, are discussed below in section IV.C.	Does not contain a description of the facts.

d. The legal challenges to the expropriation in the national fora: the *amparos*

Statement of Claim, paragraph 69

Statement of Claim	Admissions & Denials
Mexico has a federal judicial review system for the protection of individual rights guaranteed under the Mexican Constitution, known as amparo. The amparo proceeding allows claimants to request certain remedies, including	Admitted.

142 Report Technical-Administrative File. Exhibit R-58.

143 Presentation of the Rules of Operation of the Financial Emergency Program dated June 26, 2001. Exhibit R-59.

144 Minutes of the reunion between SAGARPA officials, *cañeros* and GAM's representative regarding GAM's debt to cañeros. 14 June, 2001. Exhibit R-60

145 Id.

146 Annex 3 of the Administrative Expropriation file. Qualification of the Banco de México. R-61.

specific performance, for violations of constitutional rights.	

Statement of Claim, paragraph 70

Statement of Claim	Admissions & Denials
Many mill owners, including GAM, filed amparo proceedings following the expropriation. On 24 September 2001, GAM submitted its amparo claim challenging the constitutionality of the Expropriation Law and of the Expropriation Decree.	Admitted.

Statement of Claim, paragraph 71

Statement of Claim	Admissions & Denials
GAM claims, among other grounds, that the authorities did not prove the public purpose that the government claimed to justify the expropriation of GAM's mills. In fact, neither the Expropriation Decree, nor the documents and information contained in the corresponding Administrative Record sustain the government's actions.	First sentence: Admitted. Second sentence: Denied.

Response:

155. See paragraphs 145-154

Statement of Claim, paragraph 71

Statement of Claim	Admissions & Denials
Although GAM's amparos have not yet concluded, other mill operators have succeeded in their claims. Indeed, in two cases Mexican courts have found the expropriation to be unlawful: • On 30 October 2002, a Federal Judge rendered judgment in favour of CAZE, declaring the Expropriation Decree was done in violation of the Mexican Constitution and was thus null and void. • On 2 January 2003, another Federal Judge rendered judgment in favour of one of Grupo Machado's mills, declaring that the Government had not established that the expropriation was done for a public purpose.	Denied

Response:

156. The majority of the *amparo* proceedings filed against the Expropriation Decree or the Expropriation Law (in the context of the expropriation of the mills), including GAM's and GAM's mills proceedings, have not yet been concluded with the exception of two of the proceedings.[147] Although some of the proceedings have concluded in the first stage of the judicial proceedings granting the *amparo* to the claimants, all of those have been challenged. The judicial proceedings continue and the disputing issues are *sub judice*.

157. GAMI and the Government of Mexico informed the Tribunal of the resolution granting the *amparo* to GAM and its mills. Both the Claimants and the competent authorities involved in the *amparo* challenged the judgment. The issue is still *sub judice.*

Statement of Claim, paragraph 72

Statement of Claim	Admissions & Denials
Under Mexican law, these judgments are binding only with respect to the parties before the court. They are, however, persuasive authority for the simple proposition that Mexico's nationalization of half the nation's sugar milling capacity was illegal.	First sentence: Admitted Second sentence: Denied.

Response:

158. As explained before, the judgments in both cases were challenged and the proceedings are still in process, as well as GAM's resolution.

159. However, it should be acknowledged that GAM withdrew its *amparo* proceedings in relation to two of its mills (San Francisco and San Pedro). Consequently, as GAM withdrew from its *amparo* proceedings, it implicitly admits that the expropriation was lawful and definitive. By withdrawing, GAM expressly admitted the validity and legality of the expropriation, at least for the two mills. The Supreme Court through standing jurisprudence has confirmed this.[148]

II. LEGAL SUBMISSIONS

A. Reservation of Jurisdictional Objections

160. In Procedural Order No. 4, the Tribunal noted that the positions expressed by the parties reveal a potential overlap between the issues of admissibility and jurisdiction and those regarding the nature of the controversy, and advised that the issues subject to investigation during this stage

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147 Of the two finished proceedings, one was filed by CAZE. The Supreme Court of Justice confirmed the dismissal of the proceeding. The other, was filed by Grupo Machado. A Circuit Tribunal (second instance tribunal) also confirmed the dismissal.

148. Relinquishment of the *amparo* proceeding implies the express consent to the measures complained of, and the Claimant does not have a legal right to initiate a new claim in respect of the same matter. Supreme Court of Justice. *Semanario Judicial de la Federación*: Época Novena, Part III, tesis P./J. 3/96, February 1996, p. 22. Exhibit R-62.

of the proceeding could have an effect on the former issues. The Government of Mexico reiterates its position on admissibility and jurisdictional issues and although it will try not to repeat them, in light of the Tribunal's observations, they inevitably need to be addressed. The logic and legal reasoning upon which the Respondent bases its objections, will become more evident, its implications clearer and its arguments more convincing when the Tribunal applies the rules of international law to the facts of this case.

1. The NAFTA Must Be Interpreted in Harmony With General Legal Principles and the Domestic Law of the NAFTA Party

161. In its Rejoinder on Jurisdictional Issues, and during the Oral Hearing, the Claimant disparaged Mexico's submission that the domestic law of a NAFTA Party, specifically its corporate law, is relevant to the treaty's operation and interpretation.[149] The Claimant's contention is manifestly incorrect.

162. Article 1131(1) requires tribunals to decide the issues in dispute in accordance with the Agreement "and applicable rules of international law". As Mexico pointed out in its submission concerning competence and admissibility, international law recognizes the basic principles and rules of corporate law, which were expressed in the International Court of Justice in the *Barcelona Traction* case. The legislation of the three NAFTA Parties share these principles and rules, and therefore, are pertinent to the operation and interpretation of the Treaty.

163. In fact, the NAFTA mirrors those principles and rules, refering to the different corporate interests involved, and frequently referring to the domestic law of the Parties. For example, Article 201, which defines the term "enterprise", contemplates the various forms of corporate organization and the term "enterprise of a Party" refers expressly to the legislation of the Party. Article 1139 contemplates various types of investments, including the enterprise itself, a shareholder or any other interest in the enterprise that would give the holder a right to share in the profits of the enterprise, or in its the assets in case of a liquidation, as well as debt instruments and certain types of loans to the enterprise, among others. Furthermore, it establishes that the "equity securities" as well as "debt securities" include "voting and non-voting shares, bonds, convertible debentures, stock options and warrants". Article 1139 itself defines "enterprise of a Party" as "an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there". Similarly, the definition of a "financial institution" in Article 1416 refers to a Party's legislation. A tribunal established in accordance with Chapter Eleven of the NAFTA examined that definition to determine the nature of the enterprise in issue and to determine whether the investment was regulated by Chapter XI or Chapter XIV. The tribunal analysed the applicable Mexican law, including that regarding the corporate structure of the enterprise. The tribunal agreed with Mexico that Chapter XIV applied, thereby limiting the scope of the claims that could be advanced.[150]

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149 Transcript of the Oral Hearing, p. 62, lines 17-21, p. 63, lines 9-16 of the English version.

150 See *Fireman's Fund Insurance Company* v. *United Mexican States*, ICSID Case No. ARB(AF)/02/01, generally and in particular at paragraphs 45-47. The Tribunal was comprised of: Professor Albert Jan van den Berg (President), Professor Andreas F. Lowenfeld and Mr. Francisco Carillo Gamboa.

164. NAFTA is consistent with each Party's legal provisions, as well as international legal provisions. It cannot be argued that the Parties to the NAFTA incorporated provisions and legal structures into the Treaty that are inconsistent with the principles and rules of corporate law recognized both by international law and their domestic regimes. An international treaty that addresses investment must, by definition, be coherent with the legal structures of the States in which the investments are made.

165. The national and international legal regimes should co-exist harmoniously rather than disjunctively.[151]

2. The Two NAFTA Parties Intervening in this Proceeding Have Agreed on the Interpretation of Articles 1116 and 1117

166. The Tribunal noted in Procedural Order No. 4 that it believed it was "not prudent to articulate a reasoned decision, particularly with respect to the admissibility of grievances of minority shareholders, until all facts have been determined with respect to all claims (including quantum)". Mexico accepts that decision. It wishes to record in that respect that the United States, the NAFTA Party of which GAMI is a national, agrees with Mexico on many points. Mexico wishes also to identify the points of agreement between both NAFTA Parties regarding submissions filed in the jurisdictional stage.

167. There are eight points of agreement between both NAFTA Parties regarding fundamental issues for the adequate operation of the Treaty:

a. A national of a Party cannot bring a claim against its own State under customary international law.[152]

b. The NAFTA is consistent with this principle: an enterprise of a Party cannot bring a claim against its own State. However, Article 1117 allows an investor of a Party to bring a claim under Chapter XI, on behalf of the enteprise, for damages suffered by it, provided that the enterprise is, directly or indirectly, owned or controlled by him.[153]

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151 It warrants noting that another NAFTA tribunal recently observed in the context of a denial of justice claim that having found injustices in trial proceedings in Mississippi, it asked itself whether it should intervene to right the wrong that the claimants had suffered. It stayed its hand because "[f]ar from fulfilling the purposes of NAFTA, an intervention on our party would compromise them by obscuring the crucial separation between the international obligations of the State under NAFTA, of which the fair treatment of foreign investors in the judicial sphere is but one aspect, and the much broader domestic responsibilities of every nation towards litigants of whatever origin who appear before its national courts…Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious), will damage both the integrity of the domestic judicial system and the viability of NAFTA itself." *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America*, ICSID Case No. ARB(AF)/98/3 at pp. 70-71. The Tribunal was comprised of: Sir Anthony Mason (President), Judge Abner J. Mikva and Lord Michael Mustill.

152 Submission of the United States of America (June 30, 2003) (hereinafter "U.S. Submission") at paragraph 10.

153 Id, at paras. 11 and 12.

c. Under customary international law, a shareholder cannot assert a claim for loss or damage suffered directly by a corporation. Both Mexico and the United States have directed the Tribunal to the central findings of the International Court of Justice in the *Barcelona Traction Case*.[154]

d. Both NAFTA Parties agree that minority, non-controlling shareholders have no standing to sue for alleged direct injury or damages to an enterprise of another Party[155]. Shareholders in these circumstances have no standing to bring a claim for alleged injury suffered by the enterprise.[156]

e. Customary international law distinguishes between the legal interests of the enterprise and the legal interests of the investor therein. Both Mexico and the United States agree that the legal interests of the enterprise and the investor must not be taken for each other. However, this is exactly what GAMI attempts to do.[157] Both Parties to the NAFTA have pointed out that if minority non-controlling shareholders were permitted to bring a claim under Article 1116 for indirect injuries, *i.e*., for injury allegedly suffered by the shareholder as a result of injury suffered by the enterprise, Article 1117 would be superfluous. [158]

f. Mexico and the United States concur that Articles 1116 and 1117 recognize the legal rights of the enterprise and its shareholders. The United States also concurs with Mexico that the distinction is fundamental to protecting the rights of creditors of the enterprises established in the territory of the Party against which a claim has been

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154 Id, at paras. 7 and 9.

155 Ibid. The United States gives examples of direct loss: "when the host State wrongfully expropriates the shareholder's ownership interests, whether directly through an expropriation of the shares, or indirectly by expropriating the corporation as a whole…[or]…damage sustained by a shareholder …incurred….as a result of it having been denied its right to vote its shares in a company incorporated in the territory of the host State." U.S. Submission at paragraph 9. See also Mexico's Rejoinder at paragraph 21.

156 The U.S. Submission notes: "If a minority non-controlling shareholder were permitted to bring a claim on behalf of an enterprise, the definition [in Article 1139] of "investment of investor of a Party" would be deprived of meaning." U.S. Submission at paragraph 7. See Mexico's Rejoinder at paragraph 27.

157 As the United States noted at paragraph 14, where it expressly disavows GAMI's attempt to equate injury to the enterprise with injury to the shareholder: "…the United States does not believe that Article 1116 can be fairly construed to reflect an intent to derogate from the rule that shareholders may assert claims only for injuries to their interests and not for injuries to the corporation. Nothing in the text of Article 1116 suggests an intent to derogate from customary international law restrictions on the assertion of claims on behalf of shareholders." Id. at para 14.

158 *Ibid*. Like Mexico, the United States has pointed out that if GAMI can identify an injury to its own legal rights and interests, *i.e*., *qua* shareholder, it has standing to complain about that measure under Article 1116. The United States identified various interest that could be considered in that category: "*A classic example of direct loss or damage suffered by shareholders is when the host State wrongfully expropriates the shareholders' ownership interests, whether directly through an expropriation of the shares, or indirectly by expropriating the corporation as a whole. Another example of direct loss or damage sustained by a shareholder is that incurred by the shareholder as a result of it having been denied its right to vote its shares in a company incorporated in the territory of the host State*". (The United States noted that the Claimant filed a claim for indirect expropriation and stated that it reserved its opinion on the merits; Mexico addresses this issue II.D of this Statement). None of the measures identified by GAMI in this case are of the type described above.

filed. According to the United States, Article 1135: *"...prevents the investor from effectively stripping away a corporate asset – the claim – to the detriment of others with a legitimate interest in that asset, such as the enterprise's creditors.*"[159] The United States points out further that: "*If a minority non-controlling shareholder could bring a claim under Article 1116 for loss or damage incurred directly by the enterprise, this goal [i.e., the protection of the company's creditors] would be thwarted and both Articles 1117 and 1135(2) would be rendered ineffective.*"[160] Both Parties agree that Article 1135 further highlights the fact that claims by shareholders and the corporation are based on different legal interests.[161]

g. Both NAFTA Parties agree that if a minority, non-controlling investor was permitted to bring a claim for loss or damage suffered by the enterprise there is a substantial risk of separate, consecutive proceedings and potentially double recovery, because nothing would prevent the enterprise from filing a separate claim and obtaining damages arising from the same breach.[162]

h. Both Parties agree that the alleged breach must cause direct damage or loss to the shareholder –or be a proximate cause of such damage or loss—to confer standing on the shareholder to file a claim. A shareholder cannot bring a claim in accordance with Article 1116 for damages or losses suffered directly by an enterprise.[163] The United States noted: "*In sum, a minority non-controlling shareholder may not bring a claim under the NAFTA for loss or damage incurred directly by an enterprise. A minority non-controlling shareholder has standing to bring a claim only for loss or damage to itself proximately caused by a breach"*. The position of the United States is consistent with that of Mexico concerning the scope and coverage of Chapter Eleven, in that the measures at issue must relate to the investor or its investment, which requires a relevant legal connection.[164] As noted above, the measures about which GAMI complains are measures that apply to GAM or GAM's sugar mills, and not to GAMI

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159 U.S. Submission at paragraph 17.

160 *Ibid.*

161 Mexico's Rejoinder at paragraphs 43-44.

162 The United States points out at paragraph 18 that: *"...the distinct functions of Articles 1116 and 1117 ensure that there will be no double recovery. When an investor that owns or controls an enterprise submits a claim under Article 1117 for loss or damage suffered by that enterprise, any award in the claimant investor's favor will make the enterprise whole and the value of the shares will be restored. A very different scenario arises if an investor that does not own or control an enterprise is permitted to bring a claim for loss or damage suffered by that enterprise under Article 1116. In such a case, for example, nothing would prevent the enterprise from also seeking available remedies under domestic law for the same injury..."* In fact, that is precisely what is occurring right now. GAMI is seeking to advance a claim for acts allegedly injurious of GAM and its subsidiaries, while at the same time, GAM and its subsidiaries are pursuing legal remedies against the expropriation decree. The federal government is exposed to the risks associated with the proceeding submitted under Chapter XI, as well as the risk associated with the *amparo* proceeding, and could end up paying double compensation for the same losses or damages.

163 *Id*., paras 19 and 20. The United States refers to the submissions made on this point in *Methanex Corp v. United States of America* (see submission of the United States, footnote 27)

164 Mexico's Rejoinder at paragraph 7.

itself; and the damages claimed by GAMI are solely the result of the alleged losses or damages suffered by GAM or its sugar mills.

3. *CMS* is of No Assistance to This Tribunal

168. During the Oral Hearing on Jurisdiction and Admissibility, the Claimant repeatedly referred to the Award on Jurisdictional Issues in the case of *CMS* v. *Argentina*[165] in support of three propositions: (1) that States can and have by treaty established different rules that supersede customary international law[166]; (2) that the *ius standi* of the juridical person extends to its shareholders, who are the real investors[167] and (3) that the Tribunal must disregard domestic corporate law.[168] The *CMS* case is not relevant to this proceeding, because the NAFTA has a specific provision that deals with issues regarding direct losses or damages suffered by the enterprise. Moreover, the NAFTA limits the scope of coverage of Chapter Eleven to the measures that a Party adopts or maintains in relation to investors of another Party to the Treaty or to their investments in the territory of the Party. The tribunal in that case did not consider the distinct interests of the enterprise and its shareholders.

B. General Comments on the Merits

169. Mexico will begin by making some comments on GAMI's claim as a whole. In doing so, Mexico will direct the Tribunal's attention to certain basic rules of international law, the application of which should lead the Tribunal to dismiss this claim.

a. First, this section first addresses the requirement of international law that a State be held responsible only for actions properly attributable to it.

b. Next, Mexico will address the agricultural surplus situation in the Mexican sugar market: neither allowing an agricultural surplus to develop nor failing to eliminate such a surplus implicate any international legal obligations, and in any event, within the constraints of the domestic law, the government made significant efforts to help the industry deal with the surplus. Moreover, Claimant's allegation that Mexico failed to effectively apply its law is unsustainable, as a matter of fact and as a matter of law. There is no evidence that such a claim was submitted before the competent authorities, nor that the authorities have issued a decision on this matter. GAMI has failed to identify any measure that can be interpreted as an arbitrary act according to the standards of international law.

c. Regarding the expropriation of the sugar mills, Mexico maintains that this Tribunal should not consider this issue. The Expropriatory Decree is not a measure concerning

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165 *CMS Gas Transmission Company* v. *The Republic of Argentina,* ICSID Case No. ARB/01/8, Decision of 17 July, 2003. The Tribunal was comprised of: Professor Francisco Orrego Vicuña (President), The Honourable Marc Lalonde P.C., O.C., Q.C., and H.E. Judge Francisco Rezek.

166 Transcript of Oral Hearing at page 53, line 19-21 and 54, lines 1-4 in the English version.

167 *Id.,* page 56, lines 1-13.

168 *Id.,* p. 63, lines 11-16

GAMI or its investment. The evidence –including the evidence provided by the Claimant—demonstrates that the expropriation is based on public interest. GAM has legal resources at its disposal to challenge it, and has used them before the competent tribunals. It is up to GAM –not to GAMI—to challenge the Decree's legality, including its stated reasons of public interest. Moreover, the Government offered fair market value in indemnity payment as required by the Federal Law of Expropriation. However, GAMI decided not to accept that offer but rather to challenge the Decree. Those proceedings are *sub judice*.

d. Finally, Mexico will address the alleged breaches of Articles 1105 and 1102.

1. The Conduct Must be Attributable to the State

170. State responsibility arises only with respect to acts that are properly attributable to the State. The *Articles on Responsibility of States for Internationally Wrongful Acts*, adopted in its 53rd session (the "Articles on State Responsibility"), set out the rules on attribution of conduct to a State.

171. The Expropriatory Decree is a measure attributable to Mexico. However, the Claimant is attempting to attribute responsibility to Mexico for its various responses to a problem caused by private actors. This Tribunal must carefully analyse each of the Claimant's allegations, because as shall be seen:

- In some cases the situation complained of resulted entirely from private acts;
- In others, the situation complained of involved agreements between *cañeros,* mills and the government.
- In others, the government is being blamed for the consequences of the lack of compliance by private parties or for their failure to resort to mechanisms available only to them.

172. A State is not normally responsible for the acts of private parties. These acts may be attributed to the State if the private parties were empowered by it to exercise elements of the governmental authority (Article 5) and if such persons acted in that capacity in that particular instance. (Article 8). The State is not internationally responsible for the acts of private parties.

173. The rules of State responsibility have an important bearing on the Claimant's claim.

2. The Sugar Surplus Resulted From Acts of Private Parties

174. After the privatization of the mills and NAFTA's entry into force, an eventual surplus in sugar production was expected. However, Mexico was not in the business of growing sugarcane

and milling *standard* and other grades of sugar during the relevant time. [169] As noted in sections I.A and I.B of this submission, the surplus emerged from the combined acts of private parties:

- *The mills themselves*: The mills collectively increased their output. GAM increased its production from 405,137 metric tons of sugar in 1995 to 435,126 metric tons in 2000, reaching their maximum level in 1997 with 489,290 metric tons. [170] During the same period, national production rose from 4,391,269 tons to 4,936,533 tons in 2000, reaching its maximum level in 1997 with 5,188,137 tons.[171]

- *The cañeros*: Private mill owners encouraged their growers to improve their productivity. GAM's harvested area rose from 53,229 ha. in 1995 to 63,489 ha. in 1997, the year in which it reached its maximum. The total harvested area grew from 537,106 ha. in 1995 to 642,625 ha. in 1998, the year in which it reached its maximum. [172]

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169 With the exception of two mills, La Joya and Santa Rosalia, which, due to insolvency, were under the control of Fideicomisio Liquidador ("FIDELIQ").

170 Sugar Agro-industry Committee. *Desarrollo Operativo Campo Fábrica 1996-2001*. Exhibit R-47. In the reports filed to the SEC GAM stated that due to an increase in productivity, a higher amount of sugarcane was processed and its sugar production rose at an annual rate of 9.9% and 9.5% respectively: Form 20-F Annual Report for 1999 filed with the U.S. Securities and Exchange Commission ("SEC"), at page 4. Exhibit R-33. GAM's SEC Form 20-F Annual Report for 1998 at page 3, Exhibit R-33, noted that "[d]uring the 1994-1998 harvest years, sugarcane milled and sugar produced at the Company's five mills grew at compounded annual growth rates of 9.9% and 9.5% respectively." Exhibit R-49. The SEC Form F-4 Registration Statement filed by GAM dated March 26, 1998 stated at page 4 that "[d]uring the 1994-1997 harvest years, sugarcane milled and sugar produced at the Company's three mills grew at compounded annual growth rates of 9.4% and 7.4% respectively." Exhibit R-9.

171 Id. The USDA Report entitled, "Mexico Sugar Annual 2000", (4 October 2000) notes on page 3: "*In recent years, the Mexican industry has achieved higher mill yields and recovery rates. Mill yields in MY [Marketing Year] 1998 were 10.78 percent, but the estimate for MY 1999 is 10.90 percent*." Exhibit R-50. The USDA Report entitled "*Mexican Sugar Production/Export Forecast Up*" (30 January 1997), noted on page 2: "*The Mexican Sugar production forecast for MY 1997 has been raised by about 2 percent, to 4.67 MMT (raw value), based largely on increased area. However, some sources estimate even higher production due to good weather conditions and higher cane yields. The milling industry also indicates that, due to improved efficiency in harvesting and milling, sugar yields are up the last two years*." Exhibit R-8. The USDA Report entitled, "Mexico, Sugar, Mexican Sugar Exports Increased for MY 1997/98" (30 September 1998) stated at page 1: "*FAS/Mexico has raised its MY 1997/98 estimate for Mexican sugar exports for to 1.28 MMT (raw value) because of greater production than earlier estimated and an almost flat domestic demand. The MY 1998/99 sugar export forecast has been revised upward to 1.0 MMT from the previous forecast. Mexican sugar production estimates for MY 1997/98 have been revised upward to 5.49 MMT raw value because of favorable weather and improved mill efficiencies*." Exhibit R-8.

172 Id. GAM's March 26, 1998 SEC Form F-4 Registration Statement noted on page 3 that *"[t]he Company provides short-term loans for planting sugarcane and purchasing capital equipment. The interest rate that has been charged to the growers is equivalent to the rate charged to the sugar mills by FINA. During 1997, the average interest rate charged was 29.8%. As of December 31, 1997, pro forma for the Acquisition, GAM had Ps.333.3 million (US$41.3 million) in loans outstanding to growers. The Company believes that this lending mechanism has encouraged a close relationship between the Company and the growers supplying the sugarcane to GAM's mills.*" Exhibit R-9. Also, GAM's F-20 Annual Report for 1998 stated on page 4: *"[i]n order to enhance crop yield and sugar content, the Company has promoted*

- *The US producers of High Fructose Corn Syrup*: During the relevant period, imports of U.S. HFCS displaced some 250,000 MT of Mexican sugar used in the industrial sweetener sector.[173]

- *Mexican consumers*: Consumers cut back on sugar purchases after the financial crisis struck in 1995. Thereafter, domestic consumption of sugar was flat. The USDA attributed the lack of growth in the Mexican marketplace to cutbacks in consumer spending.[174]

175. Other factors not attributable to Mexico that contributed to the surplus were good weather and growing conditions.

176. When NAFTA entered into force in 1994, Mexico had a net deficit of sugar. The privatization of the industry reversed this situation. Starting in 1995, Mexico experienced a surplus in sugar production. The USDA characterized this situation as a "remarkable rebound" in production since NAFTA's implementation. [175]

177. The growers and mill owners had the expectation of exporting the surplus of Mexican sugar to the U.S. commencing in 2000, as provided in the NAFTA GAM itself informed investors of the problems that would occur if such market access were restricted. In fact, the

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field management to the growers, including programs for irrigation, fertilization and scheduling." Exhibit R-49.

173 In a report entitled "High Mexican Sugar Production Forecast", 4 April 1997, USDA reported that in 1997, Mexico initiated an anti-dumping investigation on HFCS imports from the United States, stating at page 4: *"….The Mexican Chamber for the Sugar and Alcohol Industries alleges that the price level at which U.S. HFCS is imported prevents domestic sugar prices from reaching maximum potential levels, thus prejudicing domestic negotiations between the sugar industry and FINAZA (Mexican Sugar Financing Institution). Also, it is claimed that the sugar industry's investment projects are threatened by underpriced HFCS imports….[T]he Mexican industry indicates that, despite the increase of 20 percent in the import duty, HFCS is still being offered at prices competitive with sugar*." Exhibit R-63. A USDA Report entitled "Mexican Sugar Production to Increase for MY 1997/8", 30 September 1997, stated on page 2: "*The increasing use of HFCS is a concern for the sugar industry, because if domestic demand continues to be low for MY 1997/98, exports and ending stocks are expected to be higher.*" Exhibit R-8. The USDA Report entitled, "Mexican Sugar Exports to Increase", 10 April 1998, stated on page 6 that "*[w]ith the high levels of imported HFCS and higher levels of sugar production, the [Mexican] sugar industry claims there is a danger of closing of (sic) 15 to 20 mills, resulting in layoff of about 100,000 workers*." Exhibit R-14. A USDA Report entitled "Mexican Sugar Exports Increased for MY 1997/98", 30 September 1998 noted on page 3: "*The sugar industry maintains that sugar consumption has not been growing because alternative imported and domestic sweeteners have displaced sugar*." Exhibit R-8. The USDA also noted that "*sugar consumption has remained flat because of increased usage of alternative sweeteners, both imported and domestic*." USDA Report entitled "Mexico Sugar Semi-Annual 2000", October 10, 2000, Exhibit R-64 at page 3.

174 USDA Annual Report, 1996. Exhibit R-7.

175 According to the USDA: *"Behind the Mexican sugar industry's interest in this [bilateral dispute between Mexico and United States over Mexico's access to the U.S. market] … is the remarkable rebound in Mexican sugar production since implementation of NAFTA. As recently as the November-October marketing year 1994, Mexico produced only 3.8 million MTRV (metric tons, raw value) of sugar. By marketing-year 1998, Mexico produced a record of nearly 5.5 million. Although USDA forecasts a decrease to 5.04 million for marketing-year 1999, theyear's production would still be the second highest on record.*" Agricultural Outlook, September 1999, p. 17. Exhibit R-15

United States further restricted access to its domestic market from what was originally agreed upon in the NAFTA –which triggered a dispute between Mexico and the United States that is still alive— and, notwithstanding the increase in the quota from 25,000 MT in 1999 to 116,000 in 2000, the industry was unable to export the total amount of the surplus to the United States, and the quota was not enough to alleviate its situation.[176]

3. Having Sugar Surplus is Not a Breach of an International Obligation of the State

178. The Articles on State Responsibility set out two fundamental rules:

- Article 1 states that: "Every internationally wrongful act of the State entails the international responsibility of the State."

- Article 2 states that: "There is an internationally wrongful act of the State when conduct consisting of an action or omission: (a) is attributable to the State under international law; and (b) constitutes a breach of an international obligation of the State." [Emphasis added]

179. Thus, for State responsibility to arise, in addition to conduct attributable to the State, the action or omission must constitute a breach of an international obligation.

180. It does not appear that the Claimant is arguing that the Mexican State breached its obligations set out in the Treaty and subject to international liability, because the industry, collectively, generated sugar surpluses. Although the chapter does not fall within this Tribunal's jurisdiction, the Tribunal can take note of the fact that Chapter Seven of the NAFTA does not prohibit the generation of sugar surpluses. On the contrary, Annex 703.2 on Market Access, Section A, contains specific commitments applicable as between Mexico and the United States. Detailed provisions in Annex 703.2 set forth formulae for determining and guaranteeing Mexico's access to the U.S. market (and U.S. access to the Mexican market) for specified amounts of surplus production of sugar and syrup products. The international lawfulness of

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[176] GAM's SEC filings stated: "*Prior to NAFTA's ratification by the U.S. Senate, the U.S. and Mexican trade representatives exchanged side letters modifying certain NAFTA provisions applying to sugar. The side letters differ in their treatment of HFCS, however, especially with respect to the treatment of HFCS in the determination of whether Mexico is a net surplus sugar producer, which qualifies it for increased duty-free exports of sugar to the U.S. There can be no assurance that the current controversy surrounding the validity of the respective treatments will be resolved in a manner which is not materially adverse to the Company*." See "Overview of the Sugar Industry—Mexican Sugar Industry—Implications of NAFTA." GAM F-4 Registration Statement (March 26, 1998) at page 23 Exhibit R-9. GAM Form 20-F Annual Report for 1998 at page 17 Exhibit R-49; GAM Form 20-F Annual Report for 1999 at page 18 Exhibit R-33; GAM Form 20-F Annual Report for 2000 at page 13-14, Exhibit R-57. In the Form 20-F for 2000 at page 14, GAM also states: "*In the year 2000, this surplus tonnage of sugar will be used in exports to the US market pursuant to the new quota system under NAFTA. These provisions of NAFTA will allow for 250,000 metric tons of Mexican sugar to enter the US market tariff-free. In the event the Company's mills do not participate in the setting aside of inventory surpluses of sugar pursuant to the guidelines of the Mexican Government, they will be denied access to the US market by the Mexican Government, which could adversely affect the Company's results of operations*." In fact, Mexico's access in 2000 was not 250,000 MT; it was less than half that amount: 116,000 MT.

generating sugar surpluses is thus illustrated in the NAFTA itself. Far from prohibiting the Parties from generating surpluses, Annex 703.2 expressly encouraged Mexico to generate a surplus in sugar.

181. There is no internationally wrongful act committed by a State when a sugar surplus develops within its territory.

4. Mexico Had No International Legal Obligation to Intervene to Resolve the Surplus Problem

182. States routinely face agricultural surpluses and have wide discretion in choosing how to respond, if at all, to them. They have no legal duty to do so at international law and responses of States to agricultural surpluses therefore vary dramatically. States may:

a. employ export subsidies (a central feature of the European Union sugar program);

b. impose production controls;

c. impose marketing allocations (used occasionally by the U.S.);

d. pay storage costs to remove stocks from the market (a measure employed by the United States from time to time and one used by Mexico in this case);

e. purchase surpluses and destroy or otherwise dispose of them, such as through foreign food aid programs (a measure that has been used by the United States in the past);

f. encourage other industries to increase their consumption of surpluses (a measure used by Brazil and the United States to encourage the production of ethanol from sugar and HFCS, respectively);

g. simply allow market forces to rationalize production (a policy sometimes followed by the United States); or

h. a combination of such measures.

183. Although it had no national or international legal duty to rescue the domestic industry, Mexico faced demands for assistance from the mills, the growers, and the interested labour unions, and was cognizant of the dominant public policy concern of ensuring continued production of a key staple in the national diet from year to year. The government faced claims from the mills, *cañeros*, and workers' unions, aimed at improving the industry's health, notwithstanding that it was the industry itself which generated the surplus. Mexico responded to the industry's crisis in good faith to the extent that it was possible to act within the government's fiscal, constitutional, and legal framework. GAM itself recognized that there were legal constraints on the government's ability to assist in resolving the surplus problem. Its Form 20-F Annual Report for the year 1999, published on 28 April 2000, informed investors:

> Since the privatization of Mexico's sugar mills, the Mexican sugar industry has been subject to a rapidly changing economic and regulatory environment, principally as a result of the deregulation of domestic sugar prices, NAFTA, the Sugarcane Decree, the devaluation of the peso, periods of high inflation and the introduction of HFCS into the Mexican sweetener market. As a consequence, the Mexican sugar industry has developed a relatively high degree of internal coordination to respond to such changing circumstances. Recently, the Federal Competition Commission of the Mexican government, which enforces the Federal Law of Economic Competition, has taken an increasingly active role in the Mexican regulatory environment. While the Mexican Government has cooperated with and supported the Mexican sugar industry in its efforts to become more competitive and economically self-sufficient following the period of privatization, there can be no assurance that such cooperation will continue or that the Mexican Government's regulartory environment or policies, including under Mexican antitrust laws, will not change in a way that will subject to greater scrutiny or penalize the degree of coordination the Mexican sugar industry currently attempts to maintain.[177] [Emphasis added.]

184. GAM's statement is noteworthy for three reasons:

- First, it was made five years after Mexico first encountered a surplus in sugar production and after most of the events complained of by GAMI occurred (with the exception of the actual expropriation in September of 2001). That is, while the minority shareholder now seeks to impose international responsibility on Mexico for its allegedly poor administration of the *acuerdos* and other acts, the enterprise in which GAMI invested --the actual owner of the mills participating in the market and members of the Sugar Chamber-- described the federal government's actions as supportive and cooperative. This is radically different and, in Mexico's submission, a far more accurate characterization of the steps taken by the government than GAMI's after-the-fact allegations.

- Second, contrary to GAMI's attempt to characterize the federal government as the dominant and controlling actor in the events in question, GAM's statement correctly recognized that it was the Mexican sugar industry, not the federal government, that was coordinating responses to the sugar surplus problem within the framework of *inter alia* Mexican antitrust law and policy.

- Third, GAM's concern was that the federal government's having been supportive and cooperative of the industry's attempts to find solutions to the problem would be constrained by changing views of the antitrust authorites as to the appropriate degree of industry coordination.

185. Within the overall Mexican legal framework and the Government's fiscal constraints, the federal government took several actions: (a,b,c instead of bullets)

a. Mexico initiated a NAFTA Chapter Twenty dispute settlement proceeding and requested the establishment of an arbitration Panel that would clarify and confirm

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[177] GAM's Form 20-F for 1999 at page 19. Exhibit R-33.

Mexico's and U.S.'s rights and obligations regarding sweetener trade and specifically, the export of Mexican sugar surpluses;

b. As requested by the industry, the government eliminated the official price of sugar, which allowed the mills to increase their revenues;

c. Mexico granted a subsidy to help finance the storage costs of removing 600,000 MT of sugar;

d. Upon receiving a complaint from the domestic sugar industry (through the CNIAA), Mexico conducted an investigation into the dumping of HFCS from the United States and temporarily imposed antidumping duties.

e. Mexico entered into debt forgiveness and rescheduling negotiations with various sugar mills, including GAM's mills; indeed, Mexico, through its state-owned development banks, granted GAM a low interest loan that enabled GAM to pay off its U.S bondholders;

f. The federal government participated in the negotiations between mills and *cañeros* within the CAA, in order to address the problem of production surpluses in the domestic market. These negotiations resulted in the publication of the 1997, 1998 and 2000 *Acuerdos*;

g. Within its legal powers it sought the mills' compliance with their export quotas, by setting conditions for exports to the U.S. market and providing subsidies to mills that were in compliance.

186. All of these actions were undertaken in good faith to try to assist in a resolution of the problem caused by the industry itself.

5. Within the Framework of the CAA and the JCACA, the Federal Authorities Sought to Assist the Industry in Coping With the Surplus

187. The rules of attribution play a further role in this case. As previously demonstrated, the Claimant's characterization of the CAA and the JCACA is incorrect. The Sugarcane Decree, which itself resulted from an agreement between the federal government, states:

> … the ever-increasing participation of the social and private sectors as directly responsible for national sugar production, as well as the maturity attained by national and local sugarcane-producer organizations, make a direct treaty among the parties prudent, and that said treaty shall concern said parties' participation in the establishment of regulations and guidelines to govern business relations as well as their participation in the ruling of those controversies arising from such; [Emphasis added]

The sugar regime was predicated on direct treatment between the mills and the growers and included rules that governed their commercial relationships. In fact, the facilitation of agreements between these parties constitutes the CAA's main goal.[178]

188. The CAA is a tripartite entity comprised of an equal number of representatives of government, *cañeros* and mills: the fact that the Secretary of SAGARPA presides over the CAA and has the deciding vote, does not put the CAA under governmental control, nor does it give the government the power of imposing its decisions on the *cañeros* and mills, or allow it to annul or reject the agreements reached by them. In fact, the CAA always made its decisions on a consensual basis. The federal governement actively participated as a mediator in the CAA due to the importance of the sugar sector.

189. The instruments refered by GAMI as "applicable law", that establish the provisions allegedly breached by the Mexican government, stem from an agreement between the three sectors involved. These instruments do not establish the obligations of the Mexican government that GAMI alleges Mexico violated: the calculation of the reference price, the export requirements, and the base production levels. The industry participated in the determination of all of these three elements through the CNIAA. In fact, both the export requirements and the base production levels are the result of the commitments undertaken by the mills. Failure to comply with its commitments would give rise to penalties that could be demanded by the productive sector. In no case were these penalties enforceable by the government.

C. GAM's Disclosures and GAMI's Assumption of Risk

190. It is also appropriate, by way of context, to draw the Tribunal's attention to the risks of the investment as disclosed by GAM when it induced GAMI to invest in it.

191. The record is replete with evidence that GAM provided extensive warnings to its investors regarding precisely the types of problems it later experienced. For example, the 1997 GAM First Public Offering (*Oferta Publica Primaria*) includes a section entitled "investment considerations", which contains a subsection entitled "Unexpected Changes in Agricultural or Commercial Law." That subsection provides in pertinent part as follows:

> Although a large part of the laws and policies adopted that affect the sugar industry are supported by provisions of the NAFTA, there cannot be certainty that the Federal Government will not change the agricultural or commercial law in the future, or adopt or change the policies such that they could adversely affect the industry in general, or the Company in particular.[179]

192. Given that GAM's public offerings were directed to U.S. investors, U.S. securities law required that it submit registration statements and annual reports to the SEC. It did so between 1998 and 2001.[180] These statements and reports contain detailed descriptions of "risk factors"

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178 Sugarcane Decree, Article 2.

179 GAM's Initial Public Offering. 1 October 1997, p. 14. Exhibit R-29.

180 In response to Mexico's request for documents, GAMI provided draft reports --not the original documents. The registry forms and the annual reports are not available from the SEC web page, nor through *Lexis*, since they were not submitted in electronic format. However, Mexico obtained a copy of the documents

associated with making an investment in GAM. Amongst the risk factors listed in GAM's F-4 Registration Statement are:

- The limited combined operating history of the mills that had been acquired by GAM, which made it difficult for investors to evaluate GAM's likely performance;

- The company's high level of indebtedness and need for additional financing;

- The mills' lack of compliance with environmental law requirements;

- The fact that GAM was a holding company with no significant assets other than the stock of operating companies and sub-holding companies, and that there could be no assurance that the operating subsidiaries would generate sufficient net income to pay dividends or make payments of interest and principal on intra-company loans extended by GAM;

- Mr. Gallardo, as majority shareholder, had the power to appoint the majority of the counsellors, and make decisions requiring approval of the majority of shareholders, including those relative to and amendment in the company's bylaws, transactions with related companies, sale of assets, among others.

- GAM's acquisition of Grupo Multiazucar had resulted in complications and potential additional expenses because of a criminal proceeding against the former owner of Multiazucar; and

- GAM was from time to time named as a defendant in litigation, such as a lawsuit filed by sugarcane growers against the mills for not making additional payments as a result in increases in Mexico's official sugar price.[181]

193. The Registration Statement contains a separate section dedicated to describing the particular risks in investing in the Mexican sugar industry, which includes the following:

> *Fluctuation in Sugar Prices: The wholesale price of sugar has had and will continue to have a significant impact on the Company's profits. Like other agricultural commodities, sugar is subject to price fluctuations resulting from weather, natural disasters, domestic and foreign trade policies, shifts in supply and demand and other factors outside of the Company's control. The price of sugar, in particular, is also affected by producers' compliance with sugar export requirements and the resulting effects on domestic supply. There can be no assurance that, among other factors, competition from alternative sweeteners, including HFCS, changes in U.S. or Mexican agricultural or trade policy, ... or developments relating to international trade, including those under the World Trade Organization ..., will not directly or indirectly result in lower domestic or*

through a data recovery service. It is surprising to the Respondent that GAMI had access to the draft documents and not to the originals.

[181] GAM's Form F-4 Registration Statement, 26 March, 1998, pp. 17-26. Exhibit R-9.

U.S. sugar prices. The failure of domestic sugar prices to rise, substantially in accordance with the expectations contained in the Company's business plan, or any prolonged decrease in sugar prices, could have a material adverse impact on the Company. There can also be no assurance that the Company will be able to maintain sales at generally prevailing market prices for sugar in Mexico without discounts…

Competition From Alternative Sources: … Soft drink bottlers in many countries have switched to or increased consumption of alternative sweeteners. Additionally, the use of alternative sweeteners by sugar consumers other than the soft drink bottlers may also affect the demand for sugar in Mexico. While the Company has been reducing its sales to soft drink bottlers (which are the largest consumers of sugar in Mexico), any substantial decrease in sugar consumption by these sugar consumers, or increased competition for non-substitution sensitive sugar consumers arising from decreased sugar consumption by soft drink manufacturers, could have a material adverse effect on the Company. …

Risks Related to the Supply of Sugarcane: Adverse Weather Conditions…Dependence on Sugarcane Growers…Financing of Sugarcane Growers…Unexpected Changes in Legislation or Enforcement Policies; Competition

The Company's current business plan, in part, assumes that current US policies and legislation regarding trade and agriculture will continue relatively unchanged... There can be no assurance that … the U.S. Congress will not enact legislation which significantly modifies the U.S. sugar program. Should changes in US agriculture or trade policy or legislation occur, including changes that improve market access of other countries that produce surpluses of sugar, these changes could adversely affect the price of sugar in Mexico or U.S. demand for Mexican sugar and therefore adversely affect the Company's results of operations.

Prior to NAFTA's ratification by the U.S. Senate, the U.S. and Mexican trade representatives exchanged side letters modifying certain NAFTA provisions applying to sugar. The side letters differ in their treatment of HFCS, however especially with respect to the treatment of HFCS in the determination of whether Mexico is a net surplus sugar producer, which qualifies it for increased duty-free exports of sugar to the U.S.. There can be no assurance that the current controversy surrounding the validity of the respective treatments will be resolved in a manner which is not materially adverse to the Company….

Since the privatization of Mexico's sugar mills, the Mexican sugar industry has been subject to a rapidly changing economic and regulatory environment, principally as a result of the deregulation of the domestic sugar prices, NAFTA, the Sugarcane Decree, the devaluation of the peso, periods of high inflation and the introduction of HFCS into the Mexican sweetener market. As a consequence, the Mexican sugar industry has developed a relatively high degree of internal coordination to respond to such changing circumstances. Recently the Federal Competition Commission of the Mexican Government which enforces the Federal Law of Economic Competition, has taken an increasingly active role in the Mexican regulatory environment. While the Mexican Government has cooperated with and supported the Mexican sugar industry in its efforts to become more competitive and economically self-sufficient following period of privatization,

> *there can be no assurance that such cooperation will continue or that the Mexican Government's regulatory environment or polices, including under Mexican antitrust laws, will not change in a way that will subject to greater scrutiny or penalize the degree of coordination the Mexican sugar industry currently attempts to maintain….*[182]
>
> [Emphasis added]

194. Similar descriptions of the risk factors are incorporated into Private Placement Memorandum circulated by The Blackstone Group and InverMexico to solicit investments in GAM, as well as in GAM's Form 20-F Annual Report for 1998, 1999 and 2000.[183]

195. As noted in Mexico's Introduction to the Facts, the industry's structural and financial problems in the Mexican sugar industry were identified and described by the USDA *before* GAMI made its investment in GAM.

D. The Alleged Breach of Article 1110

196. The NAFTA recognizes each Party's right to expropriate. It prescribes both a process for effecting an expropriation and a requirement that, where the expropriation concerns "an investment of an investor of another NAFTA Party", the Party must pay compensation in accordance with paragraph 2 of Article 1110.

197. Mexico exercised its right to expropriate. By Federal Executive Decree of 3 September 2001, it expropriated 27 sugar mills, including five that were owned and controlled by GAM. The government acted in full compliance with the law: it explained the public purpose underlying its act; it caused the expropriation of those mills that were in such financial circumstances that put the sector at risk; it offered compensation at fair market value according to applicable law; and has submitted to the jurisdiction of the local courts to those affected private parties through appropriate instruments of defence, which in turn have been exercised and whose proceedings are still underway. There is no basis to allege a violation of Article 1110.

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182 *Id*. pp. 20-23.

183 According to GAMI's Notice of Intent (Oct. 1, 2001), it is a subsidiary of Equity Group Investments, LLC, a holding company chaired by financier Samuel Zell. See http://biz.yahoo.com/ic/47/47143.html. Mr. Zell, who describes himself as a "vulture investor" and as "the Grave Dancer," is known for his skill in purchasing distressed businesses and real estate at low prices. See, *e.g*., "The Return of the Wall Street Vulture," Business Week (Sept. 10, 2001) at 108; "A Tycoon Talks: Zell's World," Cincinnati Enquirer (Oct. 10, 1999) at 1E; "Bullish on Bankruptcy," Business Week (April 1, 2002) at p. 70 (referencing Zell's alleged losses on GAMI's investment in GAM). Exhibit R-65. With this background, it is not surprising that GAMI would make a high-risk investment in GAM; to the contrary, it appears that the company's practice was to make high-risk investments.

1. This Tribunal Has No Jurisdiction to Consider the Expropriation of the Sugar Mills

198. As Mexico explained in detail in its written and oral submissions, GAMI seeks to submit a claim that only GAM can make, and that in fact it has made before the proper competent forum – the domestic courts. The Federal Government expropriated five of GAM's sugar mills. GAMI claims are for the supposed effects of the expropriation on the value of its shares.

199. GAM is a Mexican entity that owned and controlled by Mexican nationals. Accordingly, GAM is prevented from submitting a claim under Chapter Eleven of the NAFTA, and this Tribunal lacks the jurisdiction to preside over the same. Nonetheless, GAMI seeks to have this Tribunal determine if the expropriation effected on GAM was illegal, and, if so, the effects of such on GAMI.

200. GAMI alleges the following:

- in two *amparo* proceedings instigated by persons other than GAM or the mills it owns, a federal judge held that the public purpose had not been proven, and added that "[t]he Government likewise has demonstrated no valid public purpose for the expropriation of GAM's mills. Accordingly, Mexico expropriated GAMI's investment without a public purpose in violation of Article 1110(1)(a)." (Emphasis added); [184]

- "[M]exico's action was discriminatory in that the mills of GAM were expropriated… while other sugar mills in like circumstances were not expropriated." (Emphasis added); [185]

- "the expropriation was not carried out in accordance with due process of law or with Article 1105" [186], because "[t]he Administrative Record concerning the expropriation of GAM, however, contains no allegations or evidence at all with respect to GAM in regard to most of the criteria of the Expropriation. Further, what little evidence is provided regarding GAM is patently false."[187] (Emphasis added); and

- "Mexico has not even offered compensation, let alone provided compensation in accordance with paragraphs 2 through 6 of Article 1110, as required by Article 1110(1)(d)."[188]

201. As noted by the Respondent, GAMI has submitted to this Tribunal a derivative claim that only GAM can submit. In fact, GAM has submitted such claim to the Mexican courts, which are the competent authorities.

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184 Statement of Claim, ¶ 143.

185 *Id.* ¶ 144.

186 *Id.* ¶ 145.

187 *Id.* ¶ 98.

188 *Id.* ¶ 146.

202. The Expropriation Decree sets out the financial situation facing the expropriated companies, and establishes the public purpose: it mentions the loss of the mills' financial well-being as a result of high levels of debt, which in turn compromised their capacity to gather the necessary financial resources to be able to process a large proportion of the harvested sugar cane. These circumstances put sugar (a basic consumption staple) production at risk, and with that the employment and assets of a large number of farm workers, as well as the economic activity in vast regions of the country. [189] The administrative file was compiled in accordance with the Federal Expropriation Law, and was made available to the interested parties. The Mexican legal system makes available to private parties those defensive means necessary to protect their rights. GAM, as other mills, resorted to them. By way of an *amparo* proceeding it challenged the validity of the Expropriation Decree. This suit is still pending. The Expropriation Decree provides for the payment of compensation that by law shall be the equivalent of the commercial value of the expropriated assets.

203. The Mexican courts must decide whether the expropriation was carried out in the public's interest; if GAMI was in fact in the situation described in the Expropriatory Decree; whether the administrative file was properly incorporated and whether the indemnity payment is in accordance with the fair market value of the expropriated assets. GAMI seeks to have this Tribunal assume a jurisdiction of the Mexican federal courts, and to decide the questions submitted to them by GAM. In Mexico's respectful submission, the Tribunal cannot so decide.

204. In addition, GAMI seeks to have this Tribunal determine the legality of the expropriation effected upon GAM, notwithstanding that GAM itself has accepted its legality – as far as two of the mills are concerned.[190] With all due respect, it would defy logic for this Tribunal to conclude that the expropriation effected against two of GAM's mills was illegal – as the Claimant seeks to do – when GAM itself has conceded its legality.

205. As for compensation, the Tribunal will appreciate that GAMI has been cautious in its language, and does not suggest that the Federal Executive has not offered any compensation to GAM. There is no dispute that that Expropriation Decree contains the offer of the federal government to pay the requisite compensation to those who verify their legitimate rights, upon the presentation of shares, coupons, or other documents representing the share capital of the expropriated companies.[191] Nor is there any dispute that the Federal Expropriation Law provides that the price to be fixed as compensation for expropriated assets shall be the equivalent of their commercial value. As such, GAMI's argument that the expropriation of the mills destroyed the value of GAMI's investment is groundless.

206. In its jurisdictional objections, Mexico referred in detail to basic rules and principles of corporate law recognized by customary international law, and the consequences that flow from the distinct legal personalities of companies and their shareholders. GAMI's efforts to have this Tribunal decide what in effect is GAM's claim perfectly illustrates Mexico's arguments. GAM has defined the strategies that best promote its own interests – and as such, those of its shareholders as a whole. GAMI apparently does not share the strategies and decisions of GAM,

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189 *See* the *considerandos* of the Expropriation Decree. Exhibit C-15.

190 See para. 159 of this Statement.

191 Expropriation Decree, Article 3.

and seeks to have this Tribunal, in effect, resolve GAM's claim (on the basis of arguments that GAM did not even make) and extrapolate its rationale in order to conclude that Mexico indirectly expropriated its investment.

2. GAMI's claim is not pertinent given the status of the legal proceedings

207. GAM's invocation of local remedies defines the legal issues that may be presented to this international Tribunal.

208. GAMI's claim is predicated upon the assumption that the expropriation is complete and that GAM's domestic legal proceedings are of no consequence to this international proceeding. This is manifestly incorrect. Numerous international authorities hold that an international tribunal must appropriately delineate its sphere of its jurisdiction *vis-à-vis* that of the domestic courts of the State.[192]

209. As in this case the owner of the expropriated shares – that is, the subject of the expropriation – is GAM, it is the municipal legal system which defines property rights[193] and determines whether an expropriation has been definitively effected. If that legal system resolves that the expropriation is not legally effective, the attempt to expropriate fails and the property interest reverts to the original owner.

210. GAMI is predicating its international claim upon certain juridical facts, the finality of which has not yet been determined by the tribunals that are properly vested with the jurisdiction to decide them. If the Decree is upheld and the expropriation definitively consummated, the competent authorities will pay the corresponding compensation on the terms provided by law and the Decree itself. If the federal courts find the Decree to be illegal, there will have not been an expropriation as defined by Article 1110.[194] The view articulated in the Statement of Claim, although counsel appeared to resile from it at the hearing on jurisdiction, was that even if GAM prevails in its domestic legal challenges and the expropriation decree is nullified, this Tribunal

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192 See *Robert Azinian et al*. v. *United Mexican States*, *Mondev International, Inc*. v. *United States of America*, *Waste Management, Inc.* v. *United Mexican States*, ICSID Case No. ARB(AF)/98/2, Award of 2 June 2000, Bernardo M. Cremades (President), Eduardo Siqueiros T. and Keith Highet (Arbitrators). *ADF Group, Inc*. v. *United States of America*, *Marvin Roy Feldman* v. *United Mexican States,* and the dissenting opinion of the late Keith Highet in *Waste Management, Inc*. v. *United Mexican States.*

193 In this regard, the Tribunal is respectfully referred to the approach taken by the *Feldman* tribunal in relation to the extensive domestic litigation between the claimant and the Mexican tax authorities. With the exception of one area of the award, which is presently the subject of an application for judicial review, that tribunal properly restricted its inquiry to ascertaining what rights Mr. Feldman had according to Mexican law as interpreted by the Mexican courts in order to determine whether Mexico had acted in accordance with its NAFTA obligations. See paragraphs 120-122.

194 Unlike other treaties, as is the case with the Argel Agreement, a Tribunal established in accordance with NAFTA Chapter XI, has no jurisdiction to determine whether a State has interfered with the property of an Investor of another Party. The jurisdiction of this Tribunal is limited to determine whether or not an expropriation has occurred. See Award in *Pope & Talbot*, Interim Decision of 26 June, 2000, p. 104. The Tribunal was comprised of: Lord Dervaird (President), Benjamín Greenburg and Murray Belman. The Tribunal in *S.D. Myers* agreed on this point. See Partial Award of 13 November, 2000, ¶ 286.

should ignore that juridical fact and hold that an expropriation has been effected at international law. The Respondent respectfully submits that such a result would be nonsensical.

211. If GAM succeeds in its *amparo* challenge, the Mexican authorities will comply with the courts' rulings and ownership of the mills will revert to GAM.[195] As Arbitrator Reisman commented:

> **Mr. Reisman**: *Mr. Perezcano has said that the Tribunal cannot assume that if there is in order for reinstatement that Mexico will not comply, which seems to me to be quite correct. I will put it in stronger terms. The Tribunal must assume that Mexico would comply. In any case, you have stated that the government would comply, which is a statement that certainly confirms it to the Tribunal.*[196]

212. The international legal effects of this eventuality were addressed further during that jurisdictional hearing:

> **Mr. Reisman**: *Mr. Aguilar, may I go back to something you said just before the Chairman posed the question, just to make sure I understood it. The reference now is to 1110. Did I understand you to say that even if Mexican processes were to reinstate GAM that a claim would still lie for GAMI under 1110?*
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> **Mr. Aguilar**: *To that I would say two things. What I said is that the amparos in Mexico are proceedings to determine whether the expropriation of GAM's mills was done in accordance with domestic law. And as such, domestic proceedings would not be dispositive of the issue submitted by GAMI to this Tribunal, namely its compensation due under NAFTA Article 10 (sic).*
>
> **President Paulsson**: *What if they happen to satisfy the NAFTA criteria?*
>
> **Mr. Aguilar**: *If that was the case and this Tribunal was so satisfied, true there would be no claim and GAMI's claim would be reduced to zero if it received compensation commensurate with what is required under Article 1110 by way of the proceedings that were initiated by GAM in Mexico.* [197]
>
> [Emphasis added]

213. Subsequently, the Claimant's counsel attempted to qualify his earlier answer:

> **Mr. Aguilar**: *... Professor, you asked about where this case would go in the event that there is restitution of the mills and pursuant to the Mexican proceedings, if I understood correctly. This takes the back to our point of departure. Our case is for indirect expropriation of GAMI's shares in GAM, and our case has been brought under Article 1110 of Chapter 11 of the agreement.*

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195 The award in *Azinian et al.* v. *United Mexican States* points out that the decisions of the domestic courts must be accepted as valid determinations of rights unless the courts themselves are disavowed at the international level. *Azinian et al. v. United Mexican States*, ICSID Case No. ARB(AF) 97/2 (1 Nov. 1999) at paragraph 97.

196 Transcript of the hearing, p. 106, lines 6-14.

197 Transcript of the hearing, pp. 59-60, lines 16-21 and 1-18, respectively.

> *Now, if there is restitution of the mills as a result of the Mexican legal proceedings and that restores the value of our shares pursuant to the international standards or to the level of the international standards under 1110, then …Mexico will have made GAMI whole, and at that point this Tribunal will only be seized with a request for a decision on costs.*
>
> *If restitution, or compensation for that matter, does not make GAMI whole, then we would still have a claim for the difference in addition to costs.*[198]
>
> [Emphasis added]

214. In Mexico's view, counsel's qualification actually succeeded in further emphasizing the expropriation claim's lack of ripeness. As of the time of this filing, the parties and the Tribunal can only speculate about the outcome of the domestic legal proceedings. Whatever the result, the Tribunal must assume that the Mexican authorities will comply with the court rulings, and the applicable expropriation regulations. Counsel questioned whether "restitution, or compensation for that matter" will make GAMI whole. In Mexico's view, the correct legal issue is whether GAM will either receive restitution or adequate compensation. Either way, the restitution or compensation will flow back to GAM to the benefit of its shareholders, Mexican and American alike.

3. The *Suspensión de Pagos* Proceeding

215. GAM filed another domestic legal proceeding that is relevant to this international claim – the *suspensión de pagos* proceedings. Leaving aside the unsettled status of the *amparo*, the Tribunal faces a second, more complex layer of domestic juridical facts, which the Claimant paradoxically invites the Tribunal to both recognize (for purposes of State responsibility) and then ignore (for purposes of damages).

216. The Claimant has stated that GAM voluntarily filed for *suspension de pagos*. Its outstanding liabilities are massive. In Mexico's view, GAMI is seeking to circumvent this fact by asserting that Mexico caused its poor financial condition and thereby forced GAM to seek such protection. Hence, its Article 1105 claim.

217. The Tribunal should recognize why GAMI is advancing this particular claim. GAMI purchased its shares in GAM between 5 December 1996 and 28 December 1998.[199] GAM's pre-existing financial condition worsened: the surplus put downward pressure on prices; needing cash flow to service its very large debt, the evidence indicates GAM (like other mills) discounted sales in order to retain or gain market share; GAM could not service its debt; and by 9 May 2000, GAM filed for creditor protection.[200] As GAMI notes, in 1996, when it first acquired shares in GAM, GAM had a profit of P$368 million; by the year 2000, when GAM petitioned for creditor protection, it had an operating loss of P$309 million.[201]

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198 Transcript of the hearing, pp. 137-138 lines 8-21 and 1-7, respectively.

199 Statement of Claim, at paragraph 11.

200 *Id*., ¶ 63.

201 *Id*., ¶ 62.

218. Obviously, GAM's serious financial difficulties affected its market value, which plummeted. GAMI does not want its 14.18 percent interest to be valued in relation to the true value of GAM. The available information on GAM's liabilities indicates that they outweigh its assets, that is, it has a negative value.[202]

219. During the jurisdictional hearing, the President referred to the difficulties underlying the Claimant's theory that paying GAMI damages in an international proceeding leads subsequently to the simple *pro rata* apportioning of damages to GAM :

> **President Paulsson**: If the minority shareholder prosecuted an international claim for the diminution of the value of his investment and succeeded, it is a 10 percent shareholder, so it gets 10 of the $100,000 total, that lost value. And the company in which it was a 10 percent shareholder prosecutes its claim as well, as is being done here, and let's say it is in a national forum, and then recovers market value, it happens to be the same thing where we are living in a world of hypothesis were everybody accepts the underlying phenomenon. So you have $100,000.
>
> And it is said to the company, actually you are only getting 90 because 10 have already been allocated and awarded elsewhere. Might not the company say when we have income as a corporation, it doesn't instantly go to our shareholders. We actually had other things in mind to do with that money, investments, paying other creditors, we have our corporate strategy in mind. Isn't there a problem at that level as well?[203]

220. The President's inquiry reflects the arguments made by Mexico's in its prior pleadings, namely, that it is universally recognized by corporate law that the shareholder is not a fractional owner of the company's assets. It has no proportional interest in the corporation's assets, and in accordance with universally accepted principles of corporate law, its interest in the company's assets is a residual one after all debts and liabilities are paid.[204] Compensation for the expropriation of GAM's mills is owed not to GAM or to GAM's shareholders but to each subsidiary of GAM that was the legal owner of a mill. However, GAM is seeking relief from its creditors who have legitimate rights and interests in GAM's assets, including the mills and any compensation paid to the mills simply adds to the asset side of a balance sheet that is dominated by outstanding liabilities. In fact, GAM is not able to freely take advantage of compensation, nor of the rest of its assets, while it remains under a state of protection from its creditors.

221. Mexico previously observed that NAFTA Article 1135(2), which deals with claims advanced under Article 1117 on behalf of an enterprise of the respondent State protects an important public interest:

> 2. Subject to paragraph 1, where the claim is made under Article 1117(1):
>
> (a) an award of restitution of property shall provide that restitution be made to the enterprise;

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202 Expert Report of FGA. Exhibit R-26.

203 Transcript of the hearing, pp. 113-114, lines 15-21 and 1-14 respectively.

204 Memorial and Rejoinder on Objections to Jurisdiction at ¶¶ 33, 44 - 47.

> (b) an award of monetary damages and any applicable interest shall provide that the sum be paid to the enterprise; and
>
> (c) the award shall provide that it is made without prejudice to any right that any person may have in the relief under applicable domestic law.
>
> [Emphasis added.]

222. This Article ensures that in the event that a tribunal determines that damages are to be paid, the moneys must be paid to the enterprise, not to any shareholder or other investors. The Treaty expressly preserves the rights that other parties, such as creditors, may have in the relief at domestic law. Article 1135 does not contain a similar provision corresponding to Article 1116.

223. Given that GAM is presently in *suspensión de pagos* proceedings, the rules that protect the interests of its creditors are well defined by applicable law. The entire proceeding unfolds under the supervision of a judge. The law provides a process for the recognition of creditors and establishes their priority. It requires that they meet as a "Group of Creditors" and negotiate an agreement with GAM. The Group of Creditors makes decisions by majority decision – the required majority varying depending on the type of agreement reached. If an agreement is reached, the company must comply with the assumed debt obligations and may emerge from creditor protection and continue to operate normally (if the company fails to fulfill the agreement it then falls into bankruptcy). If an agreement is not reached, the judge will declare the company bankrupt.

224. Permitting a shareholder to pursue an Article 1116 claim in respect of injury suffered by the enterprise improperly permits the shareholder to undermine or circumvent NAFTA's protections of third parties who have a right to the relief under applicable domestic law. Moreover, in this case the creditor proceedings are still pending, the creditors are identified and have appeared, their debts have been acknowledged, and the priorities established. To return to the President's comment, to permit a shareholder to obtain compensation could go to the detriment of the very company and its creditors.

225. As GAMI acknowledges, on the date of the expropriation GAM had a pending debt of 3,493 million pesos, equivalent to 4.5 times the value of the shareholder's equity.[205]

E. There is No Breach of the Minimum Standard of Treatment

226. GAMI alleges that Mexico violated the Article 1105(1) Minimum Standard of Treatment by: allegedly setting the price of sugarcane at a level that is higher than permitted under Mexican law and too high to permit profitable operation of sugar mills;[206] by failing to enforce the minimum export requirements, which it claims resulted in excessive domestic supply[207]; and by

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205 Expert Report of FGA, p.12. Exhibit R-26.

206 Statement of Claim, at paragraph 49.

207 *Id.* at paragraphs 50-57.

allegedly failing to implement the production controls required under Mexican law.[208] It is claimed that the cumulative effect of these alleged actions was that:

> *[f]irst, the price paid to the cañeros was too high relative to the domestic price of sugar because a high reference price inflated the cost of cane. Second, excess supplies depressed the domestic price of sugar as a result of the failure to implement export requirements and production controls.*[209]

227. GAMI claims that Mexico ignored its own law and procedures in expropriating the mills of GAM and GAMI's shares in GAM, and discriminated against GAMI's investment by seizing the mills of GAM, but left similarly-situated mills as they were.[210] As already addressed in Mexico's response to GAMI's averments, the facts do not support these allegations.

228. The Claimant's legal theory can be summarized as follows:

- at the end of 1996, GAMI invested 25 million dollars in the share capital of GAM; at the end of 1997 it invested 5 million more; and at the end of 1998 it again increased its shareholding stake.

- the Tribunal should ignore many factors that influenced the sugar market over that period, including the industry's privatization efforts, Mexico's financial crisis, the characteristics of the world sugar market, the state of the bilateral trade between the U.S. and Mexico during the relevant period, and the dispute between both countries on sweeteners trade;

- the Tribunal should also ignore the acts of innumerable private persons, including all of the sugar mills, the *cañeros* organizations, and the HFCS producers and importers;

- the Tribunal should attribute the emergence of the surplus and its impact on heavily indebted companies to Mexico and impose international responsibility on Mexico for that impact;

- consequently, the Tribunal should value GAMI's investment in 2000 by ignoring its actual financial situation, in particular, as if GAM did not petition for bankruptcy protection and considering that GAM would have performed under the most optimistic scenarios, notwithstanding that these bear no relation at all to reality; and

- in addition, the Tribunal should ignore the legitimate interests of all of GAM's creditors – and GAM itself - and pay damages to this minority shareholder in priority to the rights of the creditors (which in this case have been determined judicially), and all the other GAM shareholders, contrary to all basic rules of corporate law, the protections granted to third parties by Article 1135, and

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208 *Id,* at paragraphs 58-59.

209 *Id.*, paragraph 60.

210 *Id.,* paragraph 74.

> Mexican law in respect of bankruptcy protection and *suspensión de pagos* to which GAM voluntarily subjected itself.

In Mexico's respectful submission, this theory of international responsibility and recovery is untenable.

229. Leaving aside GAMI's patent attempt to circumvent the rights of creditors, there are other difficulties with the claimed breach of Article 1105. It is neither jurisdictionally, legally, nor factually sustainable:

(i) The measures complained of do not relate to GAMI's investment as contemplated by the plain language of Article 1105 (independently of Mexico's arguments in relation to 1101);

(ii) The measures complained of do not violate any rule of customary international law; and

(iii) The measures complained of did not have the injurious effect complained of.

1. Article 1105 applies to an "investment of an investor ", not to an "investor" *per se* nor to an investment that is not owned or controlled by an investor of another Party

230. Article 1105 expressly differentiates between the treatment accorded to "investments of investors of another Party" (addressed in paragraph 1) and treatment accorded to "investors of another Party, *and* to investments of investors of another Party" (addressed in paragraph 2). The Article states:

> **Article 1105: Minimum Standard of Treatment**
>
> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.
>
> 2. Without prejudice to paragraph 1 and notwithstanding Article 1108(7)(b), each Party shall accord to investors of another Party, and to investments of investors of another Party, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.
>
> 3. Paragraph 2 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 1102 but for Article 1108(7)(b).
>
> [Emphasis added.]

231. As pointed out in Mexico's jurisdictional objections, the only "investment of an investor of another Party" properly before the Tribunal in this case is GAMI's 14.18 percent interest in the issued share capital of GAM. The proper focus of an Article 1105(1) analysis, therefore,

must be on any measure relating to that investment (*not* to the investor therein) that is said to violate the customary international law minimum standard of treatment.

232. The Claimant has identified no such measure.

233. The Statement of Claim repeatedly refers to Mexican measures that apply to the five mills owned by GAM[211], to GAM[212], or to other mills in Mexico.[213] None of these entities is an investment of an investor of another Party.

234. Unlike paragraph 2, paragraph 1 of Article 1105 does not apply to investors of another Party. As a matter of basic treaty interpretation, by referring only to investments and not investors as well, its scope is necessarily more limited than paragraph 2.

235. Mexico therefore reiterates its objection to the Tribunal's jurisdiction to determine whether the Respondent's measures relating to GAM's five mills give rise to a cognizable claim of breach of Article 1105 at the instance of GAMI.

2. Article 1105 establishes a customary international law standard of treatment

236. In the unlikely event that the Tribunal ultimately finds that GAMI has standing to complain about measures that relate solely to the Mexican sugar industry, the Article 1105 claim still fails. The Claimant has failed to identify any rule of customary international law that Mexico has violated respecting its treatment of the Mexican sugar industry.

237. On 31 July 2001, the Free Trade Commission issued a Note of Interpretation on Article 1105. Article 1131(2) establishes that such an interpretation "shall be binding on a Tribunal established under" Section B of Chapter XI. The Interpretation clarifies that Article 1105 contains a customary international law standard; in particular, "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law standard of treatment of aliens."[214] The Tribunal must thus apply customary international law.[215]

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211 Id., at ¶ 17, 20, 35, 39, 40, 45, 46, 48, 50, 51, 52, 66, 67, 74, *etc*.

212 Id., at ¶ 21, 22, 49, 52, 61, 62, 70, 71, 74, *etc*.

213 Id., at ¶ 53- 57, *etc*.

214 *Note of Interpretation issued by the Free Trade Commission*, 31 July 2001, Section B.

215 While one Tribunal (the *Pope & Talbot* tribunal) disparaged this Note of Interpretation as a possible amendment but ultimately applied it; see its Final Award at paragraphs 53-54, subsequent tribunals expressly refused to follow the approach taken by the Pope & Talbot tribunal and readily and properly applied to the Free Trade Commission's Note. For example, the *ADF* tribunal commented:

> "We have noted that the Investor does not dispute the binding character of the FTC Interpretation of 31 July 2001. At the same time, however, the Investor urges that the Tribunal, in the course of determining the governing law of a particular dispute, is authorized to determine whether an FTC Interpretation is a "true interpretation" or an "amendment." We observe in this connection that the FTC Interpretation of 31 July 2001 expressly purports to be an interpretation of several NAFTA provisions, including Article 1105(1), and not an "amendment," or anything else. No document purporting to be an amendment has been submitted by either the Respondent or the other NAFTA

a. There are no customary international law rules prohibiting the generation of agricultural surpluses

238. The Government of Mexico has already noted that rather than prohibit the generation of sugar surpluses, NAFTA actually recognized their lawfulness. There is no evidence that under customary international law states are prohibited from generating production surpluses or that they have an obligation to eliminate them in the event of their generation. In any case, the conventional international law applicable in this case, the NAFTA, recognizes –and in fact promotes– this situation.

b. A breach by authorities of the domestic sugar policy is insufficient to establish international state responsibility

239. GAMI alleges that in administrating its sugar policy, Mexico violated its own law. [216] In the context of its Article 1105 claim, GAMI asserts "the breach by a government of its own law is clearly an example of unfair treatment". [217] This argument does not withstand analysis.

> Parties. There is, therefore, no need to embark upon an inquiry into the distinction between an "interpretation" and an "amendment" of Article 1105(1). But whether a document submitted to a Chapter 11 Tribunal purports to be an amendatory agreement in respect of which the Parties' respective internal constitutional procedures necessary for the entry into force in the amending agreement have been taken, or an interpretation rendered by the FTC under Article 1131(2), we have the Parties themselves - all the Parties - speaking to the Tribunal. No more authentic and authoritative source of instruction on what the Parties intended to convey in a particular provision of NAFTA, is possible. Nothing in NAFTA suggests that a Chapter 11 tribunal may determine for itself whether a document submitted to it as an interpretation by the Parties acting through the FTC is in fact an "amendment" which presumably may be disregarded until ratified by all the Parties under their respective internal law. We do not find persuasive the Investor's submission that a tribunal is impliedly authorized to do that as part of its duty to determine the governing law of a dispute. A principal difficulty with the Investor's submission is that such a theory of implied or incidental authority, fairly promptly, will tend to degrade and set at naught the binding and overriding character of FTC interpretations. Such a theory also overlooks the systemic need not only for a mechanism for correcting what the Parties themselves become convinced are interpretative errors but also for consistency and continuity of interpretation, which multiple ad hoc arbitral tribunals are not well-suited to achieve and maintain." [Emphasis added] (At paragraph 177.)

Similarly, the *Mondev* tribunal readily applied the Note of Interpretation. After discussing the textual meaning of Article 1105, that tribunal noted:

> "To this the FTC has added to clarifications which are relevant for present purposes. First, it makes clear that Article 1105(1) refers to a standard existing under customary international law, and not to standards established by other treaties of the three NAFTA Parties... Secondly, the FTC Interpretation makes clear that in Article 1105(1) the terms "fair and equitable treatment" and "full protection and security" are, in the view of the NAFTA Parties, references to *existing* elements of the customary international law standard and are not intended to add novel elements to that standard." [Italics in original] (Award at paragraphs 121-122.)

216 Statement of Claim, ¶ 85.

217 Statement of Claim, ¶ 77.

(i) There has been no judicial determination that the competent authorities have violated the sugar regulatory framework

240. Unlike *ELSI*, where the Italian courts ruled that the requisition of ELSI's factory was an "excess of power" under Italian law,[218] there has been no judicial determination in this case regarding Mexico's administration of its sugar program.[219] The Tribunal simply has the Claimant's bald assertion that Mexico failed to enforce its own law. Nevertheless, not even the mills –the actual subjects of the Mexican sugar regime – have submitted before the competent domestic tribunals any claims against the respective authorities for the supposed violations that GAMI alleges. The necessary juridical underpinning for GAMI's international law claim does not exist.

241. Consistent with *ELSI*, another NAFTA tribunal has held that it could not usurp the role of the domestic courts and find that a governmental agency had breached domestic law:

> *More important for present purposes, however, is that even had the Investor made out a* prima facie *basis for its claim [that a U.S. agency acted* ultra vires*], the Tribunal has no authority to review the legal validity and standing of the U.S. measures here in question under administrative law. We do not sit a a court with appellate jurisdiction with respect to the U.S. measures.*[220]

242. Previous NAFTA Tribunals consistently agree that it is not their function to determine domestic law violations.[221] This however is exactly what GAMI requires this Tribunal to do in order to lay the foundation for the second part of its Article 1105 claim. However, the second part cannot be advanced in the absence of the requisite juridical facts.

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218 *Case concerning Elettronica Sicula, S.p.A*., (United States v. Italy), 1989 I.C.J. Reports, 4 at paragraph 75.

219 These submissions concern the Claimant's arguments at Part IV of the Statement of Claim that the Mexican sugar program was poorly administered. This section concerns the allegations that Mexico set too high a reference price, failed to ensure compliance with the export requirements, and did not give effect to the *acuerdos'* machinery for resolving disputes. Mexico admits that *amparo* proceedings were initiated against the Expropriation Decree.

220 *ADF Group, Inc. v. The United States of America*, ICSID Case No. ARB(AF)/00/1, Award of 9 January 2003 (hereinafter "ADF Award"), ¶ 190.

221 In *Marvin Roy Feldman* v. *The United Mexican States* (ICSID case No. ARB(AF)/99/1), the Tribunal noted that: "…its jurisdiction under NAFTA Article 1117(1)(a), which is relied upon in this arbitration, is only limited to claims arising out of an alleged breach of an obligation under Section A of Chapter Eleven of the NAFTA. Thus, the Tribunal does not have, in principle, jurisdiction to decide upon claims arising because of an alleged breach of … domestic Mexican law. Both the aforementioned legal systems (general international law and domestic Mexican law) might become relevant insofar as a pertinent provision to be found in Section A of Chapter Eleven explicitly refers to them, or in complying with the requirement of Article 1131(1) that "A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law." Other than that, the Tribunal is not authorized to investigate alleged violations of either general international law or domestic law." [Emphasis added.] Interim Decision at paragraph 61. See also the comments of the *ADF* Tribunal in its final award at paragraph 19. The *Loewen* Tribunal stated at paragraph 51, "The Tribunal cannot under the guise of a NAFTA claim entertain what is in substance an appeal from a domestic judgment." See also, *Feldman* Final Award at paragraph 50.

(ii) The conduct of the Mexican authorities was not arbitrary

243. The Claimant is forced to admit that "a state's failure to comply with its own law or authority in a particular situation does not automatically constitute a violation of Article 1105 or international law."[222] The *ADF* Tribunal, applying well-established principles of international law, made this point:

> *190. …Our jurisdiction is confined by NAFTA Article 1131(1) to assaying the consistency of the U.S. measures with relevant provisions of NAFTA Chapter 11 and applicable rules of international law. The Tribunal would emphasize, too, that even if the U.S. measures were somehow shown or admitted to be ultra vires under the internal law the United States, that by itself does not necessarily render the measures grossly unfair or inequitable under the customary international law standard of treatment embodied in Article 1105(1). An unauthorized or ultra vires act of a governmental entity of course remains, in international law, the act of the State of which the acting entity is part, if that entity acted in its official capacity. But something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1), even under the Investor's view of that Article. That "something more" has not been shown by the Investor.* [223]
>
> [Emphasis added]

244. In order to demonstrate that there was "something more" that transforms an undetermined breach of domestic law into a violation of international law, GAMI alleges that the conduct of the Mexican authorities was arbitrary. But even if – for the sake of argument – there existed a finding by domestic courts that Mexican authorities violated domestic sugar law, those acts could not be considered as arbitrary.

245. International law strictly defines the concept of arbitrariness. Both the majority and dissenting opinions so held in the *ELSI* decision:

> *124. It must be born in mind that the fact that an act of the public authority may have been unlawful in municipal law does not necessarily mean that the act was unlawful in international law, as breach of treaty or otherwise. A finding of the local courts that an act was unlawful may well be relevant to an argument that was also arbitrary; but by itself, and without more, unlawfulness cannot be said to amount to arbitrariness. It would be absurd if measures later quashed by higher authority or a superior court could, for that reason, be said to have been arbitrary in the sense of international law. To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. Nor does it follow from a finding by a municipal court that an act was unjustified, or unreasonable, or arbitrary, that that act is necessarily to be classed as arbitrary in international law, though the qualification given to the impugned act by a municipal authority may be a valuable indication.*

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222 Statement of Claim, ¶ 77.

223 *ADF* Award, ¶ 190.

The Chamber added:

> *128. Arbitrariness is not something so much opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the* Asylum *case, when it spoke of "arbitrary action" being "substituted for the rule of law"...It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety. Nothing in the decision of the Prefect, or in the judgment of the Court of Appeal of Palermo, conveys any indication that the requisition order of the Mayor was to be regarded in that light*.[224]
>
> [Emphasis added]

The holdings of the ICJ Chamber have been expressly approved by NAFTA tribunals.[225]

246. Mexico's acts at issue in this case, viewed fairly in light of the difficult circumstances in which the sugarcane growers and the mills found themselves, and given the state of the sugar industry worldwide, within the United States, and particularly within Mexico, cannot be viewed as rising to the level of arbitrary acts at international law.

247. As the basis for its argument that Mexican authorities acted arbitrarily, GAMI, by way of an exercise in statutory interpretation, first alleges the existence of certain obligations of those authorities, and, secondly, alleges that they were not complied with. By way of a partial reading of the *considerandos* of the Sugarcane Decree, GAMI imposes an obligation on the government to intervene in the sector and manage it "either directly, or through the CAA that it controls". [226] As a derivative of this supposed obligation, the Claimant infers a further mandate to actively enforce compliance with export commitments and base levels of production.

248. Nevertheless, GAMI has not been able to refer to any concrete provisions of law that establish such obligations. What GAMI in effect asks this Tribunal to determine – as a matter of Mexican law – is that they exist under Mexican law and that the authorities did not comply with them.

249. In the absence of a determination of illegality under Mexican law, the Tribunal cannot proceed to analyze if the conduct of the Mexican authorities rises to arbitrariness under international law. The Claimant so acknowledges:

> *Because the coverage of Chapter 11 and Article 1105 is broad, just what makes up that "something more" [than simple illegality or lack of authority under the*

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224 *Elettronica Sicula, S.p.A.* (Estados Unidos c. Italia), 1989 *ICJ Reports*, p. 15.

225 *ADF* Award, ¶ 190. *Mondev* Award, ¶ 108. The ELSI Tribunal cited Mexico's statement with regard to Article 1128 and the concept of arbitrariness. It stated: "*The key point is that the Chamber accorded deference to the respondent's legal system in applying the standard, finding that even though the mayor's act of requisitioning the factory at issue in the case was unlawful at Italian law as an excess of power, mere illegality did not equate to arbitrariness at international law.*" Cited by the *Mondev* Tribunal in its award, ¶ 108.

226. See paragraph 38 of the Statement of Calim regarding paragraphs 35 and 37. GAMI states "The referred goals of certainty, profitability and equity established in the Sugarcane Decree require the intervention and direction of the Government, either directly, or through the CAA that it controls".

> *domestic law] to constitute a breach of Article 1105 beyond isolated failure to follow domestic law necessarily depends on the circumstances of the case. The ADF Tribunal itself implies, and other international law corroborates, that the arbitrariness of the violations may constitute that "something more" that renders the conduct inconsistent with the minimum standard*

250. The Tribunal will appreciate that GAMI's Statement of Claim is essentially limited to describing the conduct of the Mexican authorities as arbitrary, without more. [227] Its argument is circular: notwithstanding that it acknowledges that a finding of illegality under domestic law is insufficient in order to amount to a violation of Article 1105, it describes the conduct of the authorities as arbitrary as a result of its illegality. Apparently, the only distinct basis in which it sustains its arbitrariness argument is the "cumulative effect" of the alleged violations of Mexican legislation[228], that is, the existence of three purported unlawful acts, and not one.

251. The Government of Mexico submits that this is likewise insufficient. As stated by another Chapter 11 Tribunal, "[t]he egregiousness of any breach is in the eye of the beholder" and "[l]abeling is, however, no substitute for analysis"[229]. Beyond the realm of rhetoric, GAMI has not established that the conduct of the Mexican authorities rises to the level of arbitrariness in violation of international law. There is no "wilful disregard of due process", no "act which shocks, or at least surprises, a sense of juridical propriety".

252. The Claimant's argument is based on the purported illegality of the authorities' actions under Mexican law. To that end, GAMI seeks to have the Tribunal assume a competence that it does not have, and undertake a task tantamount to judicial review of those actions. As such, if this Tribunal has no jurisdiction to determine the existence or not of the alleged unlawful acts, it certainly can not proceed – per the terms of the submitted claim – to determine if those actions constitute a breach of international law.

253. NAFTA tribunals have consistently held that the alleged poor administration of government programs does not amount to a violation of the minimum standard of treatment under customary international law. The *S.D. Myers* tribunal, for example, concluded as follows:

> *261. When interpreting and applying the "minimum standard", a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections…*
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> *263. The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international*

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227 Statement of Claim, section IV.

228 See paragraph 84 of the Statement of Claim.

229 *Azinian* Award, ¶ 90.

> *perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. The determination must also take into account any specific rules of international law that are applicable to the case.*[230]
>
> [Emphasis in original]

254. The *Azinian* tribunal stressed that the NAFTA does not seek to provide an unlimited protection for those disappointments that foreign investors may encounter:

> 83. …It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may safely be assumed that many *Mexican* parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.
>
> 84. It therefore would not be sufficient for the Claimants to convince the present Arbitral Tribunal that the actions or motivations of the Naucalpan Ayuntamiento are to be disapproved, or that the reasons given by the Mexican courts in their three judgments are unpersuasive. Such considerations are unavailing unless the Claimants can point to a violation of an obligation established in Section A of Chapter Eleven attributable to the Government of Mexico.[231]
>
> [Italics in the original, emphasis added.]

255. The *Feldman* tribunal cited the *Azinian* award with approval, and added:

> [T]o 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.[232]

256. International law embraces and fully accepts substantial diversity in State practices.[233] Commissioner Neilson expressed the idea of international law's respect for the sovereign

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230 *S.D. Myers* Award.

231 *Azinian* Award, pp. 83-84.

232 *Feldman* Award at paragraph 112.

233 Arbitrator Reisman has made this point in another context, citing the *Declaration on Principles of International Law Concerning Friendly Relations and Co-operation Among States in Accordance with the Charter of the United Nations* (G.A. Res. 2625, U.N. GAOR, 25th Session., Supp. No. 28, at 121, U.N. Doc. A/8028 (1970), "*As an expression of and implementation of the basic right expressed in Friendly Relations, the content of the various legal codes of each state may be expected to vary, quite legitimately, reflecting the diversity of national political, economic, social, and cultural values that the international system permits and even encourages. As a reflection of those different values and social preferences, the various parts of the law of each community may vary with regard to the distribution of benefits and burdens in economic and social relationships and, in particular, in the allocation of risks for various*

differences and in his discussion of the minimum standard of treatment in the Egypt-United States Claims Commission in the *Salem* Case:

> *It may be said with reasonable degree of precision that the propriety of (governmental) acts… should be determined according to ordinary standards obtaining among members of the family of nations. Practical application may be given to this general rule if an international tribunal adheres to the principle that it can properly award damages only on the basis of convincing evidence of a pronounced degree of improper governmental action. Such a rule takes into account… the status of the members of the family of nations, which, although their standards may differ, are equal under the law of nations*.[234]
>
> [Emphasis added]

257. As demonstrated in Mexico's admissions and denials to the Claimant's allegations, the sugar regulatory regime does not impose on the Mexican authorities the obligations GAMI alleges, in fact, the federal government's response to the problem was more vigorous and effective than alleged. In this context, it is even more noteworthy that neither GAM nor its mills – the subjects of the sugar regulatory regime – have submitted before the competent Mexican tribunals claims of illegality and arbitrariness that GAMI – a passive minority shareholder – presents to this Tribunal. It also warrants noting, and further illustrates the attribution point made earlier, that the system in place required the good faith cooperation of all participants in the sugar industry. The existence of this tripartite mechanism is also pertinent to matters of attributibility.

258. These are the standards of international law to be borne in mind when considering GAMI's allegations of arbitrariness.

F. There is No Violation Under Article 1102

1. The Need for a Proper Comparison

259. The absence of any relationship between the measures complained of and GAMI – the "investor of another Party" – and its shares – the "investment of the investor of another Party" in the territory of the Party – contaminates the Article 1102 claim. This provision requires two types of comparison:

a. Paragraph 1 establishes a comparisons between the treatment granted by a NAFTA Party to its own investors and the treatment that it grants to the investors of another Party in like circumstances;

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commercial contingencies. The point of emphasis here is that the legislative expression of these variations in the law of different states is internationally lawful and entitled to respect." *See* W. Michael Reisman, "The Regime for *Lacunae* in the ICSID Choice of Law Provision and the Question of Its Threshold", ICSID Review – Foreign Investment Law Journal, Vol. 15, no. 2, Fall 2000, 362 at 367.

234 *The Salem Claim between the United States of America and Egypt under the Agreement of January 20, 1931,* (Washington, 1933), R.I.A.A., Vol. II, 1163 (1932).

b. Paragraph 2 establishes a comparison between the treatment granted by a NAFTA Party to the investments of its own investors and the treatment that it grants to investments of investors of another Party in like circumstances.

260. Both require appropriate reference points in respect of the treatment granted. It is thus indispensable to determine what treatment the Party grants, and for what and to whom it is granted.

261. Article 1101 states that Chapter Eleven applies to measures that a Party adopts or maintains relating to investors of another Party, and investments of investors of another Party in the territory of the Party. According to the rules of treaty interpretation, the treatment that the Party grants must be by way of measures that the Party adopts or maintains. The subjects or the object of those measures (or, in the case where the measure does not apply to certain subjects or objects of the same class), will define the reference point of the comparison that must be made.

262. In this case, GAMI seeks to have the Tribunal compare it to other shareholders of other sugar mill holding companies, and to compare its shares of GAM with the shares of other shareholders of other sugar mill holding companies. But none of the impugned measures apply to GAMI, to the other shareholders of GAMI, to any other sugar mill holding company, or to GAMI's shares in GAM, the shares of any other GAM shareholder, or those of any other shareholder of any other sugar mill holding company.

263. As the Respondent has set out in detail, none of the impugned measures bear any relation at all with any of these subjects or their shares. The comparison repeatedly made by the Claimant is in respect of GAM and its mills. It alleges that Mexico violated Article 1102 by comparing the following:

a. the expectations of expropriated mills versus those that were not (Statement of Claim, ¶ 112);

b. the financial situation of GAM with that of Beta San Miguel (¶¶ 116 al 120);

c. the contractual arrangements of GAM, Beta San Miguel, Puga, and Seoane mills with the cane growers (¶ 121);

d. the fact of having expropriated GAM's mills, but not those of Beta San Miguel, Puga and Seoane (¶ 122);

e. the "most favored treatment" granted to "certain mills owned by Mexicans" that did not fulfill their investment commitments, in the form of inventory financing and access to the U.S. market, versus the treatment granted to GAM's mills, likewise a Mexican company, that did comply with its investment commitments (¶¶ 126, 128 y 129);

f. the application of the "export regime" to all mills (¶130); and

g. the prices obtained by GAM's mills, versus the prices obtained by the mills that did not fulfill their export commitments (¶ 131).

264. What the Claimant challenges is not the treatment granted by Mexico to GAMI or its shares in GAM, but, at best, a supposed *indirect* effect of the treatment granted by Mexico to GAM and GAM's mills. None of these, however, is an "investor of another Party" or an "investment of an investor of another Party", and GAMI cannot base its claim on treatment accorded to them, even supposing, without conceding, that the treatment had the effects GAMI alleges.

265. One cannot confuse the treatment granted with the effects that it might have. The treatment involves a measure relating to a concrete subject or object, not the effects it might have beyond the treatment itself.

266. The Tribunal will appreciate that Article 1102 (as opposed to Article 1110, which incorporates the concept of indirect expropriation –although it too is limited by the scope of application of the Chapter) does not encompass the concept of *indirect discrimination*. GAMI has offered no basis upon which to make an appropriate comparison as required by Article 1102. As a result, the Tribunal must dismiss the claim.

267. The analysis of the appropriate reference with regard to the treatment is also pertinent to Article 1105.

2. In Any Event, GAMI Has Not Established That Mexico Violated Article 1102

268. Supposing, without conceding, that the effects on sugar holding company shareholders could serve as a basis to analyze an alleged violation of Article 1102, by way of comparing the treatment granted to holding companies and sugar mills, the claim also fails. Article 1102 sets out the following:

> **Article 1102. National Treatment**
>
> 1. Each Party shall accord to investors of another Party treatment no less favorable than it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. Each Party shall accord to investments of investors of another Party treatment no less favorable than 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

a. The Sugar Regime

269. Mexico applied its sugar law and exercised its legal powers equally in respect of all mills that were in similar circumstances. As has already been explained, the federal government has no legal authority to require mills to export their surpluses. Nevertheless, it assigned export shares to the U.S. to each mill as a function of their compliance with their export commitments. Likewise, it only granted the inventory financing subsidy to those mills that had complied with the export commitments. Accordingly, GAM obtained a subsidy and an export quota to the U.S market.

b. GAM's circumstances were not similar to those companies whose mills were not expropriated

270. Article 1102 requires that the comparison of the treatment granted by a NAFTA Party be made when like circumstances exist. GAMI compares GAM with Beta San Miguel. Dr. Pinto, Corporate Director and President of the Board of Beta San Miguel, has testified as to the very different debt burdens that each company faced. [235] In fact, GAM could not meet its credit obligations and in March 2000 turned to creditor protection proceedings. Beta San Miguel did not face such a situation.

271. Beyond GAM's enormous debt, its failure to pay the sugar cane growers, and the breach of its credit obligations, GAM did not have access to sources of financing because it was in *suspensión de pagos*.[236] By law, it could not dispose of its assets and acquire new liabilities, except with judicial authorization.

272. The expropriation was made of those mills whose precarious financial situation imperiled the harvest that was about to commence, and put at risk the work and assets of a large number of cane growers, as well as the economic stability in several regions of the country. While the *suspensión de pagos* proceedings permitted GAM to restructure its debt and avoid bankruptcy, its financial situation was still precarious. GAM and the five mills that it owned were the only companies in the sugar sector under *suspensión de pagos*.

c. Article 1102 requires that the discrimination be on the basis of nationality

273. A violation of national treatment requires discrimination on the basis of nationality. The *Loewen* Tribunal stated:

> *The effect of these provisions [Article 1102 (1) and (2)], as Respondent's expert Professor Bilder states, is that a Mississippi court shall not conduct itself less favourably to Loewen, by reason of its Canadian nationality, than it would to an investor involved in similar activities and in a similar lawsuit from another state in the United States or from another location in Mississippi itself. We agree also with Professor Bilder when he says that Article 1102 is direct only to nationality-based discrimination and that it proscribes only demonstrable and significant indications of bias and prejudice on the basis of nationality, of a nature and consequence likely to have affected the outcome of the trial.*[237]

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235 Witness Statement of José Pinto. Exhibit R-26.

236 GAM's Form 20-F Annual Report for 2000, p. 8. Exhibit R-57.

237 *Loewen* Award, ¶ 139. Other NAFTA Tribunals agree. See the analysis of the Panel in *In the matter of Cross-Border Trucking Services* (Secretariat file No. USA-MEX-98-2008-01), Final Report, 5 February, 2001, specifically paras. 247 and 292. The members of the Tribunal were J. Martin Hunter Q.C. (President), Luis Miguel Díaz, David A. Gantz, C. Michel Hathaway and Alejandro Ogarrio. The *Feldman* Tribunal also agreed: "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…" (Award, ¶ 181). Although the Tribunal noted that the necessity of proving that a deviation from national treatment has its origin in the nationality of the investor is not obvious, and that the Article itself suggests that it suffices to demonstrate a less favorable treatment to the foreign investor in similar

274. All three NAFTA Parties have expressed this view in various NAFTA proceedings. The U.S. expressed its position as follows:

> *2. Application of the national treatment provision of NAFTA Chapter 11 should be undertaken in two stages. A Tribunal should ask (i) whether a Party has accorded less favorable treatment to investors or investments on the basis of nationality, and, if so, (ii) whether the investor or investment accorded less favorable treatment was "in like circumstances" with domestic investors or investments accorded more favorable treatment.*
>
> *3. The objective of the national treatment provision is to prohibit discrimination against foreign investors and investments, in law and in fact, on the basis of nationality. Implementation of the national treatment provision requires a comparison of a measure's treatment of domestic investors and their investments with that of their counterparts from other NAFTA Parties. If the measure, whether in fact or in law, does not treat foreign investors or investments less favorably than domestic investors or investments on the basis of nationality, then there can be no violation of Article 1102 and a Tribunal should proceed no further. Only if presented with some evidence of less favorable treatment on the basis of nationality should a Tribunal examine the question of which investors are "in like circumstances."*
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> *4. The phrase "in like circumstances" ensures that comparisons are made with respect to investors and investments on the basis of characteristics that are relevant for the purposes of the comparison. The objective is to permit the consideration of all relevant circumstances, including those relating to a foreign investor and its investments, in deciding to which domestic investors and investments they should appropriately be compared, while excluding from the consideration those characteristics that are not relevant to such a comparison.*
>
> *5. The circumstances relevant to the comparison will vary by case. The relevant inquiry is not limited to whether investors or investments produce the same product: merely because investors or investments produce the same product does not mean that they are "in like circumstances." For example, the fact that producers of such products are located in different geographical or political regions may also be germane to the question of whether they are in like circumstances*.[238]
>
> [Emphasis added]

275. Canada expressed it in the following terms:

> *165. ...Article 1102(2) requires each NAFTA Party to treat investments of investors of another Party ("foreign investments") no less favourably than it treats investments of its own investors ("domestic investments") "in like circumstances." By alternately ignoring and misinterpreting the critical "in like circumstances" qualification, the Investor attempts to convert Article 1102 into a special right for*

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circumstances, it proceeded under the assumption that the discrimination was based on the investor's nationality. Mexico has requested a judicial review of the award –currently in progress. However, it agrees that the discrimination has to be by reason of nationality.

[238] Second Article 1128 Submission of the United States in *Pope & Talbot*, ¶ 225. Exhibit R-66.

> *a NAFTA investor to pick the best treatment given to any enterprise in the same sector anywhere in the country.*
>
> *166. Article 1102(2) does not prevent a Party from implementing a measure that affects investments differently as long as the measure neither directly nor indirectly discriminates on the basis of nationality as between foreign and domestic investments.*
>
> 167. Determination of "like circumstances" must be made on a case-by-case basis, depending on the facts and treatment at issue in each situation. However, there is no basis even for inquiring into a distinction between circumstances where, as here, there is neither an allegation nor evidence that the distinction is motivated by or has the effect of discriminating by nationality.[239]

276. Mexico submits that the Tribunal should give due deference to the consistent position of the three NAFTA Parties.[240]

277. The expropriation was motivated by the risk caused by the loss of the financial health of the expropriated mills. GAMI has not denied GAM's precarious financial situation and has not presented any evidence that GAM's mills were expropriated, or that the government conducted its sugar policy, on the basis of a U.S. national's 14.18% shareholding interest in GAM. The Claimant seeks to have the Tribunal ignore, at a first level of comparison, that GAM and the mills it owned were in like circumstances as relates to their precarious financial situation. At a second level of comparison, it seeks to have the Tribunal ignore that GAM's other shareholders, who were in the same circumstances as GAMI, are all Mexican nationals. It also would have the Tribunal ignore, at a third level of comparison, that all the shareholders of the other holding companies whose mills were expropriated, and thus were in like circumstances, were also Mexican nationals. GAMI suggests that the appropriate comparison be at the most remote level, between shares of other holding companies whose mills were not expropriated, notwithstanding their different financial situation.

278. The Respondent respectfully submits that the Tribunal must dismiss the claim in its entirety.

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239 Statement of Defence of the Government of Canada, dated 29 March, 2000. Exhibit R-67. The Tribunal in the case of *Pope & Talbot* did not accept the standard formulation of the three NAFTA Parties. However, in the application of its own version of the standard (the Tribunal focused its analysis on the issue of "in like circumstances", which requires to approach any differential treatment, by requiring it to be based on a reasonable relationship with rational policies and not motivated by a preferential treatment of national investments) the Tribunal was forced to seek proof of discriminatory treatment on the basis of nationality. Award ¶¶ 79-81.

240 Consistent with Article 31 of the Vienna Convention, the Tribunal in the *ADF* case noted: "…*whether a document submitted to a Chapter 11 tribunal purports to be an amendatory agreement in respect of which the Parties' respective internal constitutional procedures necessary for the entry into force of the amending agreement have been taken, or an interpretation rendered by the FTC under Article 1131(2), we have the Parties themselves —all the Parties— speaking to the Tribunal. No more authentic and authoritative source of instruction on what the Parties intended to convey in a particular provision of NAFTA, is possible*." Even if not in the form of a decision by the Free Trade Commission, tribunals must give weight to a common position of the three NAFTA Parties in accordance with the rules for treaty interpretation established in Article 31 of the Vienna Convention.

III. DEFENSE TO THE CLAIM FOR DAMAGES

A. Introduction

279. The following submissions that follow are made without prejudice to the Respondent's defence to the claim on liability.

1. Reservation of rights in collateral proceedings

280. The Respondent reserves all of its rights with respect to the Expropriation Decree and in all related proceedings taken and to be taken in domestic *fora*, in particular the right to determine the fair market value of the expropriated mills, and make the indemnity payment in accordance with the terms and procedures set forth in the Expropriatory Decree and applicable law.

281. The Respondent also reserves all of its rights under the *Ley de Quiebras y Suspensión de Pagos*, without limitation, the right of Bancomext, and all other government entities, and all private creditors to approve or object to, as they see fit, any proposal that GAM may make to its such creditors in settlement of their claims, or as to distribution of its assets on dissolution.

2. Synopsis of damages issues

282. Article 1110(2) expressly requires that in the event of an expropriation, "[c]ompensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation")…". In valuing GAMI's 14.18% interest in GAM, the Claimant's valuation expert, Navigant Consulting (Navigant) has failed to apply this mandatory requirement.

283. Navigant's valuation is limited to what it contends GAMI's interest in GAM could have been worth, assuming the following premises:

a. that the Reference Price should have been calculated with more accuracy;

b. that the Respondent failed to determine the base production level for the mills and thereafter failed to set, vouch and enforce the export quota for each mill, resulting in an oversupply of sugar in the domestic market.

Navigant also assumed that the market would behave in a certain manner and that GAM would perform in certain way.

284. Accordingly, Navigant recalculated the Reference Price and adjusted GAM's financial statements for the fiscal years 1996 to 2002. It then used these "adjusted historical financial statements" to postulate that the value of GAMI's share interest in GAM would have been US $27.8 million, if the above assumptions had in fact been true during each of the years in question.

285. Navigant does not attempt to value GAMI's interest in GAM for the purposes of Article 1110, nor does it attempt to quantify loss or damage that could arise from the alleged breach of Article 1102. It will be clear to the Tribunal that the Navigant valuation relies entirely on the Claimant's ability to establish that Mexico breached its obligations just as the Claimant alleges,

and that such violations amounted to a cognizable breach of Article 1105 for which GAMI had standing under Article 1116 to make a claim. Even in this case, Navigant's valuation relies in a number of assumptions regarding GAM's performance and the market's behavior that cannot be sustained in reality.

286. No evidence has been adduced in respect of a valuation in accordance with Article 1110 and 1102. Indeed, the Navigant report seems to acknowledge that the Claimant's interest in GAM was "worthless" without the assumptions it employed to correct the assumed affects of Mexico's alleged failure to properly administer its sugar program.[241]

287. The FGA Report confirms that GAMI's interest in GAM was in fact worthless at the date of expropriation, as GAM's debts far exceeded the value that could be attributed to its revenue producing capacity, even if Navigant's generous revenue assumptions are applied.

B. Legal Principles Applicable To The Claim For Damages

288. The Claimant's brief submission on damages does not address the legal principles applicable to the assessment of damages for breaches of Articles 1102, 1105 and 1110. Instead it tries to roll these claims together, purporting to select "fair market value" as the measure of damages for all three claims, but only after purportedly adjusting the valuation "to control for the effects of Mexico's arbitrary, unlawful and discriminatory conduct".[242]

289. The Claimant has made no effort to assess what loss or damage might actually flow from any particular alleged breach by the Respondent of a Chapter Eleven obligation, or to assess the actual fair market of GAMI's shares in GAM immediately before the expropriation took place. As noted in the Legal Submissions, the reason will become obvious upon reviewing Mexico's valuation evidence and submissions on damages: GAM was insolvent and suffered from massive indebtedness that should result in a finding of nil or negligible damages.

290. Whether or not a claim for loss or damage suffered by GAM is properly made by GAMI under Article 1116, the text stipulates the need for "loss or damage by reason of, or arising out of [the breach complained of]". Thus, the tribunal in *S.D. Myers, Inc v. Government of Canada* correctly observed:

> …damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor. Other ways of expressing the same concept might be that the harm must not be too remote, or that the breach of the specific NAFTA provision must be the proximate cause of the harm.[243]

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241 See Navigant Report at paragraph 8

242 Statement of Claim, at paragraph 151.

243 Second Partial Award, 21 October 2002, at paragraph 140. (Note that this Award is under judicial review on the grounds, *inter alia*, that the Tribunal exceeded its jurisdiction by combining losses the claimant suffered in it its capacity as a cross-border service provider with damages suffered in its capacity as investor.)

291. The prescribed measure of compensation for breach of Article 1110, although self-evident, was confirmed by the tribunal in *Metalclad Corporation v. United Mexican States*:

> 118. ...With respect to expropriation, NAFTA, Article 1110(2), specifically requires compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. This paragraph further states that the "valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value".[244]

292. As to what valuation criteria will be appropriate in a given case, the applicable jurisprudence consistently indicates that valuations based on projected profits (*i.e.*, discounted cash flow) should only be used where the enterprise at issue has a two to three year track record of profitability upon which such projections could reliably be made:

> 119. Normally, the fair market value of a going concern which has a history of profitable operation may be based on an estimate of future profits subject to a discounted cash flow analysis. *Benvenuti and Bonfant Srl v. The Government of the People's Republic of Congo*, 1 ICSID Reports 330; 21 I.L.M. 758; *AGIP v. The Government of the People's Republic of Congo*, 1 ICSID Reports 306.
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> 120. However, where the enterprise has not operated for a sufficiently long time to establish a performance record, or where it has failed to make a profit, future profits cannot be used to determine the going concern or fair market value. In *Sola Tiles, Inc v. Iran* (1987) Iran-U.S.C.T.R. 224, 240-42; I.L.R. 460, 480-81, the Iran-U.S. claims Tribunal pointed to the importance in relation to a company's value of "its business reputation and the relationship it has established with its suppliers and customers". Similarly, in *Asian Agricultural Products v. Sri Lanka* (4 ICSID Reports 246 (1990) at 292) another Tribunal observed, in dealing with the comparable problem of the assessment of the value of goodwill, that its ascertainment "requires the prior presence on the market for at least two or three years, which is the minimum period needed to establish continuing business connections".[245]

293. As to claims for damages arising from breaches of obligations other than Article 1110, the tribunal in *Marvin Roy Feldman v. United Mexican States* observed as follows:

> 194. …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 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 the 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

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244 *Metalclad Corporation* v. *United Mexican* States, ICSID Case No. ARB(AF)/97/1, Award dated 30 August, 2000.

245 Ibid.

> 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.[246]

294. In summary, the following legal principles can be derived from the ordinary meaning of Articles 1116 and 1110, and the applicable jurisprudence:

e. Article 1116 requires that the breach complained of must be the proximate cause of any loss or damage that the Claimant may recover (Mexico would add that such damages must be suffered directly rather than indirectly);

f. compensation under Article 1110 must be based on fair market value immediately before the date of expropriation (not some other more advantageous date) and any assessment using a stream of future revenue should be based on historical data (not speculative projections based on "adjusted" data); and.

g. compensation under Articles 1102 and 1105 should be the amount of loss or damage actually suffered as a result of the breach.

C. The Claimant's Valuation Evidence – The Navigant Report

295. The Claimant's valuation evidence suffers from a fatal flaw: the fundamental premises upon which it is based are wrong. Moreover, its discounted cash flow projections are based on a number of further "assumptions", making it too speculative to have any probative value.

296. The authors of the Navigant report were asked to value GAM and GAMI's interest in GAMI by assuming the Respondent "breached certain articles of the NAFTA that caused the financial performance of GAM to deteriorate". Their opinion is stated with that express caveat:

> Assuming (1) the Respondent's failure to enforce the export quotas and failure to implement base production levels led to an oversupply of sugar in the Mexican market and deteriorating financial margins for GAM, and (2) more accurately calculated reference prices had been made by the Respondent, it is our opinion that the equity value of … GAMI's 14.18 percent interest in GAM on September 2, 2001 would have been valued at U.S. $27.81 million.

297. Both of these premises are wrong. The Respondent will address them in reverse order.

1. Navigant's Recalculation Of The Reference Price

298. Navigant purported to "vouch" the Reference Price for sugar by recalculating it with available data, up to five years after the fact. By its own admission, it did not have access to the original data that was used to make the calculation. Moreover, Navigant makes no reference to

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[246] Award, 16 December, 2002, at paragraph 194.

any complaint being raised by any participant in the sugar industry or to any controversy regarding the Reference Price in 1996 to 2001.

299. Simply put, Navigant's recalculation is wrong. Instead of using SNIIM prices, it used FORMA prices (because SNIIM prices were not available on the Internet) which is clearly contrary to the 1997 and 1998 *Acuerdos*.[247] This is explained in section 4.2 of the FGA Report and in the witness statement of Mr Adalberto Gonzalez.[248]

300. Accordingly, the opinion proffered by Navigant as to the Reference Price, the second of the fundamental underpinnings of its opinion, must be rejected.

2. Navigant's Assumption As To Oversupply In The Mexican Market

301. Navigant clearly characterizes its explanation for oversupply of sugar in the Mexican market as an "assumption" rather than as a fact or as an opinion:

> We have assumed that this price squeeze was result of the Claimant's allegations that the Respondent failed to enforce the export quota system and failed to implement the bass production levels resulting in weaker domestic prices for sugar. To quantify the squeeze, we have assumed GAM should have earned the average spread between its average blended domestic price and the corrected domestic price component one year forward for fiscal year 1997 and 1998. That spread is 18.9 percent, including the additional charges applied to the Reference Price for the 1997/98 and 1998/99 harvest. [Emphasis added.]

302. It can thus be seen that the element of causation (*i.e.*, proximate cause) has been assumed, as has the quantification of the effects of the impugned conduct. In other words, neither causation nor quantum is supported by factual evidence or opinion evidence.[249] They are but mere assumptions which form the basis of the "adjusted historical financial statements" that Navigant used for all but one of the valuation criteria that it employed – net book value, initial public offering value, discounted cash flow value, comparison transaction value, and comparable publicly traded company value.

303. All of these approaches to valuation rely on the use of Navigant's "adjusted" financial statements, which rely on the unsupported assumptions discussed above, as well as Navigant's erroneous recalculation of the Reference Price over a six-year period. Simply put, the Claimant has failed to meet the basic burden of proof in each case.

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247 The 1997 *Acuerdo* established in a transitory article that starting on the 1998/1999 harvest year, SECOFI, SGARPA, the CNIAA and the two sugarcane growers' unions could recommend the use of FORMA prices. This never happened. Only SNIIM prices were used during the relevant period of time.

248 Witness Statement of Adalberto González. Exhibit R-28.

249 Although it was of course appropriate for Navigant to assume for the purposes of its analysis that violations of the NAFTA would be found by the Tribunal, it was not appropriate to simply assume that the actions or inactions of which GAMI complains had the economic impact GAMI asserts. GAMI has tendered no evidence at all of causation.

304. Navigant's revenue projections are also based on at least the following additional assumptions:

- world and U.S. prices would remain constant while domestic prices would rise marginally at 3.3 percent;
- production and consumption would grow at the rate of population growth;
- harvested cane would remain constant using the 1997/98 – 1999/00 harvests as a base;
- the percentage of exports and domestic sales would change proportionately with the growth in consumption;
- GAM would close San Francisco, process all harvested cane at San Pedro, and reduce costs of goods sold by 3 percent and SG&A expense by 7 percent as a result;
- GAM would experience slight efficiency increases over the six year period;
- GAM would not have conducted the tender offer for the public debt repurchase because the debt would likely have traded a higher price given the adjusted sugar prices and lower sugarcane costs;
- GAM would not have conducted the tender offer for the public debt repurchase because the debt would likely have traded a higher price given the adjusted sugar prices and lower sugarcane costs (thus GAM would not have become indebted to Bancomext and would have reduced its interest payments accordingly);
- interest expense would remain at 11.5 percent annually;
- capital expenditures would be 30 million pesos per year; and
- GAM would not have filed for *suspensión de pagos*.

305. Navigant has thus presumed an ideal world for GAM, one where world and domestic markets would be in equilibrium, enabling domestic producers to sell all they produce, at a fixed domestic price that ensures a profit, with surpluses sold on the world market at profitable prices; a world where GAM's productivity would improve but competition from competitors would not erode prices, where interest rates and capital expenditures would remain affordable and constant, where liquidity problems would never arise, and where sugar companies would never discount in order to gain or maintain market share and thereby generate cash flow in order to service debt. The reality of the sugar industry is and always has been very different: the world market is volatile and unpredictable, and the domestic market in Mexico (as in other countries) has been characterized by episodes of oversupply.

306. Bearing in mind the prior jurisprudence as to the need for a suitably lengthy and reliable performance record to use as the basis of any valuation based on future profits, the Claimant's attempt to use projections based on "adjusted" historic performance and its assumed improvements in future performance highlights its lack of probative value. It amounts to nothing more than speculation based on wishful thinking.

3. The Claimant's Valuation Evidence –The Navigant Report

a. Initial Investment Value

307. Only the "initial investment value" is unaffected by Navigant's adjustment of historic data. Instead it ignores historic data. GAM's shares were publicly traded from the date that GAMI acquired its interest (December 1996) until GAM filed for bankruptcy protection (May 2000), fifteen months prior to the Expropriation Decree (September 2001). A review of GAM's trading records indicates that its stock, which apparently traded sporadically, began to fall dramatically in 1997, less than a year after GAMI acquired shares at 5.80 pesos per share. The price fell to a low of 0.40 pesos in January 1999, and recovered to about 1.8 pesos per share in January 2000, some months before the *suspensión de pagos.* GAM's shares did not trade thereafter again.

308. It is not possible to attribute any particular decline in value of GAM's share price to some alleged act, error or omission of the Respondent. Literally dozens of factors will have influenced the stock market value of GAM, many of them attributable to GAM itself, including its debt level, its productivity, its capital needs, its pricing behavior (and that of every other competing sugar and HFCS supplier in GAM's markets), and the perceived skill and ability of its management. Other factors will be attributable to external forces, including the weather, the world price of sugar, the availability (or not) of U.S. quota, the level of domestic competition generally, including HFCS, as well as macroeconomic factors such as inflation, interest rates and exchange rates. The amount that GAMI paid for its investment in GAM in December 1996 bears no relationship to the fair market value of its investment (if any) immediately prior to the expropriation. Indeed, Navigant seems to acknowledge that GAMI's interest in GAM was by then worth little, if anything.

309. Like the price of GAM's shares on the stock market, the price of sugar in Mexico was affected by a host of factors in the years in question, including the world market price for sugar, the availability (or not) of U.S. import quota for surplus Mexican sugar, the effects of competition in the domestic market, including HFCS and the proclivity of some producers – including GAMI –to discount to generate needed cash flow.

310. The value of GAMI's interest in GAM was further impaired when GAM filed for *suspensión de pagos*. Thereafter, there was no active market for the shares and any attempt to dispose of them would have been complicated by the fact that GAM's future was in the hands of its creditors and the courts.

b. Comparable Transaction Approach

311. Navigant considered two transactions involving the acquisition of the companies Savannah Foods & Industries Inc. (Savannah Foods) and BC Sugar Refinery Ltd. (BC Sugar) were "reasonably comparable to GAM". Nonetheless, the comparability analysis omits important facts that demonstrate that neither of these two transactions really were.

312. The comparability analysis undertaken by Navigant was on the basis of GAM's projected financial statements that were created for the sole purpose of this proceeding, instead of the historic financial statements. Accordingly, the Navigant Report fails to demonstrate that the two transactions are in any way comparable to GAM as it actually existed at any point in time. Both transactions involved companies that had significant beet sugar related operations. The Report fails to demonstrate how GAM's operations, which involved only the production of cane sugar, can be compared to beet sugar operations, which involve a different production process and economics.[250] Moreover, both transactions involved companies that had been in operation for over 100 years, compared to less than a decade for GAM.[251] Finally, both transactions took place in foreign markets (the United States and Canada). The BC Sugar transaction, for example, occurred after the Canadian industry successfully petitioned for anti-dumping and countervailing duty protection in order to exclude surplus U.S. and European sugar from being dumped into its market; the market was accordingly significantly more stable and protected than had previously been the case. The Navigant Report fails to demonstrate the comparability of operations in those markets for valuing a Mexican company.

313. With respect to *Savannah Foods*, the *Navigant* Report also fails to demonstrate that the diversified operations of that company were comparable to GAM. For example, one of Savannah Foods' businesses was King Packaging Company, Inc., which "packs custom made meal kits for the foodservice industry and provides complementary products to the sugar and portion control products manufactured at the Registrant's other locations".[252] These products were marketed to the foodservice trade throughout the United States.[253] GAM had no comparable operations.

314. With respect to *BC Sugar*, the *Navigant* Report also inaccurately states that there was no competitive or hostile bidding situation for the takeover of the company and that the company "processes beet sugar only". *BC Sugar* was a combined sugar beet processor and sugarcane refining operation (with beet processing in Taber, Alberta, and refining in Vancouver, Montreal and St. Johns, New Brunswick) and was acquired at the end of a heated takeover battle which appears to have involved, among other things, a purchase of 1.2 million shares of *BC Sugar* by

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250 For example, with respect to the United States, Svannah Foods has stated *"[i]n the beet industry, the beet farmers participate in any increase or decrease in the selling price of refined sugar. However, in the cane industry, refiners purchase raw sugar at prices which are influenced by the United States Government's policy to support sugar farmers, and which do not fluctuate in tandem with refined sugar selling prices. Consequently, when competitive pressures reduce refined sugar prices, the margins of cane sugar refiners are affected more adversely than those of beet sugar producers"*. See Savannah's SEC Form 10-K/A, fiscal year ended September 28, 1997, at p. 2.

251 Savannah Sugar Refining Corporation, which was originally incorporated in New York in 1916. Ibid. Exhibit R-68. At the time of its acquisition, BC Sugar had been in operation for 107 years. See Exhibit R-69.

252 See Savannah's SEC Form 10-K/A, fiscal year ended September 28, 1997, at p. 2. Exhibit R-70.

253 *Ibid*.

Grupo Azucarero Mexico, SA (*i.e.*, GAM).[254] At the time of the acquisition, it was the largest sugar refiner and beet sugar processor in Canada.[255]

c. Comparable Publicly Traded Company Approach

315. The three companies that the *Navigant* Report alleges to be comparable to GAM were Sterling Sugars, Inc. (Sterling), Tate & Lyle PLC (Tate & Lyle) and Balrampur Chini Mills Ltd. (Balranpur). The comparability analysis omits important facts that demonstrate that none of these three companies were reasonably comparable to GAM.

316. With respect to all three companies, once again the comparability analysis was undertaken on the basis of GAM's projected financial statements that were created for the sole purpose of this proceeding, not its actual financial statements. Accordingly, the Navigant Report fails to demonstrate that the three companies are in any way comparable to GAM as it actually existed at any point in time. Second, the operations of the three companies are significantly different from GAM. Unlike GAM, which produced and sold only standard and refined sugar, Sterling produced and sold raw cane sugar.[256] Tate & Lyle was a broadly diversified multinational corporation that produced sugar, starches and other sweeteners and products, including HFCS, most of which were not produced by GAM.[257] In addition to sugar, Balrampur produced alcohol and bio-fertilizers, neither of which were produced by GAM.[258] The Navigant Report fails to demonstrate how GAM's operations, which were significantly different from these companies, could reasonably be compared to them. Finally, all three companies operated in foreign markets (the United States, India, and in the case of Tate & Lyle, a host of countries worldwide). The Navigant Report fails to demonstrate the comparability of operations in those markets for valuing a company that operated solely in the Mexican market.

317. In any case, the use of the comparable transaction approach and the comparable publicly traded company approach would be to the detriment of the Claimant, since, as explained in sections 4.4.5 and 4.4.6 of the FGA Report, the value of GAM would be negative if the historical financial statements (instead of the "adjusted historical financial statements") are used and the total debt of the company is taken into account.

4. The Respondent's Valuation Evidence – The FGA Report

318. It should be sufficient for the Respondent to invite the Tribunal to dismiss the claim for the Claimant's failure to meet the burden of proving the necessary elements of its claim. The Respondent has nevertheless tendered the opinion of FGA, which establishes that Mexico's alleged failure to enforce export quotas and establish base production levels was not the proximate cause of price suppression in the years in question.

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254 See Exhibit R-69.

255 *Ibid*.

256 See Sterling Sugars, Inc., *2000 Annual Report*, p. 1. Exhibit R-70.

257 See Navigant Report, p. 22, para. 77. Also see the Tate & Lyle website at www.tateandlyle.com.

258 Balrampur Chini Mills Ltd., *Annual Report 2001-2002*, p. 35. Exhibit R-71.

319. Fausto García is a senior financial advisor specializing in corporate acquisitions, corporate finance and debt restructuring through F. García Asociados (FGA), a consulting firm he established in 1981. He has acted for various clients in Mexico's sugar industry since 1994, participating directly in several major debt restructuring transactions. As a result of this experience, Mr. García is fully familiar with how and on what terms Mexican sugar mills are valued by investors and lenders.

320. Mr. García was asked to proceed in manner that would not prejudge the determination of compensation to be paid under the Expropriation Decree: to respond to the *Navigant* Report, but without expressing an independent opinion as to the value of GAM (or GAMI's interest in GAM) as that question is too closely related to matters under consideration by SAGARPA and other agencies (*i.e.*, valuation of the 27 expropriated mills) that are yet to be resolved.

321. Mr. García's analysis is based on GAM's historical financial statements instead of the "adjusted historical financial statements" used by Navigant. He demonstrates that even if Navigant's more generous price projections are used, the value of GAMI's interest in GAM is nil when GAM's debts are taken into account.

322. The Respondent urges the Tribunal to review the FGA report in its entirety. His key findings are:

- Navigant's recalculation of the Reference Price for the years 1996-2001 is wrong, since it used FORMA prices instead of SNIIM prices, as required by the 1997 and 1998 Acuerdos.

- Navigant's assumption that price suppression in the domestic market was caused by some mills' failure to comply with their export requirements is wrong –there were numerous causes, including HSCF imports, oversupply in the world market, and the proclivity of some mills (including GAM) to sell below market prices due to liquidity problems; and

- based on historical financial information, the value of GAM immediately before the expropriation took place was negative, regardless of the method used to determine its value, since its total liabilities were approximately USD $149.7 million.

IV. PETITION

323. For the reasons explained in this and prior statements and oral submissions, the Government of Mexico asks this Tribunal to dismiss GAMI's claim in its entirety and seeks an order for costs.

All of which is respectfully submitted for your consideration;

(signed in the original)

Hugo Perezcano Díaz
Agent and Counsel for the Respondent,
The United Mexican States

November 24, 2003