ICSID CASE No. ARB(AF)/04/05

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES
(ADDITIONAL FACILITY RULES)

BETWEEN:

ARCHER DANIELS MIDLAND COMPANY

and

TATE & LYLE INGREDIENTS AMERICAS, INC.
Claimants

v.

THE UNITED MEXICAN STATES
Respondent

AWARD

Before the Arbitral Tribunal constituted under Chapter Eleven of the North American Free Trade Agreement, and comprised of:

Mr. Bernardo M. Cremades, President
Mr. Arthur W. Rovine
Mr. Eduardo Siqueiros T.

Secretary of the Tribunal:
Mr. Gonzalo Flores

Date of dispatch to the Parties: ***November 21, 2007***

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I. INTRODUCTION

1.- The Claimants in this arbitration allege that an amendment by the Respondent of its tax legislation breaches Chapter Eleven of the North American Free Trade Agreement (NAFTA).

2.- On December 30, 2001, with effect from January 1, 2002, the Mexican Congress amended Articles 1, 2, 3 and 8 of the Ley del Impuesto Especial sobre Producción y Servicios, (the ***"IEPS Amendment"*** hereinafter) imposing a 20 percent excise tax on soft drinks and syrups and the same tax on services used to transfer and distribute soft drinks and syrups. This tax only applied to soft drinks and syrups that used any sweetener other than cane sugar, such as high fructose corn syrup (HFCS). Soft drinks and syrups sweetened exclusively with cane sugar were tax-exempt. The tax was repealed as of January 1, 2007. For purposes of the present Award, the excise tax measures affecting soft drinks and sugar resulting from the IEPS Amendment will hereinafter be referred to as ***"the Tax."***

3.- The Claimants seek damages and related relief alleging that the IEPS Amendment and resulting imposition of the Tax had a direct impact on Claimants' investment in HFCS production and distribution facilities, causing ALMEX substantial loss or damage in violation of the following provisions of Chapter Eleven of the NAFTA: (i) Article 1102 (National Treatment); (ii) Article 1106 (Performance Requirements); and (iii) Article 1110 (Expropriation).

4.- Mexico denies these allegations and contends that the Tax amounted to a legitimate countermeasure, in accordance with customary international law, because the United States allegedly breached its NAFTA obligations regarding: (i) US market access for Mexican sugar exports; and (ii) the State-to-State dispute settlement provisions of the NAFTA, by blocking the appointment of panelists under Chapter XX.

5.- Mexico further defends by maintaining that it did not breach any of Articles 1102, 1106 or 1110 of the NAFTA.

II. THE PARTIES

A) THE CLAIMANTS

6.- The Claimants in this arbitration are ARCHER DANIELS MIDLAND COMPANY (***"ADM"*** hereinafter) and TATE & LYLE INGREDIENTS AMERICAS, INC (***"TLIA"*** hereinafter).

7.- ADM is incorporated under the laws of the State of Delaware, United States of America, with its principal place of business at 4666 Faries Parkway, Decatur, Illinois 62525, United States of America. TLIA is incorporated under the laws of the State of Delaware, United States of America, with its principal place of business at 2200 E. Eldorado Street, Decatur, Illinois 62525, United States of America.

8.- ALMIDONES MEXICANOS S.A. de C.V. (***"ALMEX"*** hereinafter) is a company organized under the laws of Mexico and incorporated in the State of Jalisco. ALMEX is a joint venture that ADM and TLIA wholly own and control. The Claimants claim on their own behalf pursuant to Article 1116 of the NAFTA, and on behalf of ALMEX pursuant to Article 1117.

9.- In these proceedings, the Claimants are represented by:

ARCHER DANIELS MIDLAND COMPANY
Mr. Warren E. Connelly
AKIN GUMP STRAUSS HAUER & FELD LLP, Washington, D.C.

and

TATE & LYLE INGREDIENTS AMERICAS, INC
Mr. Stanimir A. Alexandrov
SIDLEY AUSTIN BROWN & WOOD LLP, Washington, D.C.

B) THE RESPONDENT

10.- The Respondent is the Government of Mexico. It is represented by:

Lic. Luís Alberto González and
Lic. Alejandra G. Treviño
Secretaría de Economía
México, D.F.

Messrsr. J. Christopher Thomas and
J. Cameron Mowatt
THOMAS & PARTNERS, Vancouver

and

Messrs. Stephan E. Becker and
Sanjay J. Mullick
PILLSBURY WINTHROP SHAW PITTMAN LLP, Washington, D.C.

11.- For purposes of the present Award, the Claimants and the Respondent are collectively referred to as ***"the Parties."***

12.- In the elaboration of the present Award, the Arbitral Tribunal has considered, analyzed and evaluated all arguments of the Parties, including all their claims and defenses, documents, witness statements, expert reports and all other evidence submitted before the Tribunal, rendering its decision on the basis of the following procedural history, factual background and legal position of the Parties.

III. PROCEDURAL HISTORY

13.- On October 14, 2003, the Claimants delivered to Mexico a Notice of Intent to Submit a Claim to Arbitration in accordance with Article 1119 of the NAFTA, thereby instituting proceedings on their own behalf pursuant to Article 1116 of the NAFTA, and on behalf of ALMEX pursuant to Article 1117. Subsequently, the Claimants delivered to Mexico a written consent and waiver in compliance with Article 1121 (2) (a) and (b) of the NAFTA.

14.- On October 21, 2003, Corn Products International (***"CPI"***) filed a Request for Institution of Arbitration Proceedings before the International Centre for Settlement of Investments Disputes ("ICSID" or "the Centre" hereinafter) under ICSID's Additional Facility Rules. On January 24, 2004, ICSID informed the parties that it had approved access to the Additional Facility and registered the case under reference ARB(AF)/04/1.

15.- On August 4, 2004 and pursuant to Article 1120 of the NAFTA, ADM and TLIA filed a Request for the Institution of Arbitration Proceedings with ICSID and requested the Secretary-General of ICSID to approve and register its application and to permit access to the ICSID Additional Facility. The Request for the

Institution of Arbitration Proceedings was filed after the expiration of the six-month period of time addressed in Article 2103.6, for the competent authorities to agree that the alleged measures do not constitute an expropriation under the NAFTA.

16.- On September 8, 2004, Mexico submitted to ICSID, pursuant to Article 1126 of the NAFTA, a request for the consolidation of the claims submitted to arbitration by CPI and those submitted jointly by ADM and TLIA, and accordingly requested the appointment of an Arbitral Tribunal to determine whether the CPI and ADM/TLIA claims should be consolidated.

17.- On September 29, 2004, the Secretary-General of ICSID informed the parties that the requirements of Article 4(2) of the ICSID Additional Facility Rules had been fulfilled and that the Claimants' application for access to the Additional Facility was approved. The Secretary-General issued a Certificate of Registration of the Request for the Institution of Arbitration proceedings on that same day.

18.- On January 7, 2005, Mexico informed ICSID that the Parties and CPI had reached an agreement as to the composition of the Tribunal (***"the Consolidation Tribunal"*** hereinafter). The Parties and CPI agreed that the Consolidation Tribunal would be composed of Mr. Bernardo M. Cremades, a national of Spain, Mr. Arthur W. Rovine, a national of the United States, and Mr. Eduardo Siqueiros, a national of Mexico.

19.- On April 8, 2005, the Claimants, the Respondent and CPI jointly submitted a "Confirmation of Agreement of the Disputing Parties Regarding Consolidation" regarding the membership and mandate of the Consolidation Tribunal, stating that all proceedings of the Consolidation Tribunal were to be *"...governed by the ICSID Additional Facility Arbitration Rules, as modified by the procedural requirements of NAFTA Chapter 11."* Subsequently, the Consolidation Tribunal asked the Parties to file their submissions on the question of consolidation.

20.- The Parties and CPI presented written submissions before the Consolidation Tribunal on April 12, 2005, and oral arguments, through their counsel, at a hearing held at the seat of the Centre in Washington, D.C. on April 18, 2005. Representatives from the Governments of Canada and the United States also attended the hearing.

21.- The question before the Consolidation Tribunal was whether the Article 1120 claims submitted by CPI on one hand, and ADM/TLIA on the other, should be consolidated in whole or in part, considering whether the claims had "a question of law or fact in common." If that requirement is met, the Tribunal may, "in the interests of fair and efficient resolution of the claims," issue a consolidation order (Article 1126(2)).

22.- On May 20, 2005, the Consolidation Tribunal issued an Order rejecting Mexico's request for consolidation of the claims submitted by CPI and the Claimants. The Order of the Consolidation Tribunal, in its material part, reads as follows:

> 5. The question before this Tribunal is whether the Article 1120 claims submitted by CPI on the one hand, and ADM/ Tate & Lyle on the other, should be consolidated in whole or in part. In order to issue an order of consolidation, the Consolidation Tribunal must first be "satisfied" that the claims have "a question of law or fact in common." If that requirement is met, the Tribunal may, "in the interests of fair and efficient resolution of the claims," issue a consolidation order (Article 1126(2)).
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> 6. The Consolidation Tribunal accepts that the claims submitted to arbitration do have certain questions of law or fact in common for purposes of Article 1126(2). The Tribunal must therefore consider whether in the interests of the fair and efficient resolution of the claims it should grant or refuse the consolidation order.
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> 7. In this regard, the Tribunal notes first and foremost that the parties do not dispute that CPI and the ALMEX shareholders are direct and "fierce competitors." Mexico has maintained that these parties could coordinate their respective Charter 11 claims against Mexico, but has not disputed that CPI and the ALMEX shareholders are global competitors. As such, each company emphasized that it cannot make known to the other, before an arbitration tribunal or anywhere, details as to the nature of its investments, business strategies, production costs, plant design, the effect of the tax on their investors and investments, and other data that must be put to a tribunal engaged in examining whether or not there has been discrimination, illegal performance requirements, or an expropriation within the meaning of Chapter 11.
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> 8. The direct and major competition between the claimants, and the consequent need for complex confidentiality measures throughout the arbitration process, would render consolidation in this case, in whole or in part, extremely difficult. The parties would not be in a position to work together and share information. The process, including essential confidentiality agreements, discovery, written submissions and oral arguments would have to be carried out, in substantial measure, on separate tracks. The consolidation of the claims of direct and major competitors would necessarily result in complex and slow proceedings in order to protect the confidentiality of sensitive information.
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> 9. The Tribunal considers that the competition between the claimants will adversely affect their ability in a consolidated proceeding to be fully able to present their cases. Due process is fundamental to any dispute resolution procedure, and the parties should not have to calculate which items of information, evidence, documents and arguments they can share with their competitors and which ones they cannot share. The tribunal hearing the claims should not have to require separate procedures to accommodate the competitive sensitivity of the evidence and submissions of the different claimants. Under such circumstances, a consolidation order cannot be in the

> interests of fair and efficient resolution of the claims. Two tribunals can handle two separate cases more fairly and efficiently than one tribunal where the two claimants are direct and major competitors, and the claims raise issues of competitive and commercial sensitivity. [...]
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> 20. For the foregoing reasons, Mexico's request for consolidation is rejected.

23.- On June 14, 2005, Mexico sent a letter to ICSID confirming that the Parties had reached an agreement as to the constitution of the Arbitral Tribunal. The Parties agreed that the Arbitral Tribunal would have the same composition as the Consolidation Tribunal: Mr. Bernardo M. Cremades as presiding arbitrator, and Mr. Arthur W. Rovine and Eduardo Siqueiros as co-arbitrators. Subsequent to the Tribunal's acceptance of its mandate, in accordance with Rule 13(1) of ICSID Additional Facility Arbitration Rules, the proceedings began on August 11, 2005.

24.- The first session of the Tribunal with the Parties was held on October 7, 2005 at the seat of the Centre in Washington, D.C. At this session, the Parties confirmed their agreement that the Tribunal had been duly constituted, pursuant to the relevant provisions of ICSID Additional Facility Arbitration Rules and Chapter Eleven of the NAFTA. It was decided that the place of arbitration would be the City of Toronto in Ontario, Canada, and that the venue for each hearing would be determined by the Tribunal in consultation with the Parties. English and Spanish were agreed as the languages of the proceedings. The Claimants would file their submissions in English and the Respondent would file its submissions in Spanish. It was decided that the Tribunal would render its decision in both languages. A schedule for the filing of pleadings was agreed between the Parties and the Tribunal.

25.- In compliance with the schedule agreed at the Tribunal's hearing on October 7, 2005, the Claimants submitted on December 21, 2005, a Memorial on the Merits with accompanying exhibits. A copy of the Memorial and exhibits was sent to each member of the Tribunal, the Centre and the Respondent.

26.- On January 24, 2006, the Parties requested the Arbitral Tribunal to issue an order recording the Parties' agreement regarding the protection of confidential information that either party might include in its pleadings to the Tribunal.

27.- On April 10, 2006, the Centre informed the Parties of the Tribunal's decision to invite the Governments of the United States of America and Canada to file submissions under Article 1128 by June 9, 2006.

28.- In compliance with the schedule agreed at the Tribunal's hearing on October 7, 2005, the Respondent submitted on May 15, 2006, a Counter-Memorial with accompanying exhibits. A copy of the Counter-Memorial and exhibits was sent to each member of the Tribunal, the Centre and the Claimants.

29.- On June 19, 2006, the Parties informed the Centre that they had agreed on a modification of the briefing schedule. Pursuant to that agreement, Claimants would submit their Reply on July 10, 2007; and the Respondent would submit its Rejoinder on August 25, 2006.

30.- By letter of July 7, 2006, the Centre informed the Parties that the U.S. State Department and Canada's Trade Law Bureau had declared that their respective governments did not intend to file NAFTA Article 1128 submissions at that point, but reserved their right to attend the hearings.

31.- On July 10, 2006, the Claimants submitted their Reply on the Merits, with accompanying documentation. A copy of the Reply and exhibits was sent to each member of the Tribunal, the Centre and the Respondent.

32.- On July 21, 2006, the Arbitral Tribunal issued Procedural Order No. 1 "Concerning Confidential Information" which might be included in the pleadings and the evidence of the Parties. The terms of the Order were as follows:

> 1. Any document (including a file in electronic form) submitted by the Parties during the course of the proceeding that contains Confidential Information shall be designated as confidential by the submitting party. All such documents (the "Confidential Documents") and all information derived there from, but not from any source independent of the Confidential Documents, are to be treated as confidential pursuant to the terms present Order. Confidential Documents and information derived therefrom shall be subject to this Order except if they (i) are already in the public domain at the time of designation; (ii) subsequently become public through means not in violation of this Order; or (iii) are disclosed to the receiving party by a third party who is not bound by any duty of confidentiality and who has the right to make such disclosure.
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> 2. All Confidential Documents and any information derived therefrom shall be used solely in the context of the present arbitration and shall not be used for any other purpose.
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> 3. Prior to the receipt of Confidential Documents or any information derived there- from, any person authorised under paragraph 4(b), (c) and (d) below, shall execute a declaration substantially in the form of the declaration annexed hereto as Exhibit A.
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> 4. Confidential Documents or the information contained therein may be disclosed or described only to the following persons:

a) The Tribunal and its staff, including the staff of the International Centre for Settlement of Investment Disputes ("ICSID");
b) Attorneys, counsel, paralegals and other staff of counsel for each Party;
c) Representatives of the Parties (including in the case of Respondent, government officials and employees) who are actively engaged in, or who are responsible for decision-making in connection with, the present arbitration; and
d) Fact witnesses and consulting or testifying experts of the Parties.

5. All Confidential Documents shall be marked clearly on each page: "CONFIDENTIAL". Confidential Information contained in documents submitted to the Tribunal shall be placed within brackets.

6. The Parties shall designate information as confidential in good faith and not in an arbitrary manner. Confidential information is (i) business confidential information of the Claimants that is protected form public disclosure under U.S. statutes such as the antitrust and trade remedy (e.g. antidumping and countervailing duty) laws, and (ii) information in the possession of the Mexican government that is protected from the public disclosure under Mexico's Ley Federal de Transparencia y Acceso a la Información Pública Gubernamental and applicable privacy statutes. Legal argumentation presented to the Tribunal is not Confidential Information. If a Party does not agree that information designated by the other Party as Confidential Information meets these criteria, it may request that the Tribunal issue a ruling on whether the information at issue is covered by this Order.

7. Each party shall be responsible for preparing a public version of its documents containing Confidential Information from which such information has been redacted.

8. All Confidential Documents and all information derived therefrom shall be securely stored by the persons authorised under paragraph 4 of the present Order when not actively in use, in such manner as to safeguard their confidentiality and to ensure they are accessible only to those persons.

9. If the Tribunal makes use of Confidential Documents or information derived therefrom in any decision, including an arbitral award, it shall designate the portions relating to such document or information as confidential, and place them between brackets; the portions so designated shall not be disclosed by either party or any person authorised under paragraph 4 of the present Order.

10. Within 30 days after the final conclusion of the dispute (including any appeals or settlement), counsel for each Party shall destroy (and shall certify in writing to counsel of the other Party that it has destroyed) all Confidential Documents and any copies thereof, as well as any information derived therefrom, in whatever form, and that no person authorised under paragraph 4(b), (c) and (d) of the present Order remains in possession of such document or information. The Tribunal and its staff (excluding the staff of ICSID), shall destroy such documents and information within the same period of time, without prejudice to the provisions of paragraph 7.

33.- On August 25, 2006, the Respondent requested a one-week extension of time for submission of its Rejoinder on the Merits until September 1, 2006. On August 29, 2006, the Centre advised the Parties that the Tribunal had agreed to the requested extension. Subsequently, on September 1, 2006, the Respondent submitted its Rejoinder with accompanying documentation.

34.- On September 11, 2006, the Arbitral Tribunal consulted with the Parties regarding their proposals for the conduct of the hearing, including the question of whether the hearing would deal with both liability and damages or liability only. On September 22, 2006, the Tribunal issued Procedural Order No. 2, scheduling the hearing for October 9 until October 16, 2006, subsequently postponed to March 19 – March 26, 2007. The Tribunal informed the Parties that the Hearing would include all matters at issue, including all questions regarding liability and damages; and that the Hearing and transcript of the meetings would be covered by the provisions of Procedural Order No. 1 dated July 21, 2006, regarding the protection of business confidential information.

35.- CPI, a separate Claimant against Mexico in connection with the Tax, requested permission from the Arbitral Tribunal to attend the hearing, but the Claimants objected to the request. The Tribunal noted that the competition between CPI and the Claimants, the commercially sensitive nature of the evidence presented in the arbitration, and the difficulties of protecting business confidential information were amongst the grounds for the rejection of the consolidation of the present proceedings with the CPI Arbitration. Accordingly, the Arbitral Tribunal declined CPI's application to attend the hearing.

36.- The hearing took place over six days at the seat of the Centre in Washington DC, from Monday, March 19, 2007, to Saturday, March 24, 2007. The parties were represented during the hearing as follows:

Attending on behalf of the Claimant, ADM:

Mr. Warren E. Connely, AKIN GUMP STRAUSS HAUER & FELD, L.L.P.

Also on behalf of ADM:

Mr. James Shafter
Mr. Dennis Riddle
Ms. Shannon Herzfeld
Mr. David Smith

Attending on behalf of the Claimant, TLIA:

Mr. Daniel M. Price
Mr. Stanimir A. Alexandrov
Ms. Marinn Carlson
Ms. Amelia Porges

Mr. Patricio Grane,
SIDLEY AUSTIN BROWN & WOOD, L.L.P.

Also on behalf of TLIA:

Mr. J. Patrick Mohan

On behalf of ALMEX:

Mr. Jaime Hermosillo
Mr. Luis Casillas

Attending on behalf of the Respondent:

Lic. Florinda Pasquel Peart
Lic. Luís Alberto González,
Dirección General de Consultoría Jurídica de Negociaciones
Secretaría de Economía

Prof. James Crawford

Mr. J. Christopher Thomas
Mr. J. Cameron Mowatt,
THOMAS & PARTNERS

Mr. Stephan E. Becker
Mr. Sanjay Mullick
Mr. Jonathan Mann
PILLSBURY WINTHROP SHAW PITTMAN, L.L.P.

Lic. Salvador Behar,
Embassy of Mexico in Washington D.C.

Ms. Yannick Mondy attended the hearing on behalf of the Government of Canada.

37.- The Arbitral Tribunal heard the testimony of the following witnesses and/or experts, all of whom were subject to direct and cross-examination:

On behalf of the Claimant:

Mr. John Nichols
Mr. Edward Harjehausen
Mr. Lynn Grider
Mr. James Fry
Mr. M. Alexis Maniatis

On behalf of the Respondent:

Mr. Luis de la Calle Pardo
Mr. Ildefonso Guajardo Villareal
Mr. Ángel Villalobos Rodríguez
Mr. José Ignacio Huerta
Mr. Gabriel Ramírez Nambo
Mr. Jorge Mario Soto Romero
Mr. Pablo Rión Santisteban

38.- Transcripts in English and Spanish of the Hearing were prepared and distributed to the Parties and members of the Tribunal.

IV.- FACTUAL BACKGROUND

a) High Fructose Corn Syrup (HFCS)

39.- The Claimants and ALMEX manufacture and distribute HFCS, a fructose syrup made from yellow corn, which is first milled to produce slurry starch and then refined and further processed to produce fructose. It is a capital intensive, multi-stage production process. HFCS is widely used in the beverage industry as a sugar substitute. One particular type of HFCS, called HFCS-55, was developed to replace sugar as closely as possible in soft drink production. HFCS-55 was designed to have a neutral taste, to be exactly as sweet as sugar, and to work well in complicated formulas for Coca-Cola and Pepsi-Cola.

40.- The United States soft drink industry switched to HFCS as their sweetener of choice during the late 1970s and 1980s. In the United States HFCS has consistently been available at a significant discount to the sugar price. HFCS also has advantages over sugar in that it is provided to bottlers in liquid form, and the bottlers using HFCS can avoid the warehouse storage costs for sugar liquefaction, as well as the extra equipment maintenance required to avoid microbiological contamination when bottling with sugar.

41.- The Claimants pioneered the development of HFCS as an alternative sweetener in the 1970s and 1980s, and today are two of the largest corn refining companies in the world. The Claimant ADM has several corn wet milling plants and is one of the largest producers of HFCS in the United States. The Claimant TLIA manufactures HFCS at their wet milling plants in the United States.

42.- The Claimant TLIA first invested in ALMEX in 1968. ALMEX owned a corn wet milling plant in Guadalajara, Mexico, that produced basic and modified starches. TLIA acquired 100 % ownership of ALMEX in 1990. Subsequently, TLIA sold 50% of its shareholding in ALMEX to ADM in 1993. The fructose produced at ALMEX's wet corn milling plant (HFCS-42) is blended with an imported fructose (HFCS-90) to produce HFCS for sale to soft drinks bottlers.

43.- HFCS is obtained principally from yellow corn. In Mexico, white corn predominates, which is used primarily for human consumption and is less apt for the production of HFCS. Accordingly, HFCS in Mexico is produced from yellow corn imported from the United States.

b) Sugar

44.- There are more than 120 sugar producing nations in the world. Sugar is sold internationally as either raw sugar, refined sugar, or as a semi-refined sugar called standard sugar. Sugar is a highly protected product. Many nations, including the United States and Mexico, restrict sugar access to their domestic markets in order to support domestic prices. International sugar prices can fluctuate dramatically.

45.- The sugar industry is characterised by a high degree of interdependence between the growers and the sugar mills that refine the sugar. Sugar mill profits are based on the 'refining margin' or the difference between the sale price of refined sugar and the cost of raw sugar. The high capital investment costs for a refining plant, and the lengthy production cycles for cane sugar, mean that the sugar industry is not able to respond flexibly to changes in the prices of sugar or of competing crops.

46.- The United States and Mexico produce a significant share of their sugar needs. Mexico is the third largest sugar producer in the Americas, behind Brazil and the United States. Sugar has a significant importance, both economically and socially and every Governmental decision affecting the sugar industry has had an important social impact in rural Mexico. Sugar production in Mexico is destined mostly for domestic consumption as opposed to other countries that rely on the international market. The importance of sugar for the domestic market has resulted in the Government's commitment to this industry for social and political reasons. This commitment has been manifested in a series of policies seeking to regulate the market for the benefit of mill and cane producers. These policies led to direct management, starting in the 1970s. and expropriation of sugar mills on September 3, 2001, when a presidential decree nationalized 27 of the 60 sugar mills in Mexico, which amounts to more than 55 per cent of the Mexican sugar industry. These measures were a response to the likelihood that the sugar mills would not be able to honor their payment obligations to sugar cane growers nor to finance the planting of the harvest year that was about to begin. Sugar also plays an important role in the agricultural economy of the United States and has faced problems in recent years.

47.- In both the United States and Mexico the price received by domestic sugar producers is directly or indirectly supported by their respective governments, and there are barriers to international competition. The Claimants in this arbitration have drawn attention to the political influence of the Mexican sugar industry and the Respondent has noted the strong relationships between the U.S. sugar industry with U.S. legislators.

48.- HFCS can replace sugar in various uses, although not in all. Both HFCS and cane sugar are nutritive sweeteners or sweeteners with a caloric content (as opposed to non-nutritive or non-caloric sweeteners, such as saccharine) consisting of a combination of fructose and glucose. Both have a similar appearance when dissolved for use in bottling, and both have nearly the same chemical compositions. As such, both are completely interchangeable and may be used, by means of an industrial process, for the purpose of sweetening products such as soft drinks and syrups. HFCS and cane sugar are similar in terms of smell and color: both are odorless and, when presented as liquids, colorless. The taste, color and other physical characteristics of soft drinks and syrups sweetened with HFCS and cane sugar are indistinguishable.

49.- When HFCS became available in Mexico as an alternative and cost-effective sweetener, Mexican producers of soft drinks and syrups started substituting HFCS for cane sugar. The Claimants estimate that from a zero percent market share as a sweetener for the Mexican soft drink industry in 1991, HFCS had acquired a 25 percent market share by 1997.

c) The Mexican Beverage Sweetener Market

50.- Mexico has the world's highest per capita consumption of carbonated soft drinks, and the world's highest per capita consumption of Coca-Cola. The Mexican market for carbonated soft drinks was valued at almost $US 15 billion in 2001, and was forecasted to reach a value of $US 19 billion in 2006.

51.- The Mexican soft drink bottling industry comprises basically three groups: (i) the bottlers of Coca Cola account for over 70% of the Mexican soft drink market. Its three major Mexican bottlers include Fensa, Arca and Continental Panamco; (ii) the bottlers of Pepsi-Cola, which account for about 15% of the market. The main bottlers are Pepsi Bottling Group and Geusa; and (iii) other national and international soft drinks brands.

52.- Mexican production of sweeteners for soft drinks and syrups is concentrated on cane sugar. Traditionally the Mexican soft drink industry, in both the national and international brands, used exclusively sugar as its sweetener (except in the case of its diet products). When the sugar refining industry was privatised in the 1980s many bottlers directly or indirectly acquired shareholdings in sugar refineries, vertically integrating an important aspect of the beverage sweetener market. There are estimates that in 2000 the soft drinks industry consumed 33% of Mexican annual sugar deliveries.

53.- ALMEX began to sell imported HFCS in Mexico in 1994 and commenced domestic production of HFCS in December 1995. HFCS grew to become ALMEX's most important product, accounting in 2001 for [redacted] of its total sales and [redacted] of its profits.

54.- From the perspective of the Mexican soft drink industry, HFCS had cost advantages over the State supported sugar price. There was an initial capital investment in order to receive the sweetener in a liquid form, requiring storage tanks and changes in the piping and modifications in the production processes. The smaller brands had more flexibility in their choice between sugar and HFCS, and were most influenced by the price differential. The Coca-Cola and Pepsi bottlers moved more slowly, because of the importance of maintaining a consistent flavour and because of their own ownership interests in sugar refineries. Amongst the bottlers of Coca-Cola products, for example, there were three distinct approaches: first, to persist with the exclusive use of sugar because of the direct ownership of sugar refineries by the particular bottler; secondly, to persist in the exclusive use of sugar owing to doubts as to consumer reaction to a change to HFCS and the capital costs of the change; and thirdly, to use a combination of sugar and HFCS in proportions authorised by the Coca-Cola parent company. Coca-Cola eventually favoured a blend of sugar and HFCS which was seen as a good balance between the two competing sweeteners, meaning a cost saving, exercising downward pressure on the sugar price, and avoiding dependence on a single industry for the supply of this vital input for the soft drink industry.

55.- From the perspective of United States/Mexican bilateral sweetener trade, the HFCS penetration of the Mexican soft drink sweetener market involved three distinct commodities: (a) HFCS, which was imported from the United States to Mexico (as well as manufactured locally); (b) yellow corn, which was imported from the United States to Mexico as the raw material for the manufacture in Mexico of HFCS; and (c) sugar, which faced severe competitive pressure in the Mexican soft drinks beverage market from HFCS. In both Mexico and the United

States sugar enjoyed a State supported price, was a politically active industry, and of considerable social significance in certain parts of each country.

56.- HFCS was an aggressive competitor of sugar in Mexico (and the United States). However, HFCS was also an indirect beneficiary of the support programmes for sugar. These programmes maintained a high sugar price in the United States and Mexico, enabling HFCS to compete in the soft drinks sector on price. The price of HFCS in both Mexico and the United States was consistently above the international price for refined sugar, although below domestic prices. The HFCS manufacturers therefore had an incentive to support the protection (and therefore higher domestic prices) for sugar. The Respondent alleges that the Claimants are active members of the American Sugar Alliance, the sugar industry lobby group in the United States.

d) Sugar, Corn and HFCS in the NAFTA Negotiations

57.- The formal negotiations of the NAFTA Agreement began in December 1991 and officially concluded in August 1992. The NAFTA was signed by the Heads of State of Canada, the United States and Mexico on December 17, 1992, which was followed by approval by the legislatures of the three Parties.

58.- The North American Free Trade Agreement establishes a free trade zone pursuant to Article XXIV of the General Agreement on Tariffs and Trade of 1994 (the ***'GATT'*** hereinafter).[1] Chapter III of the NAFTA is entitled *National Treatment and Market Access for Goods,* and deals with the principles of market access in general. Certain sectors are subject to separate treatment in the NAFTA. The special rules relating to Agriculture are set out in Chapter VII.A.

59.- Article 302 of the NAFTA (Tariff Elimination) provides in general terms:

> 1. Except as otherwise provided in this Agreement, no Party may increase any existing customs duty, or adopt any customs duty, on an originating good.
> 2. Except as otherwise provided in this Agreement, each Party shall progressively eliminate its customs duties on originating goods in accordance with its Schedule to Annex 302.2.
> 3. On the request of any Party, the Parties shall consult to consider accelerating the elimination of customs duties set out in their Schedules. An agreement between two or more Parties to accelerate the elimination of a customs duty on a good shall supersede any duty rate or staging category determined pursuant to their Schedules for such good when approved by each such Party in accordance with its applicable legal procedures.

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[1] Art XXIV.5 of GATT states: *"5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area....."*

> 4. Each Party may adopt or maintain import measures to allocate in-quota imports made pursuant to a tariff rate quota set out in Annex 302.2, provided that such measures do not have trade restrictive effects on imports additional to those caused by the imposition of the tariff rate quota.
> 5. On written request of any Party, a Party applying or intending to apply measures pursuant to paragraph 4 shall consult to review the administration of those measures.

In addition, Annex 302 provides for the staged reduction of existing tariffs between the Parties:

> 1. Except as otherwise provided in a Party's Schedule attached to this Annex, the following staging categories apply to the elimination of customs duties by each Party pursuant to Article 302(2):
> a) duties on goods provided for in the items in staging category A in a Party's Schedule shall be eliminated entirely and such goods shall be duty-free, effective January 1, 1994;
> b) duties on goods provided for in the items in staging category B in a Party's Schedule shall be removed in five equal annual stages beginning on January 1, 1994, and such goods shall be duty-free, effective January 1, 1998;
> c) duties on goods provided for in the items in staging category C in a Party's Schedule shall be removed in 10 equal annual stages beginning on January 1, 1994, and such goods shall be duty-free, effective January 1, 2003;
> d) duties on goods provided for in the items in staging category C+ in a Party's Schedule shall be removed in 15 equal annual stages beginning on January 1, 1994, and such goods shall be duty-free, effective January 1, 2008; and
> e) goods provided for in the items in staging category D in a Party's Schedule shall continue to receive duty-free treatment.

Mexico and the United States agreed that sugar was to be subject to a fifteen year tariff elimination period.

Annex 703.2 in Chapter VII contains special provisions relating to the bilateral trade in agricultural goods between Mexico and the United States. Annex 703.2.A.13-22 deal with Trade in Sugar and Syrup Goods. Annex 703.2.A.13-18 read as follows:

> 13. The Parties shall consult by July 1 of each of the first 14 years beginning with 1994 to determine jointly, in accordance with Appendix 703.2.A.13, whether, and if so, by what quantity either Party:
> a) is projected to be a net surplus producer of sugar in the next marketing year; and
> b) has been a net surplus producer in any marketing year beginning after the date of entry into force of this Agreement, including the current marketing year.
>
> 14. For each of the first 14 marketing years beginning after the date of entry into force of this Agreement, each Party shall accord duty-free treatment to a quantity of sugar and syrup goods that are qualifying goods not less than the greatest of:
> a) 7,258 metric tons raw value;

> b) the quota allocated by the United States for a non-Party within the category designated "other specified countries and areas" under paragraph (b)(i) of additional U.S. note 3 to chapter 17 of the Harmonized Tariff Schedule of the United States; and
>
> c) subject to paragraph 15, the other Party's projected net production surplus for that marketing year, as determined under paragraph 13 and adjusted in accordance with Appendix 703.2.A.13.
>
> 15. Subject to paragraph 16, the duty-free quantity of sugar and syrup goods under paragraph 14(c); shall not exceed the following ceilings:
> a) for each of the first six marketing years, 25,000 metric tons raw value;
> b) for the seventh marketing year, 150,000 metric tons raw value; and
>
> c) for each of the eighth through 14th marketing years, 110 percent of the previous marketing year's ceiling.
>
> 16. Beginning with the seventh marketing year, paragraph 15 shall not apply where, pursuant to paragraph 13, the Parties have determined the exporting Party to be a net surplus producer:
> a) for any two consecutive marketing years beginning after the date of entry into force of this Agreement;
> b) for the previous and current marketing years; or
>
> c) in the current marketing year and projected it to be a net surplus producer in the next marketing year, unless subsequently the Parties determine that, contrary to the projection, the exporting Party was not a net surplus producer for that year.
>
> 17. Mexico shall, beginning no later than six years after the date of entry into force of this Agreement, apply on a most- favored-nation (MFN) basis a tariff rate quota for sugar and syrup goods consisting of rates of customs duties no less than the lesser of the corresponding:
> a) MFN rates of the United States in effect on the date that Mexico commences to apply the tariff rate quota; and
> b) prevailing MFN rates of the United States.
>
> 18. When Mexico applies a tariff rate quota under paragraph 17, it shall not apply on a sugar or syrup good that is a qualifying good a rate of customs duty higher than the rate of customs duty applied by the United States on such good.

Annex 703.2.A.26 defines 'net production surplus' as meaning *"...the quantity by which a Party's domestic production of sugar exceeds its total consumption of sugar during a marketing year, determined in accordance with this Section...,"* and 'sugar' as meaning *"...raw or refined sugar derived directly or indirectly from sugar cane or sugar beets, including liquid refined sugar."*. There is no definition in Annex 703.2.A of 'syrup goods'.

In addition to these bilateral provisions, Mexico and the United States established a customs union in respect of sugar by applying the same tariff to imports from any other countries. This tariff was set at a high level (approximately $US0.36 per kilo).

60.- The NAFTA scheme for the sugar trade between Mexico and the United States can be summarised as follows: (i) staged tariff elimination between Mexico and the United States over fifteen years; (ii) an annual minimum tariff-free quota; (iii) an increase in the tariff-free quota if any Party produced a 'net production surplus'; and (iv) a common tariff at a high level for sugar imports from other countries.

61.- At the time of the execution of the NAFTA both the United States and Mexico were net importers of sugar, and so produced no 'net production surplus' within the meaning of the NAFTA definition.

62.- HFCS and corn are subject to less complex bilateral arrangements between Mexico and the United States under the NAFTA. HFCS was subject to a ten year tariff elimination period, by equal annual reductions beginning from a base rate of 15 per cent, meaning that the tariff was eliminated completely from January 1, 2004. The imports of United States corn to Mexico were subject to a tariff elimination period of fifteen years, and a tariff-free quota of 2.5 million tons, increasing at 3 percent per annum.

e) The 1993 Exchange of Letters between the United States and Mexico Regarding the Sugar Provisions of the NAFTA

63.- During 1993 the United States raised with Mexico the question of 'ambiguities' in the sugar provisions of the NAFTA. By letter dated July 26, 1993 the United States Trade Representative (Michael Kantor) wrote to the Mexican Secretary of Commerce and Industrial Development (Jaime Serra Puche) in the following terms:

> Dear Jaime:
>
> It was a pleasure to meet with you last week in Mexico...
>
> One of the issues I raised was the ambiguity in the sugar provisions of the NAFTA. This issue has assumed extraordinary importance. In response to my concerns, you asked that I set out in writing the nature of the ambiguity and how we believe it could be resolved.
>
> In brief, Appendix 703.2.A.13 of the NAFTA defines sugar for domestic consumption as "all sugar and syrup goods," a definition that would properly include high fructose corn syrup (HFCS). HFCS is a sugar syrup that clearly is a complete substitute for sucrose syrups, particularly in uses such as soft drinks. The ambiguity arises, however, because the appendix considers sugar for production to be "all sugar and syrup goods derived from sugar cane or sugar beets grown in a Party's territory." Annex 703.2, Section C provides a similarly narrow definition of sugar "for imports" into each country, "for purposes of this Annex."

> To resolve this ambiguity and assure a common and equitable definition of sugar, I propose that we exchange side letters to clarify that, in determining a party's "net production surplus" status, sugar will be considered to include raw or refined sugar derived directly or indirectly from sugar cane or sugar beets, liquid refined sugar, and high fructose corn sweetener.
>
> With this clarification, the NAFTA will continue to provide for accelerated removal of restrictions should either party become a net surplus producer of sugar. The clarification would prevent inequitable results if a multiplicity of definitions were used of if either party were considered to become a net surplus producer of sugar without an actual increase in sugar production.
>
> I would appreciate your reaction to this proposal at the earliest possible opportunity.

Trade officials in the United States and Mexico, as well as representatives of the sugar industries in both countries, subsequently discussed this issue.

64.- On November 3, 1993, one day before President Clinton would formally submit the NAFTA to the United States Congress for its approval, the Mexican sugar industry (Cámara Nacional de las Industrias Azucarera y Alcoholera) representatives advised the Mexican trade officials that an agreement had been reached with the United States' sugar industry.

> Respetable Señor Secretario:
>
> Me permito informarle que los representantes de la Industria Azucarera Mexicana hemos llegado a un acuerdo con nuestra contraparte estadounidense, en dos sentidos:
>
> 1.- Ha quedado debidamente clarificada la ambigüedad pre-existente en la definición de autosuficiencia en endulzantes, para determinar los excedentes de exportación. Es decir, que el concepto de autosuficiencia involucra, sumatoriamente, azúcares de caña y remolacha y alta fructosa de maíz.
>
> 2.- También hemos decidido solicitar a nuestros respectivos gobiernos que se amplíe la cuota de exportación de 150,000 a 250,000 toneladas el primer año en que se obtenga la autosuficiencia, a partir del séptimo año de entrada en vigor del Tratado de Libre Comercio. Esto, con el principal propósito de ampliar las posibilidades de exportación de azúcares mexicanos.
>
> Todo lo anterior en confirmación y abundancia de lo que hoy le expresamos verbalmente los representantes industriales que nos entrevistamos con Usted.

On the same date, draft letters in English and Spanish were prepared to record the agreement of the Parties. These letters were intended to be signed by the respective Ministers (Jaime Serra Puche on the part of Mexico, and Michael Kantor on the part of the United States). However, on the evening of November 3, 1993 the Spanish and English texts, both expressed to be authentic, were initialled by the chief trade negotiators of each country (Dr. Herminio Blanco on the Mexican side, and Ambassador Rufus Yerxa on behalf of the United States). The English and Spanish texts of these letters read as follows:

> The Honorable Jaime Serra Puche
> Secretary of Commerce and Industrial Development
> Alfonso Reyes 30, Piso 10
> Colonia Condesa
> 06140 Mexico D.F.
>
> Dear Dr. Serra:
>
> I have the honor to confirm the following understanding reached between the delegations of the United States of America and the United Mexican States with respect to the implementation of Annex 703.2 of the North American Free Trade Agreement ("NAFTA").
>
> Section A of Annex 703.2 of the NAFTA provides in part for market access between the United States of America and the United Mexican States with respect to "trade in sugar and syrup goods". The text generally provides, reciprocally for the United States and Mexico, that market access in sugar and syrup goods depends to a certain extent on whether the two countries have determined whether either has been or is projected to be a net surplus producer. "Net surplus producer" is defined as a Party that has a net production surplus.
>
> "Net production surplus", in turn, is defined as "the quantity by which a Party's domestic production of sugar exceeds its total consumption of sugar during a marketing year, determined in accordance with [Section A of Annex 703.2]"
>
> High fructose corn syrup is readily substitutable for sucrose sugar syrups, particularly in such uses as soft drinks. Such substitution could result in effects not intended by either Party. Accordingly, the United States of America and the United Mexican States agree that the determination of "net production surplus" for purposes of Section A of Annex 703.2 shall include consumption of high fructose corn syrup provided for in Harmonized System subheadings 1702.40, 1702.50 and 1702.60.
>
> In addition, notwithstanding the provisions of paragraph 15(b) and (c) of Section A of Annex 703.2, the ceiling for each of the seventh through 14th marketing years shall be 250,000 metric tons, raw value, and paragraph 16 of Section A of Annex 703.2 shall not apply.
>
> I would also like to take this opportunity to affirm the provisions in paragraph 6 of Section A of Annex 703.2 which provide that each Party may count the in-quota quantity under a NAFTA tariff rate quota toward the satisfaction of in-quota quantity commitments undertaken by the Party as a result of the Uruguay Round of multilateral trade negotiations under the General Agreement on Tariffs and Trade.
>
> I have the honor to propose that this letter, which is authentic in English, and your letter of confirmation in reply, constitute an agreement between our two governments, to enter into effect upon the entry into force of the

NAFTA for the United States and Mexico and to remain in effect through the fourteenth marketing year for such time as they remain parties to the NAFTA.

Sincerely,

Michael A. Kantor

Embajador Michael A. Kantor
Representante Comercial de los
Estados Unidos de América
600 Seventeent Street, N.W.
Washington, D.C. 20006

Estimado Embajador Kantor:

Tengo el honor de confirmar el siguiente entendimiento alcanzado entre las delegaciones de los Estados Unidos Mexicanos y los Estados Unidos de América en relación con la aplicación del Anexo 703.2 del Tratado de Libre Comercio de América del Norte ("TLC").

La Sección A del Anexo 703.2 del TLC establece algunas disposiciones en materia de acceso a mercado entre los Estados Unidos Mexicanos y los Estados Unidos de América con respecto al "comercio de azúcares y jarabes". En general, el texto dispone, de manera recíproca para México y Estados Unidos, que el acceso al mercado de azúcares o jarabes depende, en cierta medida, de que los dos países determinen que uno de ellos ha sido o estima que será un productor superavitario. Productor superavitario significa que una Parte tiene un excedente de producción neto.

"Excedente de producción neto", a su vez, está definido como "la cantidad de la producción nacional de azúcar de una de las Partes que excede a su consumo total de azúcar durante un año comercial", calculado de acuerdo con la Sección A del Anexo 703.2.

La fructosa de maíz puede fácilmente sustituir a los azúcares, particularmente para la elaboración de refrescos. Dicha sustitución podría tener resultados no deseados por las Partes. En consecuencia, los Estados Unidos Mexicanos y los Estados Unidos de América, acuerdan que la determinación de "excedente de producción neto" incluirá, para efectos de la Sección A del Anexo 703.2, fructosa de maíz, descrita en la subpartidas 1702.40 y 1702.60 del Sistema Armonizado.

Además, no obstante lo dispuesto en el párrafo 15(b) y (c) de la Sección A del Anexo 703.2, el límite para cada uno de los años comerciales del séptimo al décimo cuarto, será de 250,000 toneladas métricas valor crudo, y no aplicará el párrafo 16 de la Sección A del Anexo 703.2.

Quisiera también aprovechar esta oportunidad para confirmar lo dispuesto en el párrafo 6 de la Sección A del Anexo 703.2, que establece que cada Parte puede contar la cantidad dentro de la cuota de un arancel cuota del TLC para satisfacer los compromisos sobre cantidades dentro de las cuotas adoptados por la Parte como resultado del las negociaciones comerciales multilaterales de la Ronda Uruguay del Acuerdo General sobre Aranceles y Comercio.

> Tengo el honor de proponer que esta carta, que es auténtica en español, y su carta de respuesta que la confirme, constituyan un entendimiento entre nuestros dos gobiernos, con efectos a partir de la entrada en vigor del TLC para México y Estados Unidos, y que permanezca en vigor hasta que concluya el décimo cuarto año comercial, mientras México y Estados Unidos sean Partes del TLC.
>
> Atentamente
>
> Dr. Jaime Serra Puche
> Secretario de Comercio y
> Fomento Industrial

The reference to Harmonized System subheading '1702.50' was added by hand in the fourth paragraph of the typewritten English text.

65.- These draft letters affected the provisions of Annex 703.2.A of the NAFTA relating to Trade in Sugar and Syrup goods in the following respects: (i) The definition of 'net production surplus' (Annex 703.2.A.26); (ii) The figure for the ceiling of the duty free quantity of sugar for the seventh marketing year (Annex 703.2.A.15(b); and (iii) The removal of the ceiling for the duty free quantity of sugar beginning from the seventh marketing year in the event that one of the Parties was a net surplus producer (Annex 703.2.A.16).

66.- In respect of the definition of 'net production surplus' the English and Spanish texts differ. The amendment to the NAFTA definition of 'net production surplus' in the English letter (*«for the purposes of section A of Annex 703.2 shall include consumption of high fructose corn syrup...»*) differs from the Spanish text (*«...incluirá, para efectos de la Sección A del Annex 703.2, fructosa de maíz...»*) in that the English text includes only the consumption of high fructose corn syrup in the definition. The effect of this difference on the NAFTA definition of 'net production surplus' (*«the quantity by which a Party's domestic production of sugar exceeds its total consumption of sugar during a marketing year, determined in accordance with this Section»*) is that the English text includes fructose only in the calculation of consumption, whereas in the Spanish text fructose is included in the calculation of both consumption and production.

Further, after these draft letters had been initialled on November 3, 1993, Mexico complained of the clause (in both the Spanish and English texts) that rendered Annex 703.2.A.16 inoperative on the basis that this had not in fact been part of the agreement between the Parties. The United States responded to Mexico in a letter dated December 8, 1993 which read as follows:

> The Honorable Jaime Serra Puche
> Secretary of Commerce and Industrial Development
> Alfonso Reyes 30, Piso 10
> Colonia Condesa

06140 Mexico D.F.

Dear Dr. Serra:

As you know, we need to complete before January 1 a formal exchange of letters confirming the understandings we reached on November 3 involving the sugar and frozen concentrated orange juice provisions of the North American Free Trade Agreement. I am accordingly enclosing signed original letters to you on behalf of the United States. Your response will constitute a formal exchange of letters.

In your fax of November 29, there was a note raising a question pertaining to paragraph 16 of Section A of Annex 703.2 of the NAFTA. My recollection, which was confirmed when I checked the texts initialled by Herminio Blanco and Rufus Yerxa, is that this language was indeed part of our understanding of November 3. I am also enclosing copies of the initialled letters, which were also sent to the Congress as part of the NAFTA package.

As noted in your fax, the provision on paragraph 16 was not in the proposal we sent you on October 26. However, during our meeting at Dulles Airport on October 28, you rejected both the orange juice and sugar proposals we had asked you to consider. Subsequent to that meeting, we drafted new proposals on both sugar and orange juice. Those were the ones we considered and which formed the basis for the agreement ultimately reached on November 3.

I hope this clears up any lingering confusion on this point.

Sincerely,

Michael A. Kantor

With this letter the United States enclosed a letter, signed by Ambassador Michael Kantor and dated December 8, 1993, in the exact terms of the draft initialled on November 3, 1999 (except that the handwritten reference to subheading 1702.50 in the fourth paragraph was now typed as part of the text).

On behalf of Mexico, Dr. Jaime Serra Puche signed and returned a letter in Spanish dated November 4, 1993 which differed from the draft previously initialled in that the statement in the fifth paragraph that paragraph 16 of Annex 1703.2.A would not apply ("y no aplicará el párrafo 16 de la Sección A del Annex 703.2") was deleted. (The Spanish text signed by Dr. Serra Puche did however include a reference to subheading 1702.50 in the fourth paragraph making the English and Spanish texts consistent on this point).

67.- The result was that there were two material uncertainties in the final exchange of letters by Mexico and the United States: (i) whether Annex 703.2.A.16 (relating to the removal of the ceiling for duty free quantity of sugar beginning from the seventh marketing year in the event that one of the Parties was a 'net surplus producer'), was inoperative, and (ii) whether the definition of 'net production surplus' in Annex 703.2.A.26 included consumption and production of HFCS, or simply consumption.

68.- On January 1, 1994, the NAFTA entered into effect.

f) The Mexican Sugar and Beverage Sweetener Markets in the Early Years of the NAFTA

69.- From 1989-1994 Mexico was a net importer of sugar. In 1995 Mexico became a surplus producer. Annex 703.2.A.13 required the United States and Mexico to consult by July 1 of each year regarding whether either Party was a 'net surplus producer' as this term was defined in the NAFTA. From 1995 the United States and Mexico agreed that Mexico was a surplus producer, but they did not share the same calculation of the surplus. Mexico made its calculation of the net production surplus on the basis of the definitions in Annex 703.2.A.26 and without regard to the 1993 exchange of letters. Mexico took the position that the Parties had not reached any agreement in this exchange of letters, and therefore the terms of the NAFTA Agreement applied without amendment. The United States calculated the net production surplus on the basis of the English text of the letter from Ambassador Kantor to Dr. Serra Puche.

70.- Mexican sugar production grew from 1994/1995 to 2000/2001. At the same time, HFCS imports and domestic production grew substantially. HFCS replaced sugar, particularly in the soft drink industry, thereby restraining domestic sugar consumption.

71.- The Mexican sugar surplus during the period had negative effects on the Mexican sugar industry. The Mexican producers saw the tariff-free export of surpluses to the United States as fundamental to their profitability, particularly considering the impact on the Mexican sweetener market of HFCS imported from the United States or made locally from American corn. Mexican sugar producers saw themselves prejudiced in the imbalance of commercial flows in sugar on the one hand, and HFCS and corn on the other. Mexican sugar access to the United States became a political issue of major importance that Mexico raised at all levels of trade negotiations, including at the level of Heads of State. President Zedillo of Mexico wrote to President Clinton of the United States on July 14, 1997. This letter included the following paragraphs:

> Las importaciones de fructosa de maíz en México han aumentado más del 250 por ciento durante los últimos 12 meses. El cien por ciento de estas importaciones provienen de EE.UU. En contraste, México solamente ha participado marginalmente en los cupos de importación de azúcar de su país, a pesar de sus crecientes necesidades (las importaciones de azúcar mexicana representaron menos del 1.5 por ciento de las importaciones

totales de EE.UU. en el ciclo 96-97). Incluso, en marzo y mayo de este año, su país asignó cuotas adicionales por un total de 400,000 toneladas sin que México resultara beneficiado por esta asignación. Las reducidas posibilidades de acceso del azúcar mexicano al mercado de EE.UU. aunado a las crecientes importaciones de fructosa de maíz, podrían traducirse en fuertes excedentes que afectarían seriamente a cientos de miles de campesinos mexicanos.

Estoy seguro que, considerando que la fructosa de los Estados Unidos tiene ya un acceso sin restricciones cuantitativas al mercado mexicano, si trabajamos juntos, se podrán encontrar formas de que el azúcar mexicana pueda beneficiarse de los crecientes cupos de importación de azúcar que viene otorgando su país. Se trata de una oportunidad más para continuar promoviendo la rica relación bilateral entre nuestros países.

g) Mexico imposes Anti-Dumping Duties and Import Licensing Requirements

72.- On January 14, 1997 the Cámara Nacional de las Industrias Azucarera y Alcoholera requested an anti-dumping investigation against HFCS from the United States. The investigation was carried out by the Secretaría de Comercio y Formento Industrial ("SECOFI") and resulted in a final decision dated January 23, 1998 imposing anti-dumping duties on HFCS from the United States.

73.- The Mexican HFCS anti-dumping duties were challenged in two distinct processes. Firstly, the United States challenged these duties under the dispute settlement procedures of the World Trade Organization (WTO). On February 24, 2000 a WTO Panel found the Mexican anti-dumping determination to be in violation of the WTO Anti-Dumping Agreement in various respects.

74.- On September 20, 2000 SECOFI issued a re-determination revising its early anti-dumping determination. The United States also challenged this re-determination before the WTO. A WTO Panel found the Mexican re-determination was inconsistent with Mexico's obligations under the WTO Anti-Dumping Agreement, and this decision was upheld by the WTO Appellate Body in a decision dated October 5, 2001: see *Mexico's Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States: Recourse to Article 21.5 of the DSU by the United States* (AB-2001-5; WT/DS 132/AB/RW 22 October 2001).

75.- Secondly, involved parties (United States exporters and Mexican importers) challenged the SECOFI anti-dumping determination pursuant to Chapter 19 of NAFTA ('Review and Dispute Settlement in Antidumping and Countervailing Duty Matters'). The Chapter 19 Panel, in its Final Decision dated August 3, 2001 (entitled *Review of the Final Determination of the Antidumping Investigation on Imports of High Fructose Corn Syrup, originating from The United States of*

America Case MEX-USA-98-1904-01), required Mexico to terminate the anti-dumping duties and refund the duties collected since their imposition.

76.- In 2001 Mexico also initiated a series of import restrictions on HFCS. ALMEX challenged in the Mexican administrative courts a December 2002 import license requirement for HFCS, which was found to be unconstitutional, as it was considered to be contrary to Mexico's obligations under the NAFTA. Accordingly, ALMEX currently benefits from an *amparo* court order exempting it from the import licensing requirement for HFCS.

h) Mexico initiates the NAFTA Chapter XX State-to-State Dispute Resolution Procedures

77.- On the basis of the Mexican interpretation of the effect of the 1993 exchange of letters (that is, that there was no agreement in the 1993 exchange of letters and so the NAFTA continued to apply in its original terms), Mexican sugar producers would have an unrestricted right to duty free exports to the United States pursuant to Annex 703.2.A, and particularly paragraph 16, from October 2000. Before this date, Mexico activated the State-to-State dispute resolution provisions of Chapter XX of the NAFTA. In April 1998, the United States and Mexico held consultations pursuant to Article 2006 of the NAFTA. In November 1999 there was a meeting of the Free Trade Commission pursuant to Article 2007, at Mexico's request, but no satisfactory resolution was achieved. As the 'seventh marketing year' approached, Mexico moved to the next stage of the NAFTA State-to-State dispute resolution procedure. On August 17, 2000 Mexico requested the establishment of an arbitration panel pursuant to Article 2008 of the NAFTA.

78.- In September 2000 the United States advised that the duty free quota for Mexican sugar for the 2000/2001 trade year would be 116,000 tons, which was the amount of the Mexican surplus calculated in accordance with the English text of the 1993 letter. Mexico considered its surplus to be approximately 500,000 tons. In September 2001 the United States announced the duty free import quotas for Mexican sugar for 2001/2002. On the basis of its 1993 letter, the United States granted a quota to Mexican sugar of 148,000 tons. Mexico considered its surplus to be approximately 650,000 tons.

79.- There were further negotiations without any resolution. The arbitration panel pursuant to Article 2008 had still not been constituted when Mexico enacted the IEPS Amendment.

i) The IEPS Amendment

80.- The IEPS Amendment originated as a proposal from certain members of the Mexican Congress to protect the domestic cane sugar industry from HFCS. A report by the Committee on Treasury and Public Credit of the Mexican Congress –submitted by the Claimants– describes the plan to enact the Tax *"...with the objective of not causing a major injury to the sugar industry..."* (Cámara de los Diputados, año II, No. 6, December 31, 2002, at p. 692). In introducing the Tax proposal, Representative Raúl Ramírez Avila noted:

> We legislators, however, are committed to protecting the domestic sugar industry because on it depends the subsistence of a great number of Mexicans. To that effect, it is proposed that the tax on sift drinks apply only to those which for their production utilize fructose in substitution fir cane sugar (Claimants' Memorial on the Merits, para. 52, citing Minutes of Legislative Debate, December 31, 2001, at pp. 711 – 712).

81.- The Tax was approved on December 31, 2001 and entered into force on January 1, 2002. Articles 1, 2, 3 and 8 of the IEPS Amendment read as follows:

> **LEY del Impuesto Especial sobre Producción y Servicios.**
>
> «**Artículo 1°.** Están obligadas al pago del impuesto establecido en esta Ley, las personas físicas y las morales que realicen los actos o actividades siguientes:
>
> I. La enajenación en territorio nacional o, en su caso, la importación, definitiva, de los bienes señalados en esta Ley.
> II. La prestación de los servicios señalados en esta Ley.
>
> El impuesto se calculará aplicando a los valores a que se refiriere este ordenamiento, la tasa que para cada bien o servicio establece el artículo 2° del mismo.
>
> ...
>
> **Artículo 2°.** Al valor de los actos o actividades que a continuación se señalan, se aplicarán las tasas siguientes:
>
> **I.** En la enajenación o, en su caso, en la importación de los siguientes bienes:
>
> ...
>
> **G)** Aguas gasificadas o minerales; refrescos; bebidas hidratantes o rehidratantes; concentrados, polvos, jarabes, esencias o extractos de sabores, que al diluirse permitan obtener refrescos, bebidas hidratantes o rehidratantes que utilicen edulcorantes distintos del azúcar de caña... 20%
>
> **H)** Jarabes o concentrados para preparar refrescos que se expendan en envases abiertos utilizando aparatos automáticos, eléctricos o mecánicos, que

utilicen edulcorantes distintos del azúcar de caña..20%

II. En la prestación de los siguientes servicios:

A) Comisión, mediación, agencia, representación, correduría, consignación y distribución, con motivo de la enajenación de los bienes señalados en los incisos A), B), C), G) y H) de la fracción I de este artículo. En estos casos, la tasa aplicable será la que le corresponda a la enajenación en territorio nacional del bien de que se trate en los términos que para tal efecto dispone esta Ley. No se pagará el impuesto cuando los servicios a que se refiere este inciso, sean con motivo de las enajenaciones de bienes por los que no se esté obligado al pago de este impuesto en los términos del artículo 8° de la misma.

...

Artículo 3°. Para los efectos de esta Ley se entiende por:

I. ...

XV. Refrescos, las bebidas no fermentadas, elaboradas con agua, agua carbonatada, extractos o esencias de frutas, saborizantes o con cualquier otra materia prima, gasificados o sin gas, pudiendo contener ácido cítrico, ácido benzoico o ácido sórbico o sus sales como conservadores, siempre que contengan fructosa.

XVI. Bebidas hidratantes o rehidratantes, las bebidas o soluciones que contienen agua y cantidades variables de carbohidratos o de electrolitos.

...

Artículo 8°. No se pagará el impuesto establecido en esta Ley:

I. Por las enajenaciones siguientes:...

(d) Las de cerveza, bebidas refrescantes, puros y otros tabacos labrados, así como las de los bienes a que se refieren los incisos G) y H) de la fracción I del artículo 2° de esta Ley, que se efectúen al público en general, salvo que el enajenante sea fabricante, productor, envasador, distribuidor o importador de los bienes que enajene.

...

(f) Las de los bienes a que se refieren los incisos G) y H) de la fracción I del artículo 2° de esta Ley siempre que utilicen como edulcorante únicamente azúcar de caña.»

[English Translation:

LAW on the Special Tax on Production and Services.

Article 1. Physical and legal persons engaged in the following actions or activities are required to pay the tax established in this Law:

I. The final transfer in national territory or, as applicable, the final importation, of goods identified in this Law.

II. The provision of services indicated in this Law.

The tax shall be calculated by applying the rate established in Article 2 herein to the value of each good or service.

...

Article 2. The rates given below shall apply to the value of the actions or activities indicated:

I. On the transfer or, as applicable, importation of the following goods:

...

G) Carbonated or mineral waters; soft drinks; hydrating or rehydrating drinks; concentrates, powders, syrups, essences or extracts that can be diluted to produce soft drinks, hydrating or rehydrating drinks that use sweeteners other than cane sugar: 20%

H) Syrups or concentrates for preparing soft drinks sold in open containers, prepared using automatic, electric or mechanical equipment and containing sweeteners other than cane sugar: 20%

II. On the provision of the following services:

A) Commissions, dealers, agencies, representation, brokering, consignment, and distribution, for the purpose of transferring goods indicated in subsections A), B), C), G) and H) of this Article's Section I. In these cases, the applicable rate shall be the rate for domestic transfer of the good in question under terms provided by this Law. The tax is not payable when services referred to in this section are for the transfer of goods not required to pay this tax in accordance with Article 8 herein.

...

Article 3. For purposes of this Law, the following definitions apply:

I. ...

XV. Soft drinks are unfermented beverages, prepared with water, carbonated water, fruit extracts or essences, flavourings or any other raw material, carbonated and uncarbonated, and may contain citric acid, benzoic acid or sorbic acid or their salts as preservatives, provided they contain fructose.

XVI. Hydrating or rehydrating drinks are beverages or solutions containing water and variable amounts of carbohydrates or electrolytes.

...

Article 8. The tax established in this law shall not be paid:

I. On the following transfers:

...

(d) Those of beer, coolers, cigars and other processed tobaccos, as well as those of the goods referred to in Article 2(I)(G) and (H) of this Law, to the general public, unless the transferor is the manufacturer, producer, bottler, distributor or importer of the transferred goods.

...

(f) Those for goods referred to in Article 2(I)(G) and (H) of this Law, provided only cane sugar is used as a sweetener.]

82.- The Tax measures included: (i) a 20 percent tax on the transfer and importation of soft drinks and other beverages that use any sweetener other than cane sugar; (ii) a 20 percent tax on specific services (commission, mediation, agency, representation, brokerage, consignment, and distribution), when such services are provided for the purpose of transferring products such as soft drinks and other beverages that use any sweetener other than cane sugar; and (iii) a number of requirements imposed on taxpayers subject to the soft drink tax and to the distribution tax.

Therefore, the Tax applied only to soft drinks that used sweeteners other than cane sugar (Article 2G and 2H). The definition in Article 3.XV requires soft drinks, in order to be subject to the 20% tax, to contain fructose. Finally, Article 8.I.f. exempts from the tax soft drinks that use only cane sugar as a sweetener.

83.- Within Mexico, the IEPS Amendment was temporarily suspended by Presidential Decree. On July 12, 2002 the Mexican Supreme Court declared this suspension unconstitutional and reinstated the IEPS Amendment. The IEPS Amendment was also the subject of an advisory ruling by the Mexican Comisión Federal de Competencia. The IEPS Amendment was also subject to constitutional challenge in the Mexican courts by individual taxpayers, with the result that some soft drink bottlers, but not others, are exempt from the tax on the basis of successful *amparo* challenges.

84.- Apart from these present NAFTA Chapter Eleven arbitration proceedings, the IEPS Amendment was challenged by the United States in the WTO, and was also the subject of proceedings before Mexican tribunals.

j) The WTO Dispute Settlement Proceedings

85.- On March 16, 2004 the United States requested consultations with Mexico regarding the IEPS Amendment pursuant to Articles 1 and 4 of the WTO Disputes Settlement Understanding. These consultations were held in May 2004. The Parties failed to reach a satisfactory conclusion, and on June 10, 2004 the United States requested the establishing of a Panel pursuant to Article 6 of the Disputes Settlement Understanding.

86.- The United States maintained that these taxes were inconsistent with Mexico's national treatment obligations under Article III of the GATT. In particular, they appeared to be inconsistent with Article III:2 of the GATT, first and second sentences, and Article III:4 of the GATT. The relevant parts of Article III of the GATT provide as follows:

> 1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.
>
> 2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.
>
> 3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.
>
> 4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

87.- The dispute before the Panel was factually similar to the present arbitration. The WTO dispute concerned the same tax measures –imposed through the IEPS Amendment– including:

> (i) a 20 per cent tax on the transfer or, as applicable, the importation of soft drinks and other beverages that use any sweetener other than cane sugar ("soft drink tax"); (ii) a 20 per cent tax on specific services (commission,

> mediation, agency, representation, brokerage, consignment and distribution), when provided for the purpose of transferring products such as soft drinks and other beverages that use any sweetener other than cane sugar ("distribution tax"); and, (iii) a number of requirements imposed on taxpayers subject to the "soft drink tax" and to the "distribution tax" (Report of the Panel dated October 7, 2005, *Mexico – Tax Measures on Soft Drinks and Other Beverages,* WT/DS308/R, para. 2.2).

88.- Mexico's defences were twofold. First, Mexico contended that the U.S. complaint was linked to the dispute between the two countries arising under the NAFTA, on the interpretation of Section 703:2 and Annex 703:2.32. Invoking these provisions, Mexico argued that the United States had not provided Mexican cane sugar producers with the market access to which they allegedly had a right under the NAFTA. In particular, Mexico argued that the NAFTA allowed Mexico to sell its surplus sugar in the U.S. market free of any duties, because Mexico qualified as a "surplus producer" under Section 703:2 and Annex 703:2 (paragraphs 13-22).

The United States maintained that there was a limit on the amount of sugar Mexico could export duty free to the United States, until free trade in sugar is established in 2008. The United States referred to the Side Letter of 1993, which provided that Mexico's domestic consumption of HFCS should be considered when calculating Mexico's net sugar market access to the U.S. market; and that Mexico would be considered to be a net surplus producer only when production of sugar exceeded consumption of sweeteners, including both sugar and HFCS. The Side Letter further established a limit on Mexican sugar imports into the United States at a zero duty rate to 250,000 tons annually. Mexico contested the applicability of the Side Letter, because it was never signed by the competent authorities nor approved by the Mexican legislature.

89.- Second, Mexico contended that the Tax was a justified countermeasure under Article XX(d) of the GATT, which provides one of the general exceptions that may justify any measure which is inconsistent with the GATT, *"...if necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of [the GATT]...."* Furthermore, Mexico argued that the United States could not avail itself of the fact that Mexico had not fulfilled its GATT obligation, or had not had recourse to redress under the NAFTA, because the United States had prevented Mexico from having recourse to the NAFTA Chapter XX dispute settlement mechanism. The United States countered that the Tax was not "necessary" and the NAFTA is not a "law or regulation" within the meaning of Article XX(d).

90.- The Panel Report dated October 7, 2005 (*Mexico – Tax Measures on Soft Drinks and Other Beverages;* WT/DS308/R) - the ***'Panel Report'*** hereinafter– found that the IEPS Amendment was a breach of the national treatment obligations of Article III:2 (first and second sentences) and Article III:4 of the GATT.

91.- In considering whether the Tax amounted to a breach of Mexico's national treatment obligation under Article III of the GATT, the Panel analysed the issue of likeness between sugar and fructose. GATT Article III:2 (first sentence) demands that products be "like," as does Article III:4. GATT Article III:2 (second sentence), coupled with Article III:1 and Ad Article III, Paragraph 2 (the Interpretative Note), enlarges the scope of covered products to include not only like ones, but also directly competitive or substitutable ones. A threshold question for the Panel was whether a soft drink sweetened with fructose is "like" one sweetened with cane sugar (under Article III:2, first sentence, and Article III:4), or possibly not "like," but "directly competitive or substitutable" with one sweetened with cane sugar (under Article III:2, second sentence).

92.- The Panel concluded that:

(a) <u>With respect to Mexico's soft drink tax and distribution tax</u>:

(i) As imposed on sweeteners, imported beet sugar is subject to internal taxes in excess of those applied to like domestic sweeteners, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994;

(ii) As imposed on sweeteners, imported HFCS is being taxed dissimilarly compared with the directly competitive or substitutable products, so as to afford protection to the Mexican domestic production of cane sugar, in a manner inconsistent with Article III:2, second sentence, of the GATT 1994;

(iii) As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994;

(iv) As imposed on soft drinks and syrups, imported soft drinks and syrups sweetened with non-cane sugar sweeteners (including HFCS and beet sugar) are subject to internal taxes in excess of those applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

(b) <u>With respect to Mexico's bookkeeping requirements</u>: As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994 (Panel Report, para. 9.2., original underlining).

93.- The Panel dismissed Mexico's defence that the IEPS Amendment was justified pursuant to Article XX(d) of the GATT as a measure necessary to secure compliance by the United States with laws and regulations which are not inconsistent with the provisions of the GATT; and recommended that the Dispute Settlement Body requested Mexico to bring the inconsistent measures into conformity with its obligations under the GATT 1994.

94.- On 6 December 2005, Mexico notified the Dispute Settlement Body of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU; and on 13 December 2005, Mexico filed an appellant's submission. In its appeal, Mexico challenged the Panel's ruling, including the findings concerning Article XX(d) of the GATT. Mexico did not appeal the Panel's findings under Article III.

95.- The Appellate Body Report dated March 6, 2006 (*Mexico – Tax Measures on Soft Drinks and Other Beverages;* WT/DS308/AB/R) upheld the Panel's conclusions and recommended *"...that the Dispute Settlement Body requests Mexico to bring the measures that were found in the Panel Report to be inconsistent with the General Agreement on Tariff and Trade 1994 into conformity with its obligations under that Agreement"* (the **'Appellate Body Report'**).[2] The Appellate Body reasoned, inter alia, that *"...the phrase 'to secure compliance' in Article XX(d) does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty."* (Appellate Body Report, para. 60, 69, quoting Panel Report, para. 8.181).

96.- The United States and Mexico agreed that Mexico would have until 1 January 2007 to implement the WTO ruling. On December 20, 2006, the Mexican Senate voted to repeal the disputed measures and Mexico's *Official Journal* published notice of the repeal a week later.

[2] See the Panel Report in the case in *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R (issued 7 October 2005, adopted by the DSB as modified by the Appellate Body, on 24 March 2006) (complaint by United States, with Canada, China, European Communities, Guatemala, and Japan as third party participants) para. 85 and 86.

k) The July 2006 Mexico/United States Understanding Regarding the Bilateral Sweeteners Trade

97.- The repeal of the Tax, effective as of January 1, 2007, was part of an agreement of July 2006, reached between the United States and Mexico, to achieve free trade in HFCS by January 1, 2008.

98.- On July 3, 2006 the United States and Mexico advised the Chairman of the WTO Disputes Settlement Body that the Parties had mutually agreed on a reasonable time for Mexico to comply with the recommendations and rulings of the Disputes Settlement Body in the WTO proceedings relating to the IEPS Amendment.

99.- On July 27, 2006 there was an exchange of letters in identical terms between the Under Secretary for International Trade Negotiations on behalf of Mexico, and the Chief Agricultural Negotiator on behalf of the United States. This exchange of letters recorded the

> understandings reached between our Governments regarding trade in sweetener goods, which are intended to promote an orderly transition to the elimination of tariffs on sugar and syrup goods and HFCS goods.

It was expressly stated that this exchange of letters *"...shall constitute an agreement between our two Governments..."* (*'constituyan un acuerdo entre nuestros dos gobiernos'*). The letters set out the respective agreements regarding the level of duty free treatment for Mexican sugar or syrup goods by the United States, and for American HFCS by Mexico. There is an explicit reference to the IEPS Amendment in paragraph 6. There are also some general provisions relating to the resolution of the bilateral dispute concerning trade in sweeteners, and to preparation for tariff elimination on sugar or syrup goods and HFCS goods. Paragraphs 6-9 of the Mexico/United States 2006 Understanding read as follows:

> 6.- Beverage tax. Mexico and the United States confirm that on July 3, 2006 they submitted a joint letter to the WTO Dispute Settlement Body (WT/DS308/15) expressing their agreement that Mexico shall eliminate its tax measures on soft drinks and other beverages no later than January 1, 2007, except that if the Mexican Congress approves the necessary legislation to eliminate these measures during the month of December 2006, Mexico shall eliminate its tax measures on soft drinks and other beverages no later than January 31, 2007.
>
> 7. Standstill. Except as provided in this agreement or permitted under other agreements to which both countries are party, Mexico shall not limit, directly or indirectly, imports of HFCS goods of the United States into

Mexico, and the United States shall not limit, directly or indirectly, imports of sugar or syrup goods of Mexico into the United States, including through the application or imposition of any tax or other internal measure that has the effect, directly or indirectly, of discriminating against HFCS goods of the United States or sugar or syrup goods of Mexico, as the case may be.

8. Consultations and dispute settlement. Mexico and the United States recognize that there are ongoing disputes concerning trade in sweeteners, which have not been resolved, and that this agreement contributes to finding a resolution to those disputes. Mexico and the United States further recognize that this agreement will facilitate an orderly transition to full tariff elimination on sugar and syrup goods and HFCS goods on January 1, 2008. Mexico and the United States shall continue to consult on trade in sweeteners with a view toward facilitating that transition, further liberalizing trade in such goods, and making further progress on the issues underlying those disputes.

9. Task force. Mexico and the United States shall establish a joint industry/government task force to assist the government to prepare for tariff elimination on sugar or syrup goods and HFCS goods in January 2008 and to periodically review shipments of sugar or syrup goods and HFCS goods with a view toward ensuring prompt and full utilization of the tariff-rate quotas described in paragraphs 1 through 3.

V. THE LEGAL POSITION OF THE PARTIES

A) THE CLAIMANTS

100.- The Claimants contend that the Tax was deliberately designed and structured so as to discriminate in favor of the Mexican cane sugar industry, penalizing the use of HFCS so severely that it substantially affected the beverage market for HFCS manufacturers and distributors, including ALMEX. In particular, the Tax destroyed the value of the substantial investment that the Claimants made through ALMEX in the production and distribution of HFCS in Mexico.

101.- The Claimants allege that the Tax falls within the category of *"...measures adopted or maintained by a Party..."* relating to investors and investments of another Party, within the meaning of Article 1101 of the NAFTA; and that these measures amount to a breach by Mexico of its obligations under Section A of Chapter of Eleven of the NAFTA, including Articles 1102 (National Treatment), 1106.3 (Performance Requirements) and 1110 (Expropriation).

102.- The essence of Claimants' denial of national treatment argument is that Mexico discriminated against ALMEX during the period the Tax was in force, in violation of Article 1102. The Mexican legislature favored domestic users and distributors of products made with cane sugar over foreign producers of HFCS in Mexico, as there is a complete exemption from the Tax for users and distributors of products sweetened exclusively with cane sugar. Therefore, the Tax treated HFCS producers less favorably than cane sugar producers, discriminating against the Claimants and ALMEX in order to protect the domestic cane sugar industry.

103.- The Claimants further contend that the Tax amounts to an impermissible performance requirement in breach of Article 1106.3 of the NAFTA because the Tax confers advantages –*i.e.*, exemption from the tax– to Mexican bottlers who exclusively buy domestic cane sugar, punishing bottlers severely for using any amount of HFCS. The essence of Claimants' position is that Article 1106.3 covers all investors regardless of nationality, including Mexican investors. Thus Mexico may not condition the grant of an advantage in connection with an investment of any investor on compliance with certain performance requirements. The Claimants argue that they can challenge Mexico's imposition of performance requirements because the advantages conferred on Mexican investors had a direct impact on Claimants' investment in HFCS production and distribution facilities, causing ALMEX substantial loss or damage in violation of Article 1106.

104.- In addition, the Claimants contend that the Tax amounts to an indirect expropriation of their investment within the meaning of Article 1110, as the Tax deprived them of the value and economic use of their investment in the production of HFCS in Mexico, diminishing the reasonably expected economic benefits of their investment without compensation by Mexico. The Claimants recognize that their assets or real property has not been seized, but contend that the Tax harmed their investment, substantially depriving them of the fair market value of their investment, with the effect of an expropriation for purposes of Article 1110 of the NAFTA and international law.

105.- Accordingly, because Mexico breached its obligations under Chapter Eleven, it is required to compensate the Claimants for all the damage that the Tax caused to their investment, including any applicable interest.

B) THE RESPONDENT

106.- The Respondent maintains that Mexico adopted the Tax as a countermeasure in response to violations by the United States of its obligations under the NAFTA. Mexico contends that the Tax was adopted in response to the refusal by the United States: (i) to respect NAFTA's provisions regarding Mexican sugar access to the U.S. market; and (ii) to comply with the dispute settlement mechanism established in Chapter XX. Additional defenses against the alleged violations of Articles 1102, 1106 and 1110 include the following.

107.- The Respondent contends that the Tax does not breach Article 1102 (National Treatment) because it did not target U.S. investors as such. The Tax was not intended to inflict harm upon HFCS producers and manufacturers, but was a reaction and compensatory measure to the restrictions adopted by the U.S. Government against Mexican sugar. Therefore, the Tax was not discriminatory, but a measure which in essence corresponds to a suspension of the treaty-benefits pursuant to Article 2019(1) of the NAFTA ('Non-Implementation – Suspension of Benefits).[3] Further, the parties were not "in like circumstances."

108.- The Respondent alleges that Article 1106.3 (Performance Requirements) does not apply to the present case. Article 1106.3 plainly addresses obligations imposed directly on an investment of an investor. However, the measure at issue was not imposed on the Claimants, nor was the alleged advantage –*i.e.* relief from the tax– ever available to the Claimants, but was only in connection with the bottlers, who have no identity of ownership interest with ALMEX.

109.- Finally, the Respondent counters that the expropriation claim is groundless because the alleged impairment was neither substantial nor permanent. At all times the Claimants' maintained ownership and control of the investment; and the economic effects of the Tax were of insufficient degree and duration to amount to a taking.

VI.- THE RESPONDENT'S COUNTERMEASURES DEFENSE

110.- A central defense asserted by the Respondent in this case is that the Tax, in effect from January 1, 2002 until December 31, 2006, was a lawful countermeasure, enacted as a response to alleged violations by the Government of the United States concerning its obligations to Mexico regarding access of Mexican-produced sugar to the U.S. market, and for failure to take part in the NAFTA Chapter Twenty dispute settlement process with respect to such obligations. Therefore, the Respondent maintains, even if the Tax were a breach of Articles 1102, 1106 or 1110 of Chapter Eleven, no international responsibility would attach since the Tax was a countermeasure, permissible under customary international law, as applied in the NAFTA setting.

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[3] Article 2019(1) NAFTA: *"1. If in its final report a panel has determined that a measure is inconsistent with the obligations of this Agreement or causes nullification or impairment in the sense of Annex 2004 and the Party complained against has not reached agreement with any complaining Party on a mutually satisfactory resolution pursuant to Article 2018(1) within 30 days of receiving the final report, such complaining Party may suspend the application to the Party complained against of benefits of equivalent effect until such time as they have reached agreement on a resolution of the dispute."*

a) General jurisdictional issues.-

111.- The initial question is whether this Tribunal has jurisdiction to decide on the validity of the defense. The Respondent maintains that the Tax was enacted in accordance with customary international law. The central jurisdictional point, according to the Respondent, is that, pursuant to Article 1131(1) of the NAFTA, the Tribunal has jurisdiction to apply a customary international law defense to any claimed breaches of Articles 1102, 1106 and 1110. Article 1131 (1) provides that "*a Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.*" The Tribunal agrees with the Respondent that this provision includes the application of rules of customary international law with respect to claimed breaches of Articles 1102, 1106 and 1110. The parties did not dispute the matter.

112.- In the alternative, the Respondent maintains that if the Tribunal finds that, in the absence of a Chapter Twenty panel report concerning Mexico's allegations of U.S. breaches of Chapter Twenty, this Tribunal cannot make a determination of Mexico's customary international law rights, "*...then it must stay this proceeding until the Chapter Twenty Panel resolves Mexico's grievances*" (Mexico's Rejoinder, p. 32, para. 106).

b) Lex specialis.-

113.- The Claimants maintain that "*...the NAFTA Parties, including Respondent, have waived their right to resort to countermeasures under customary international law for alleged violations of NAFTA provisions*" (Claimants' Reply, para 9). Article 55 of the International Law Commission (ILC) Articles on State Responsibility (the ***"ILC Articles"*** hereinafter) provides that the ILC Articles do not apply where the matter is "*...governed by special rules of international law*" ("Responsibility of States for Internationally Wrongful Acts," Report of the International Law Commission on the Work of its Fifty-third Session, UN GAOR, 56th session. Supp No. 10). The Claimants allege that the Commentary to the ILC Articles recognizes that Article 55 provides that in the context of State Responsibility, the ILC Articles "*...operate in a residual way...*" (Commentary to Article 55, para. 2) and that these residual rules on countermeasures are excluded when a treaty provides:

> A regime for dispute resolution to which States must resort in the event of a dispute, especially if (as with the W.T.O. dispute settlement system) it requires an authorization to take measures in the nature of countermeasures in response to a proven breach (Commentary to the ILC Articles on State Responsibility, Commentary to Chapter II, para. 9).

114.- The Claimants' position is that

> The NAFTA meets that criterion, because it establishes the conditions for the existence of an internationally wrongful act under the free trade agreement and the legal consequences of such an act. Chapters Nineteen and Twenty establish the regime for dispute resolution that governs the 'existence of an internationally wrongful act' and the 'content' of the international responsibility of the Parties in the event of a breach of their obligations under the NAFTA (Claimants' Reply, p. 14, para. 34).

In the Claimants' view,

> these provisions constitute lex specialis within the meaning of Article 55 and thus the residual rules in the Articles on State Responsibility do not apply to alleged breaches of NAFTA provisions. In other words, by signing the NAFTA, the Parties have deliberately forgone the residual right to take countermeasures under customary law (Claimants' Reply, p. 15, para. 35).

The Claimants also point out that Article 2005 of the NAFTA gives Parties a choice to have recourse to the dispute settlement system of either the WTO or the NAFTA if:

> ...any matter arising under both this Agreement [NAFTA] and the General Agreement on Tariffs and Trade...may be settled in either forum at the discretion of the complaining Party (Article 2005 of the NAFTA, cited by the Claimants' Reply, p. 15, para. 36).

This is important, according to Claimants, because

> ...if the WTO dispute settlement regime is lex specialis, as the Commentary on the Articles on State Responsibility clearly notes, its NAFTA dispute settlement counterpart should also be considered lex specialis. As such, they preclude the application of the residual rules on countermeasures (Claimants' Reply, p. 15, para. 37).

115.- The Respondent, on the other hand, maintains that *"...a State party cannot be bound by a lex specialis that has proved impossible to invoke"* (Respondents' Rejoinder, p. 44, para. 142). Respondent argues that

> Articles 2004 and 2019, on which the Claimants rely for their *lex specialis* argument, logically presuppose the correct operation of the dispute settlement process. If a respondent Party ignores Article 2004's injunction that Chapter Twenty 'shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement' and blocks the complainant Party's access to a panel, Article 2019, which regulates the use of countermeasures in Chapter Twenty proceedings, cannot apply (Respondents' Rejoinder, p. 44, para. 143).

116.- The Tribunal acknowledges the fact that the ILC Articles are the product of over five decades of ILC work. They represent in part the "progressive development" of international law –pursuant to its UN mandate– and represent to a large extent a restatement of customary international law regarding secondary principles of state responsibility. But the provisions of the ILC Articles may be derogated from by treaty, as expressly recognized in Article 55 in relation to *lex specialis:*

> Lex specialis.- These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the internal responsibility of a State are governed by special rules of international law.

Accordingly, customary international law does not affect the conditions for the existence of a breach of the investment protection obligations under the NAFTA, as this is a matter which is specifically governed by Chapter Eleven.

117.- The Tribunal finds that Section A of Chapter Eleven offers a form of *lex specialis* to supplement the under-developed standards of customary international law relating to the treatment of aliens and property. In addition, Chapter Eleven confers upon the investor a right of action under Section B –through arbitration– that the dispute will be decided in accordance with the standards of Section A.

118.- The customary international law that the ILC Articles codify do not apply to matters which are specifically governed by lex specialis –*i.e.,* Chapter Eleven of the NAFTA in the present case. These matters also include the possibility of private claimants (who are nationals of a NAFTA Member State) invoking in an international arbitration the responsibility of another NAFTA Member State, as it is a matter of the particular provisions of Chapter Eleven to determine whether and to what extent persons or entities other than States are entitled to invoke responsibility on their own account. This is confirmed by Article 33 (2) of the ILC Articles, which provides that the customary rules on state responsibility codified by the ILC Articles operate *"...without prejudice to any right, arising from the international responsibility of a State, which may accrue directly to any person or entity other than a State."* Customary international law –pursuant to which only sovereign States may invoke the responsibility of another State– does not therefore affect the rights of non-State actors under particular treaties to invoke state responsibility. This rule is not only true in the context of investment protection, but also in the human rights and environmental protection arena.

119.- However, the Claimants' position regarding the application of lex specialis is oversimplified in this arbitration. Chapter Eleven of the NAFTA constitutes *lex specialis* in respect of its express content, but customary international law continues to govern all matters not covered by Chapter Eleven. In the context of

Chapter Eleven, customary international law –as codified in the ILC Articles– therefore operates in a residual way. This is confirmed by Article 1131.1 of the NAFTA, endorsing the Tribunal's mandate to complement the provisions of Chapter Eleven and to *"...decide the issues in dispute in accordance with [the NAFTA] and applicable rules of international law."*

120.- Chapter Eleven neither provides nor specifically prohibits the use of countermeasures. Therefore, the question of whether the countermeasures defence is available to the Respondent is not a question of lex specialis, but of customary international law.

121.- Under customary international law, *"...the wrongfulness of an act of a State not in conformity with an international obligation towards another State is precluded if and to the extent that the act constitutes a countermeasure...."* (Article 22 of the ILC Articles). Countermeasures may constitute a valid defence against a breach of Chapter Eleven insofar as the Respondent State proves that the measure in question meets each of the conditions required by customary international law, as applied to the facts of the case.

122.- The only instance in which the NAFTA refers to countermeasures is under Article 2019. Under this provision, non-compliance with a decision rendered in a Chapter Twenty State-to-State arbitration can lead to penalties. In the event of such non-compliance, the complaining State can retaliate by taking countermeasures suspending tariff concessions or other obligations under the treaty. Outside Article 2019, the NAFTA makes no express provision for countermeasures. Accordingly, the default regime under customary international law applies to the present situation.

123.- The Tribunal therefore agrees with Respondent that countermeasures may serve as a defence under a Chapter Eleven case, as this is a matter not specifically addressed in Chapter Eleven, but valid under customary international law if certain conditions are met.

c) Customary International Law on Countermeasures.-

124.- As noted, a central defense for the Respondent in the instant case is that the Tax, even if judged to be a breach of one or more Articles of Chapter Eleven, is a countermeasure authorized under customary international law and imposed as a response to U.S. breaches of Chapter Twenty. Thus, Respondent maintains, no international responsibility can properly attach as a result of the Tax.

125.- The Tribunal takes as an authoritative statement of customary international law on countermeasures the position of the International Court of Justice, as confirmed by the ILC Articles. Article 22 provides that *"the wrongfulness of an act of a State not in conformity with an international obligation towards another State is precluded if and to the extent that the act constitutes a countermeasure…."*

Article 49 of the International Law Commission's Articles on State Responsibility, provides at paragraphs 1 and 2 as follows:

> 1. An injured State may only take countermeasures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations under Part Two.
>
> 2. Countermeasures are limited to the non-performance for the time being of international obligations of the State taking the measures towards the responsible State.

126.- The International Court of Justice provided the test for the validity of countermeasures in the case concerning the *Gabcikovo-Nagymaros Project:*

> In order to be justifiable, a countermeasure must meet certain conditions…In the first place it must be taken in response to a previous international wrongful act of another state and must be directed against that State… Secondly, the injured state must have called upon the state committing the wrongful act to discontinue its wrongful conduct or to make reparation for it… In the view of the Court, an important consideration is that the effects of a countermeasure must be commensurate with the injury suffered, taking account of the rights in question… [and] its purpose must be to induce the wrongdoing state to comply with its obligations under international law, and… the measure must therefore be reversible (Gabcikovo-Nagymaros Project, ICJ Reports, 1997, pp- 7, 55-6).

127.- While the written submissions of the parties varied in many respects on the questions involved in this context, at the hearing the Claimants maintained and the Respondent did not dispute (with the exception noted) that for the Respondent to prevail on its countermeasure defense, the Respondent was required to demonstrate each of the following cumulative conditions:

1. The United States breached Chapter Three and/or Seven and Chapter Twenty. (Respondent did not agree with the conjunctive with respect to Chapter Twenty).

2. The Tax was enacted in response to the alleged U.S. breaches, and was intended to induce U.S. compliance with its NAFTA obligations concerning access of Mexican sugar to the U.S. market and concerning U.S. obligations pursuant to NAFTA Chapter Twenty.

3. The Tax was a proportionate measure.

4. The Tax did not impair individual substantive rights of Claimants.

128.- With respect to the first listed item, this Chapter Eleven Tribunal has no jurisdiction to decide whether the United States breached any of its international obligations under Chapter Three or Chapter Twenty of the NAFTA. This Tribunal has before it a Chapter Eleven investment dispute, comprising allegations of violations by the Respondent of Articles 1102, 1106 and 1110 and not a Chapter Twenty dispute.

129.- The Respondent acknowledges that Chapter Eleven tribunals *"...lack authority to address violations of other chapters of the NAFTA..."* (Mexico's Rejoinder, para. 132). However, the Respondent *"...maintains that this Tribunal has jurisdiction to find that Mexico's use of countermeasures is a matter that precludes unlawfulness in its conduct, and hence, precludes international responsibility"* (Id.)

130.- The Respondent argued at some length that the WTO Panel that examined the same Tax considered it to be a countermeasure (Respondents' Rejoinder, para. 132). Yet the WTO tribunal found that the Tax, while a countermeasure, was inconsistent with Mexico's obligations under Article III of the GATT and had to be repealed, which was done as of December 31, 2006. The Panel reasoned that the Tax was not a valid countermeasure because the term *"...to secure compliance..."* in Article XX (d) of the GATT does not apply to measures taken by a Member State in order to induce another Member to comply with obligations owed to it under a non-WTO agreement. Therefore, the Panel dismissed the countermeasure defense, not because the measure was in itself contrary to international law, but because Mexico could not resort in the WTO proceedings to a countermeasures defense in relation to the alleged breach by the United States of a non-WTO treaty, such as the NAFTA.

131.- In the present case, the Tribunal has no jurisdiction to decide whether the United States committed an internationally wrongful act which justified a countermeasure. However, there are other requirements as well for a valid countermeasure over which we do have jurisdiction, and the Respondent must meet each of them if the Tribunal is to reach Respondent's request for a stay of the proceedings until a Chapter Twenty procedure is completed.

132.- Both parties agree that the Tribunal has jurisdiction to decide any defense under Chapter Eleven, including a countermeasures defense. The Tribunal has indeed all the relevant information to reach a decision regarding whether or not the IEPS

Amendment meets the test for a valid countermeasure under customary international law.

133.- Customary international law provides the test for the validity of countermeasures. As noted, each of the requirements, as applied to the facts of the instant case, must be met. If one fails, the defense fails. If all three over which the Tribunal has jurisdiction are met, then the Tribunal is confronted with the Chapter Twenty allegations made by Mexico against the Government of the United States, and those allegations being beyond our jurisdiction, Mexico's request for a stay of the proceedings would need to be considered.

d) Whether the Tax was enacted in response to the alleged U.S. breaches, and was intended to induce U.S. compliance with its NAFTA obligations.-

134.- One of the central issues to be decided with respect to the Respondent's countermeasures defense, and which the parties debated at length, is the question whether the Tax was enacted by Mexico, in accordance with Article 49 of the ILC's Articles on State Responsibility and its Commentary, "in order to induce" the United States to comply with its NAFTA obligations.

135.- The Respondent maintains that the Tax was designed, and had as its intent, the goal of inducing the United States to comply with its NAFTA obligations concerning sugar access to the U.S. market, and concerning U.S. obligations in the Chapter Twenty dispute resolution process. The Claimants maintain that the Tax was enacted for the purpose of protecting the domestic Mexican sugar industry against fructose imports from the United States.

136.- In the Tribunal's view, the period just prior to the enactment of the Tax is important in terms of the context for the passage of the tax and Mexico's intent in enacting it. Mexico had imposed anti-dumping duties against HFCS for almost four and one half years prior to the Tax. But beginning in 2001, Mexico lost a set of NAFTA and WTO cases on the legality of its anti-dumping measures. Talk of a tax concerning fructose began to emerge. Mr. John Nichols, President and Managing Director of ALMEX, testified on behalf of the Claimants at the Hearing that he first heard in October 2001 about the possibility of the Tax, and that members of the Mexican Congress had told him the concern was to protect the sugar industry.

137.- The evidence on record before the Tribunal indicates that the most immediate relevant context in which the dispute over the Tax arose were the Mexican anti-dumping measures, the WTO and NAFTA rulings against these measures, and the order for their final repeal. The evidence before us indicates that this was the setting for the enactment of the Tax, rather than the dispute between Mexico and the United States over access to the U.S. market of Mexican-produced excess sugar, a dispute that ripened in the year 2000, well after the imposition of the anti-dumping measures.

138.- In their Memorial on the Merits, the Claimants describe a number of these pre-tax measures aimed at HFCS from the United States. In June, 1997, for example, Mexico imposed provisional anti-dumping duties and in January, 1998, Mexico imposed final anti-dumping duties at the trade-prohibitive rate of US$55-$175/MT, depending on the grade and the supplier. As part of an investigation by the Mexican Ministry of the Economy (then known as SECOFI, Ministry of Trade and Industrial Promotion) the Claimants state that:

> Respondent examined in detail the competitive relationship between HFCS and cane sugar in the Mexican marketplace, particularly in the soft drink market. SECOFI determined that the [Mexican] Sugar Chamber, as the petitioner (representing sugar refiners and growers), represented producers of a "like product" to imported HFCS. SECOFI's final determination of dumping and injury concluded that "HFCS and sugar are like products because they have very similar characteristics and composition, which allows them to fulfill the same functions and be commercially interchangeable (Claimants' Memorial, p. 17, para. 38).

139.- The anti-dumping determinations were then challenged by the United States at the WTO. On February 24, 2000, a WTO Panel determined that the anti-dumping measure was inconsistent with the WTO Anti-Dumping Agreement (WTO Panel Report, *Mexico-Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States,* WT/DS132/R, Feb. 4, 2000). Mexico issued a revised anti-dumping determination, but a subsequent WTO Panel and Appellate Body decided (on November 21, 2001) that the new determination was still not in compliance with Mexico's WTO obligations (WTO Appellate Body report – *Anti-Dumping Investigation of High Fructose Corn Syrup from the United States – Proceedings under Article 21.5 of the DSU,* WR/DS132/AB/RW, adopted on November 21, 2001, para. 135-136).

140.- The final anti-dumping determination of 1998 was also challenged by U.S. exporters and Mexican importers under NAFTA Chapter Nineteen. The NAFTA arbitrators determined on August 3, 2001 that the measure was illegal under Mexico's law and implementing regulations (*Review of the Final Determination of the Anti-Dumping Investigation on Imports of High Fructose Corn Syrup Originating from the United States of America,* NAFTA Case: MEX-USA-98-1904-01, August 3, 2001, at para. 824). The final NAFTA decision, affirming its initial decision, came on April 15, 2002, ordering a repeal of the anti-dumping duties (Final Decision, *Review of the Final Determination of the Anti-Dumping*

Investigation on Imports of High Fructose Corn Syrup, NAFTA Case: MEX-USA-98-1904-01, April 15, 2002, at 24).

141.- Subsequently, the WTO Panel Report –confirmed by the WTO Appellate Body– provides an in-depth analysis on the underlying intent of the Tax. The WTO Panel confirmed that *"...the protective effect of the measure on Mexican domestic production of sugar does not seem to be an unintended effect, but rather an intentional objective"* (Panel Report, para. 8.91). The Claimants maintain that there is no reason why this Tribunal should come to a different conclusion than the WTO Panel.

142.- The Tribunal begins its review of the intent of the IEPS Amendment by first examining its text. In the Tribunal's view the IEPS Amendment was the culmination of a series of measures adopted by the Respondent to protect the domestic cane sugar industry. Nothing in the text of the IEPS Amendment indicates that it was enacted as a countermeasure against the United States. Rather it was a device to protect domestic sugar producers from competition by the HFCS industry.

143.- The Claimants have pointed out that neither the text of the IEPS Amendment, nor the previous legislative debate in Congress mentioned the dispute with the United States Government on access of Mexican-grown sugar to the U.S. market, or U.S. Chapter Twenty obligations. Respondent has submitted only slim evidence to challenge this. In the various documents relating to the legislative history of the Tax there is only one brief reference to the measure as a reaction to the sugar dispute (see Exhibit R-58 at 32, and Exhibit 59, at 8), and there was no mention of countermeasures. Except for such references, there are no other contemporaneous documents from Mexico mentioning the dispute with the United States over sugar access or Chapter Twenty as underlying reasons for the Tax.

144.- The evidence on the record proves that the position of the legislature when enacting the IEPS Amendment was to protect the domestic cane sugar industry, rather than inducing the United States to comply with the NAFTA.

145.- The Claimants presented extensive evidence showing that the Mexican Government publicly acknowledged that the IEPS Amendment was aimed at protecting the Mexican sugar industry from HFCS, as both sugar and HFCS are part of the same sector. Officials of the Respondent have recognized that HFCS and sugar distributors and producers compete head-to-head in the domestic market, and that the Tax was intended to discriminate against the HFCS industry and to protect the domestic sugar industry.

146.- The Mexican judiciary has also confirmed that the design and operation of the Tax was to afford protection to Mexican production of cane sugar. When President Fox of Mexico issued a decree on March 5, 2002, suspending the application of the Tax, the Supreme Court of Justice was asked by the Chamber of Deputies of the Mexican Congress on April 2, 2002, to annul the exemption on the ground that it was unconstitutional. The Supreme Court rendered a decision on July 12, 2002, reinstating the Tax (Suprema Corte de la Nación, *sentencia relativa a la controversia constitucional 32/2002, promovida por la Cámara de Diputados del Concreso de la Unión, en contra del Titular del Ejecutivo Federal,* Diario Federal, Primera Sección, 44 – 82, July 17, 2002).

147.- The Supreme Court considered the *"....motives that prompted..."* the legislature *"to extend the scope of subjects to that tax [the Law on the Tax on Production and Services] to those who use sweeteners different than cane sugar"* and determined that the Mexican Congress had a clear *"...non-tax related purpose...;"* the Tax was enacted for the purpose of *"...protecting the Mexican sugar industry...."* (Mexican Supreme Court Decision Annulling the Suspension of the Tax, July 17, 2002, at p. 80). In particular, the Supreme Court held:

> The legislator's intent when extending the aforementioned tax to gasified waters, soft drinks, hydrating drinks and other taxed goods and activities, when they use fructose in their production rather than cane sugar, was that of protecting the sugar industry (Mexican Supreme Court Decisión Annulling the Suspension of the Tax, July 17, 2002 at para. 79).

The Supreme Court further held that the Government, in its exemption decree, violated not only the fiscal objective of the measure, but *"also its extra-fiscal objective that was expressed in the legislative procedure, that is the protection of the domestic sugar industry"* (*Id*).

148.- If the Tax was not enacted to induce compliance by the United States with its NAFTA obligations, then the Tax was not a valid countermeasure within the meaning of Article 49 of the ILC Articles on State Responsibility.

149.- In sum, there is insufficient evidence in the record before us to support Respondent's contention that Mexico intended the Tax to induce the United States to comply with its obligations concerning access of sugar to the U.S. market or its obligations concerning Chapter Twenty dispute resolution. Save for the statement in passing during a legislative debate, at the time the Tax was enacted, there were no statements from Mexico that it was a countermeasure, or a response to U.S. actions or inactions. There were no indications from Mexico that the Tax would or could help resolve the sugar access dispute. Yet there were government statements provided as evidence by the Claimants that the Tax was designed to protect Mexican sugar growers. In particular, Mexico's Minister of the Economy, Ernesto Derbez, stated that *"...the law violates the NAFTA in the section about investment protection and changes the rules of the game."* Also, Undersecretary of Commerce Rocio Ruiz warned of claims against Mexico *"...because we don't let HFCS producers sell their product in Mexico, and according to the NAFTA and the World Trade Organization rules, they can sue us."*

150.- Perhaps the Tax could have been enacted for both purposes, i.e., protection of the domestic sugar industry in Mexico, as well as inducing the U.S. Government to comply with its NAFTA obligations. But the evidence before us, as well as the Respondent's statements in the instant case, indicate that protection of the Mexican sugar industry was the true motive and intent underlying the enactment of the tax. For a successful defense of inducement, even coupled with protection, the Tribunal would expect to see substantial evidence supporting inducement at the time of the enactment of the Tax. But inducement when the Tax was enacted is not in evidence here. The Tribunal emphasizes that its finding is one of fact. It is not a determination of law. The fact question is Mexico's intent in enacting the Tax.

151.- Accordingly, the Tribunal finds that the Respondent has neither proved that the Tax was enacted in response to the alleged U.S. breaches nor that the measure was intended to induce compliance by the United States with its NAFTA obligations.

e) Proportionality.-

152.- Article 51 of the ILC Articles emphasizes the requirement of proportionality, noting that countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question. Therefore, proportionality plays a prominent role, limiting the power of taking countermeasures in response to an international wrongful act. Further, as expressly stated in the Commentary of ILC Article 51:

> (7) Proportionality is concerned with the relationship between the international wrongful act and the countermeasure. In some respects proportionality is linked to the requirement of purpose specified in article 49: a clearly disproportionate measure may well be judged not to have been necessary to induce the responsible State to comply with its obligations but to have had a punitive aim and to fall outside the purpose of countermeasures enunciated in article 49

153.- In the present case, the Tribunal has found that Mexico did not adopt the Tax to induce the US to comply with the NAFTA, but to protect the domestic sugar industry. Therefore the Tax was not necessary and reasonably connected with the aim purportedly pursued. Indeed, the Tribunal believes that even if the Tax was enacted by the Respondent in response to an alleged violation of the NAFTA by the United States, the measure was not appropriate for the particular purpose of securing compliance by the United States.

154.- Proportionality requires not only employing the means appropriate to the aim chosen, but implies an assessment of the appropriateness of the aim itself, considering the structure and content of the breached rule. Proportionality therefore must be assessed in the light of the proper function of the response, as the International Court of Justice recognized in *Gabcíkovo-Nagymaros Project* [ICJ Reports (1997) 7]. The Court considered that Hungary's failure to abide by its obligation under a bilateral treaty with Slovakia, and its refusal to carry out a joint project of diversion and exploitation of the waters of the Danube, could not justify the unilateral diversion of the river by Slovakia and the implementation of a project of exploitation carried out entirely on its territory. Such measures amounted to a breach of the principle of equitable apportionment of resources between watercourse states and thus failed to meet the proportionality requirement.

155.- In the present case, the test of whether the countermeasure was appropriate to the particular purpose of securing compliance with the NAFTA by the United States, requires a qualitative comparison between all the international obligations involved: Section A of Chapter Eleven, on the one hand; and Annex 703.2.A (regarding access of Mexican sugar to the United States) and the state-to-state dispute resolution provisions of Chapter XX, on the other hand.

156.- The Tribunal finds that the alleged breaches by the United States of certain obligations under Chapter Seven or Twenty –together with the fact that the Tax was not enacted to induce compliance by the US of those obligations– does not justify the enactment of the Tax in breach of Section A of Chapter Eleven.

In the *Case Concerning the United States Diplomatic and Consular Staff in Tehran* [Judgment of 24 May 1980, ICJ Reports (1980) 2] the United States brought a claim against Iran in response to the seizure by military revolutionaries of the U.S. diplomatic offices and personnel in Tehran. Iran contended that the United States' application before the ICJ *"...could not be examined by the Court divorced from its proper context..."* including *"...more than 25 years of continual interference by the United States in the internal affairs of Iran..."* (Id. at para. 80, 81). The Court dismissed the allegation, finding that *"...even if the alleged criminal activities of the United States in Iran could be considered as having been established..."* they could not *"...be regarded by the Court as constituting a justification of Iran's conduct and thus a defence to the United States' claims"* (*Id* at para. 83).

Iran had at its disposal other measures to put an end to the alleged wrongful acts by the United States and could have resorted to other means for obtaining cessation of those acts without impairing the function of diplomatic law. The intrusion and seizure of the diplomatic premises revealed that Iran pursued a different aim, which was not connected with the alleged breaches and thus disproportionate.

157.- In the present case, Annex 703.2.A is part of Chapter VII of the NAFTA, setting forth trade-related obligations between the Member States in relation to *"...agricultural goods and to sanitary and phytosanitary measures..."* (Article 701 of the NAFTA) without establishing specific treatment-standards for qualified categories of nationals of the Member States. Nor does Chapter Twenty endorse specific obligations whereby private individuals or non-state actors are the object or beneficiaries of those obligations. However, under Chapter Eleven, investors from the Member State are the direct objects and beneficiaries of the standards endorsed under Section A, notwithstanding the fact that they do not hold independent substantive rights.

158.- Any of the obligations allegedly breached by the United States do not involve investment protection standards for private individuals and companies, but only provide inter-state obligations concerning international trade and the settlement of state-to-state disputes. However, the IEPS Amendment resulted in the non-performance by the Respondent of its obligations under Section A. The adoption of the Tax was not proportionate or necessary and reasonably connected to the aim said to be pursued.

159.- In the Tribunal's view, Mexico's aim to secure compliance by the United States of its obligations under Chapter Seven and Twenty could have been attained by other measures not impairing the investment protection standards under Section A. On the other hand, the Tribunal has already decided that the Tax pursued a different aim rather than securing such compliance, unconnected with the breach by the United States of its obligations under the NAFTA.

160.- Accordingly, the Tribunal finds that the Tax does not meet the proportionality requirement for the validity of countermeasures under customary international law.

f) The Question of Independent Rights.-

(i) Views of the Disputing Parties.-

161.- Another issue relating to the validity of countermeasures is whether the Tax impaired individual substantive rights of the Claimants. This question raises the issue of whether Chapter Eleven of the NAFTA provides a self-contained mechanism endorsing substantive and procedural rights for qualified investors; and whether these rights are independent of the legal relationship between the Member States.

162.- The Claimants' position is that qualified investors under Chapter Eleven are vested with direct independent rights and that they are immune from the legal relationship between the Member States. The investor's cause of action is grounded upon substantive investment obligations which are owed to it directly. A breach of these obligations does not therefore amount to a breach of an inter-state obligation; thus the general rules of state responsibility –including those regarding the circumstances precluding wrongfulness– cannot be presumed. Accordingly, investors are to be compensated for the negative effects that measures adopted in breach of Chapter Eleven may have on their investments, including countermeasures between the Member States, if those measures, standing alone, constitute a breach of any of the rights addressed in Section A of Chapter Eleven.

163.- However, if the substantive investment obligations under Section A remain inter-state, the issue of whether the host State breached any of these obligations vis-à-vis qualified investors is to be considered in the context of the treaty relations with the other Member States. This approach is supported by a traditional derivative theory –pursuant to which when investors trigger arbitration proceedings against a State they are in reality stepping into the shoes and asserting the rights of their home State– and an intermediate theory –whereby investors are vested only with an exceptional procedural right to claim state responsibility under Section B before an international arbitral tribunal, deciding the dispute in accordance with the rights and obligations defined under Section A, which remain inter-state.

164.- In the present case *"...Mexico has never argued that the Claimants do not enjoy rights of action under Chapter Eleven..."* (Mexico's Rejoinder of September 1, 2006 at p. 55, para. 185) but *"...the substantive obligations are obligations that each NAFTA Party has assumed vis-à-vis the other Parties. They do not cease to be interstate obligations just because an investor has been granted a right of action..."* (Mexico's Rejoinder of September 1, 2006 at p. 56, para. 187). Therefore, the Respondent maintained during the hearing that it is *"...necessary to distinguish between procedure and substance..."* and that the Claimants *"...derive individual rights and obligations from the outcome of [Chapter Eleven]* *proceedings...*" (Transcript of the hearing, pp. 191 – 192). The Respondent further argued that even investors' procedural rights are *"not indefeasible,"* by referring to the Softwood Lumber Agreement between the United States and Canada, where rights to bring proceedings under Chapter Eleven were suspended for investors.

165.- The Claimants, on the other hand, maintain that NAFTA case law, negotiating history, and scholarly writings demonstrate that investors possess individual substantive rights that may not be superseded or diminished by countermeasures directed against a non-party to the dispute between Claimants and Mexico. For example, Claimants cite the 1993 U.S. Statement of Administrative Action for NAFTA, which provides in part that NAFTA:

> guarantees that U.S. investors in Mexico and Canada will be treated on an equal basis with locally-owned firms. The NAFTA provides U.S. investors with the *right* to establish new firms, acquire existing firms, and receive the same treatment as domestic business, with specified exceptions. In addition, the NAFTA gives U.S. industries in Mexico and Canada the *right* to repatriate profits and capital and to obtain hard currency...and the *right* to international law protection against expropriation, including the *right* to compensation equal to the fair market value of their investment.

Claimants also cite the United States Senate Report 107-139 on the Trade Promotion Act of 2002, which states, inter alia,

> Since the early 1980s, the United States has entered into bilateral investment treaties (BITs) to secure the rights of U.S. investors abroad (at p. 12).
>
> [I]t is a priority for negotiators to seek agreements protecting the rights of U.S. investors abroad and ensuring the existence of an investor state dispute settlement mechanism (at p. 13).
>
> This should help ensure that investment agreements do not confer on foreign investors in the United States a right to compensation for expropriation that differs substantially from the right to compensation that U.S. citizens already enjoy (at p. 15).

Claimants cite the case of *Marvin Roy Feldman Karpa v. United Mexican States* [ICSID Case No. ARB(AF)/99/1, Award (December 16, 2002)] in which the Tribunal made the following statements:

> a finding of expropriation...depends in significant part on whether under the circumstances [the measures] are inconsistent with the Claimant's rights under NAFTA Article 1110 (at para. 128).

> The Chapter 11 scheme establishes a right to national treatment for investors (and damages for breach thereof) that is distinct from the right to damages from acts of expropriation (at para. 137.)
>
> Mexico has violated the Claimant's rights to non-discrimination under Article 1102 of NAFTA (at para. 187).

166.- The result of the direct theory supported by the Claimants is that there are two distinct legal relationships under an investment treaty: the investor and the host State on one hand, and the State Parties on the other hand. Thus, two types of disputes may arise in the application of an investment treaty: between the Contracting Parties –over the interpretation and application of the treaty– or between the host State and the investor. Investment treaties regulate these two types of disputes in separate provisions.

167.- The Respondent has cited previous NAFTA jurisprudence, scholarly writings and the position of the Member States in their intervention in other NAFTA Chapter Eleven proceedings in order to demonstrate that investment treaties provide a set of obligations which require the State to treat investments of qualified investors in accordance with the standards of the treaty, but that these obligations are owed only to the State of the investors' nationality. In particular, the Respondent referred to *Loewen Group, Inc. & Raymond v. United States of America* [(Award) ICSID Case No. ARB(AF)/98/3 (June 26, 2003)] where the Arbitral Tribunal was of the opinion that Chapter Eleven provides what in origin are the rights of the Member States regarding the treatment of their nationals' investments in the other Member States:

> There is no warrant for transferring rules derived from private law into a field of international law where claimants are permitted for convenience to enforce what are in origin the rights of Party states (at para. 233).

The U.S. Reply to the Counter-Memorial of the Loewen Group on Jurisdiction, cited by the Respondent, stated the position of the United States that investor rights under Chapter 11 are subject to the same rules as 'espoused claims' under diplomatic protection. The Respondent also referred to Canada's pleadings before the Courts of Ottawa challenging the NAFTA Award in *S.D. Myers Inc. v. Government of Canada,* stated:

> ...the obligations listed in Section A of NAFTA Chapter Eleven are not owed directly to individual investors. Rather, the disputing investor must prove that the NAFTA Party claimed against has breached an obligation owed to another NAFTA Party under Section A... (Amended Memorandum of Fact and Law of the Applicant, the Attorney General of Canada, The Attorney General of Canada v. S.D. Myers, Inc., Court File No. T-225-01, para. 67)

(ii) The Tribunal's Views on the Nature of Rights under Chapter Eleven

168.- For the reasons that follow, the Tribunal believes that the approach supported by the Respondent respects the traditional structure of international law and the object and purpose of Chapter Eleven. The Respondent is correct in its position that Section A of Chapter Eleven sets forth substantive obligations which remain inter-State, without accruing individual rights for the Claimants.

169.- Different doctrinal theories coexist regarding the nature of investors' rights under international investment agreements. The derivative theory, briefly described above, supports the proposition that investment treaties provide a set of obligations which require the State to treat investments of qualified investors in accordance with the standards of the treaty; but these obligations are only owed to the State of the investor's nationality. If a breach of any of these standards occurs, the investor may bring the host State to an international arbitration in order to request compensation, but the investor will be in reality stepping into the shoes and asserting the rights of the home State.

170.- The Tribunal agrees with Claimants that international law may under specific circumstances confer direct rights on individuals, the breach of which may amount to an international wrongful act if attributable to the State in question. Thus, the responsibility of a State may be invoked not just by other States, but also in certain areas, such as foreign investor protection, human rights and environmental protection, where there may be a significant role for individuals and non-state entities to assert state responsibility before international dispute settlement bodies.

171.- However, the proper interpretation of the NAFTA does not substantiate that investors have individual rights as alleged by the Claimants. Nor is the nature of investors' rights under Chapter Eleven comparable with the protections conferred by human rights treaties. Chapter Eleven may share (under Section B) with human rights treaties the possibility of granting to non-State actors a procedural right to invoke the responsibility of a sovereign State before an international dispute settlement body. But the fundamental difference between Chapter Eleven of the NAFTA and human rights treaties in this regard is, besides a procedural right of action under Section B, that Chapter Eleven does not provide individual substantive rights for investors, but rather complements the promotion and protection standards of the rules regarding the protection of aliens under customary international law.

172.- The NAFTA provides two separate set of obligations under Chapter Eleven. On one hand, Section A of Chapter Eleven establishes substantive protection obligations regarding investments of the other Member States. On the other hand, a breach of these obligations will trigger a procedural obligation of that State under Section B of Chapter Eleven to submit the dispute to investor-to-State arbitration –as provided under Article 1115– in which the host State conduct will be decided in accordance with the adjudicative standards addressed in Section A.

173.- In the Tribunal's view, the obligations under Section A remain inter-state, providing the standards by which the conduct of the NAFTA Party towards the investor will be assessed in the arbitration. All investors have under Section B is a procedural right to trigger arbitration against the host State. What Section B does is to set up the investor's exceptional right of action through arbitration that would not otherwise exist under international law, when another NAFTA Party has breached the obligations of Section A.

174.- Section B of Chapter Eleven endorses an irrevocable offer under Article 1122 for investors of the NAFTA Member States to submit the investment dispute to arbitration. The investor accepts the host State offer to arbitration upon filing of the request for arbitration; and at that moment the investor may waive its procedural rights. This is not the nature of the substantive investment obligations under Section A because they remain at the inter-state level and cannot be waived. Upon the filing of the request for arbitration, accepting the host State's offer, the two parties –the State and the investor– enter into a direct legal relationship in the form of an arbitration agreement. Therefore, the only right of the investor is that under Section B: to invoke the responsibility of the host State in an international arbitration, according to the promotion and protection standards addressed in Section A. These standards include –by virtue of Article 1131 of the NAFTA– not only the provisions of Section A, but all customary international law rules not covered by the *lex specialis* under Chapter Eleven.

175.- The Claimants argue that Section A of Chapter Eleven sets forth rights which are owed directly to individual investors, as confirmed by United States legislator, the *Feldman* case (supra page 55) and scholarly writings which refer to "rights" of investors. In particular, the Claimants cite the 1993 U.S. Statement of Administrative Action for NAFTA and the United States Senate Report 107-139 on the Trade Promotion Act of 2002, which refer to "the rights" of investors under the NAFTA. The Tribunal finds that the Claimants' literal-wording approach does not provide sufficient evidence to sustain the proposition of direct rights under Chapter Eleven. While the U.S Senate generally referred to the rights of investors under the NAFTA, without specifically addressing the nature of Section A, the intervention of the United States during the *Loewen* arbitration proceedings –pursuant to Article 1128 – reveals the contrary as regards interpretation of Chapter Eleven.

176.- The position of the NAFTA Parties in their intervention in other Chapter Eleven proceedings –pursuant to Article 1128 of the NAFTA– reveals indeed the Member States' view that investors do not enjoy individual substantive rights under Chapter Eleven; and that the rights under Section A are therefore inter-State rather than direct individual rights of investors.

The position of the United States, in its Reply to the Counter-Memorial of the *Loewen Group on Jurisdiction*, cited by the Respondent, provided as follows:

> Mexico is correct that 'the right of direct access conferred by Section B of the NAFTA does not in any way alter the interpretation of the Treaty's substantive rights and obligations, which exist at the international plane between the States *inter se'* (Response of the United States of America to the June 27 and July, 2002 Submission of the Governments of Canada and Mexico pursuant to NAFTA Article 1128 at p. 8).

Regarding the NAFTA arbitration *Metalclad v. Mexico* [ICSID Case No. ARB(AF)/97/1] the Attorney General of Canada made the following statement during the appeal of the award in the domestic appellate court of British Columbia:

> The NAFTA is an international agreement between three State Parties. Investors of NAFTA Parties have the extraordinary and limited right to seek damages for a Party's alleged breach of a Chapter Eleven obligation. But investors are not parties to the NAFTA. The obligations under the NAFTA are owed by the three State parties to each other. There is no privity between NAFTA investors and the Parties to the Agreement ... [a]s was summarised by the NAFTA Chapter Eleven Tribunal in S.D. Myers, Inc. v. Government of Canada... (Outline of Argument of Intervenor Attorney General of Canada in <u>United Mexican States v. Metalclad</u> at para. 8).

Canada's written submissions at the jurisdictional stage of *Methanex v. the United States of America,* pursuant to Article 1128 of the NAFTA, reveals Canada's understanding that individual investors do not directly enjoy rights from Section A of Chapter Eleven:

> When interpreting the NAFTA, tribunals should recall that the NAFTA is a treaty among three Parties, namely the sovereign states of the United Mexican States, the United States and Canada. The obligations undertaken by the three Parties, including those under NAFTA Chapter Eleven obligations, are owed by the Parties to one another and are subject to the dispute settlement procedures in NAFTA Chapter Twenty. <u>They are not owed directly to individual investors. Nor do investors derive any rights from obligations owed to the Party of which they are nationals</u>. Rather, the disputing investor must prove that the Party claimed against has breached an obligation owed to another Party under Section A...(Second Submission of Canada of April 30, 2001, para. 9).

177.- The procedural obligation under Section B of Chapter Eleven to submit the investment dispute to arbitration –which may arise from the breach of the primary obligations of the host State addressed in Section A– is owed directly to the beneficiary of the obligation, in this case the investors, who have opted in the present case, as a secondary right holder, to commence international arbitration proceedings under Chapter Eleven. The power to bring international arbitral proceeding under Section B, makes the investor the holder of a procedural right, irrespective of whether this right may be suspended by the NAFTA Parties.

178.- Other investor-to-State arbitrations pursuant to Chapter Eleven have indirectly referred to the nature of investors' rights under the NAFTA. The *Feldman* arbitration, cited by the Claimants, does not support the proposition that Section A of Chapter Eleven provides direct individual rights for investors. The Tribunal agrees, as referred to in the *Feldman* case, that the Chapter Eleven scheme establishes rights regarding the treatment of investors, but these rights are not owed by the host State to the investors, but to the investors' home State. Therefore, the rights provided by Section A only exist at the international plane between the NAFTA Parties. Investors are the objects or mere beneficiaries of those rights. Accordingly, under Chapter Eleven, the Member States have an obligation to treat investors of the other NAFTA Parties under the standards addressed in Section A, but this obligation is only owed to the state of the investor's nationality.

179.- It therefore follows that the only individual rights investors enjoy under Chapter Eleven is the procedural right under Section B to invoke the responsibility of the host State. In particular, Article 1116(1) gives investors the right to bring a claim on its own behalf, while Article 1117(1) specifies that an investor of a Party that owns or controls, either directly or indirectly, an enterprise in the territory of another NAFTA Party may advance a claim on behalf of that enterprise. The Arbitral Tribunal believes that the countermeasure did not impair the Claimants' procedural right to bring a claim against the Mexican State, as the countermeasure had no relation whatsoever with the Respondent's offer to submit the present dispute to arbitration.

180.- Notwithstanding the Tribunal's finding that investors' do not enjoy individual or independent rights under Section A of Chapter Eleven –and that the countermeasure did not affect the Claimants' procedural right under Section B– the Tribunal believes that the Tax was not a valid countermeasure because it was not adopted to induce US' compliance with the NAFTA; nor does the Tax meet the proportionality requirements under customary international law.

VII. THE RESPONDENT'S REQUEST FOR SUSPENSION OF THE PROCEEDINGS

181.- Mexico contends that if the answer to the validity of the countermeasures defence requires a finding that the United States breached the NAFTA, and the Tribunal considers that this is a matter for a Chapter 20 Tribunal, Mexico requests the suspension of the proceedings pending a determination of a Chapter 20 Tribunal as to the validity of the countermeasures.

182.- As noted, the Tribunal considers that the Tax does not amount to a valid countermeasure, in accordance with customary international law, because it was not adopted to induce the United States to comply with its obligations under the NAFTA, nor did it meet the proportionality requirement.

183.- The Tribunal does not need to suspend the proceedings because the validity of the countermeasures defense does not require a finding that the United States breached the NAFTA. Therefore, even if the United States breached any of its NAFTA obligations vis-à-vis the Respondent, the Tax would still not amount to a legitimate countermeasure.

184.- For the above reasons, the Respondent's request for suspension of the proceedings is denied.

VIII. THE CLAIMANTS' NAFTA CLAIMS

A) NATIONAL TREATMENT

185.- The relevant part of Article 1102 of the NAFTA (National Treatment) reads as follows:

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

> 3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

(i) Views of the disputing Parties

186.- The essence of the Claimants' National Treatment claim is that Mexico's enactment and maintenance of the Tax favors domestic investors and investment over their foreign competitors. Therefore, under Article 1102, Mexico was obliged to accord the Claimants and to ALMEX the best treatment that Mexico gave to the domestic cane sugar industry.

187.- The Claimants argue that Article 1102 guarantees equal competitive opportunities between foreign and domestic investors in like circumstances, prohibiting *de facto* discrimination, such as the Tax. The Claimants request the Tribunal to follow a three step analysis in determining whether a *de facto* discrimination has taken place in the present case, determining first whether the 'treatment' relates to the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of the investment in question. Second, the Tribunal must determine whether manufacturers and producers of HFCS in Mexico –all of them U.S. investors– are "in like circumstances" with the Mexican industry that manufactures and distributes cane sugar; and third, the Tribunal must determine whether the treatment accorded to the foreign investor is less favorable than the best treatment accorded to the domestic investor in "like circumstances."

188.- The first step in the analysis of Article 1102 requires that the Tax relate to the expansion, management, conduct and operation of the Claimants' investment. The Tribunal finds that the Tax, by reducing ALMEX's profits on the sale of HFCS, particularly in the early years of the Tax, did impair to a certain extent the ability of ALMEX to conduct or expand operations to satisfy the domestic demand for HFCS in Mexico.

189.- The Claimants contend that the HFCS and the sugar industries are "in like circumstances" in Mexico, as both industries operate in the same sector and compete with each other, as recognized by Mexico's own administrative and judicial rulings. Furthermore, a binational panel convened under Chapter XIX of the NAFTA to examine the challenge to Mexico's anti-dumping determination on HFCS, agreed that sugar and HFCS are "like products;" and that a WTO Panel Report dated October 7, 2005, found that HFCS and cane sugar are competitive or substitutable products. As the "like products" test is more restrictive than the "like circumstances" test under Article 1102, HFCS and cane sugar producers and distributors can in the present case be considered to be in like circumstances, thus meeting the second requirement of Article 1102.

190.- Finally, the Claimants stress that the Tax discriminates against HFCS manufacturers, importers and distributors, thereby treating the Claimants and ALMEX less favorably than cane sugar producers in order to protect the domestic cane sugar industry. In particular, the Tax imposes sharply different tax treatment on the domestic cane sugar industry as compared with the U.S.–owned Mexican HFCS industry. The best treatment available under the Tax is the exemption from the tax. The protectionist motivation behind the adoption of the Tax was recognized by the Mexican Supreme Court, *i.e.*, the legislature's intent underlying the Tax was to protect the domestic sugar industry (Mexican Supreme Court Decision Annulling the Suspension of the Tax, July 17, 2002). Furthermore, Mexico's top trade officials publicly acknowledged the tax was designed to protect the domestic sugar industry and admitted that it may violate Chapter Eleven of the NAFTA. In addition, the WTO had ruled that the tax was discriminatory, as it was imposed so as to afford protection to Mexican domestic production of cane sugar. This Tribunal agrees that the intent of the measure was to protect the domestic cane sugar industry (see paras. 134 to 160 of the present Award, regarding the intent of the Tax).

191.- The Claimants contend that Mexico's breach of its national treatment obligation under Article 1102 caused ALMEX and its U.S. investors to lose significant existing and potential business in HFCS, thereby substantially diminishing the value of the Claimants' investment in the production and distribution of HFCS in Mexico.

192.- The Respondent contends that the Tax was a countermeasure not directed to HFCS manufacturers or distributors, but to the United States as a NAFTA Party, although Respondent also said at the hearing that the Tax was aimed at a product, *i.e.*, HFCS. Mexico did not target U.S. investors as such, but the tax was a reaction and measure of compensatory nature to the restrictions adopted by the U.S. against Mexican sugar. The Respondent contends that the tax was not intended to inflict harm upon HFCS producers, the essence of which is no different than the suspension of treaty-benefits pursuant to Article 2019(1) of the NAFTA.

In addition, the Respondent maintains that the fact that sugar and HFCS are similar or like products for the purposes of an anti-dumping investigation or a WTO Panel does not establish that the Claimants are "in like circumstances" to those of the sugar industry in Mexico, as there are no grounds to import the concept of "like products" under the GATT into the context of Article 1102. While likeness in products is relevant, it is not the only aspect to consider in establishing whether the parties in question are in like circumstances, which requires more than a comparison of the goods that are produced or the investors' circumstances that are affected by the measure. In particular, Mexico contends that the Claimants were not in similar or like circumstances to those of Mexican investors of the sugar industry; nor was ALMEX in similar circumstances to Mexican sugar producers because fructose had a growing share of the Mexican sweetener market, while Mexican sugar faced significant restrictions in gaining access to the U.S. market, in breach of the NAFTA; and Mexican sugar producers were severely harmed by national HFCS consumption, affecting the conditions of competition within Mexico.

(ii) The Tribunal's decision regarding Article 1102

193.- Article 1102 requires the Member States to accord investors and investments of the other Member States "treatment" that is "no less favorable" than that given to domestic investors and investments in "like circumstances." The basic function of this provision is to protect foreign investors vis-à-vis internal regulation affording more favorable treatment to domestic investors. The national treatment obligation under Article 1102 is an application of the general prohibition of discrimination based on nationality, including both *de jure* and *de facto* discrimination. The former refers to measures that on their face treat entities differently, whereas the latter includes measures which are neutral on their face but which result in differential treatment.

194.- Pursuant to Article 1131(1), the Arbitral Tribunal is to decide all the issues in dispute in accordance with the provisions of Chapter Eleven and the applicable rules of international law.

195.- The starting point for interpreting any provision of the NAFTA is therefore the Vienna Convention on the Law of Treaties,[4] which codifies customary international law [*Methanex Corporation v. United States of America,* UNCITRAL, Final Award (August 7, 2005) Part IV, Chapter B, para. 29)]. As such it forms part of the customary rules of interpretation of public international law which the Arbitral Tribunal has been directed, by Article 1131.1 of the NAFTA, to apply in seeking to clarify the provisions of Chapter XI. That direction reflects a recognition that the NAFTA is not to be read in isolation from public international law. Article 31(1) of the Vienna Convention on the Law of Treaties provides as follows:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

[4] Vienna Convention on the Law of Treaties, done in Vienna on 23 May 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679.

196.- Pursuant to the ordinary meaning of Article 1102, the Arbitral Tribunal shall: (i) identify the relevant subjects for comparison; (ii) consider the treatment each comparator receives; and (iii) consider any factors that may justify any differential treatment. The logic of Articles 1102.1 and 1102.2 thus suggests that the Arbitral Tribunal does not need to compare the treatment accorded to ALMEX and the Mexican sugar producers unless the treatment is being accorded "in like circumstances." Therefore, it is necessary to consider the question of "like circumstances" before the question of "no less favorable treatment" because if the circumstances are not "like," no obligation arose for the Respondent State to accord Claimants' HFCS investment the best treatment accorded to Mexican cane sugar investments.

(1) Like Circumstances

197.- In order to determine the meaning of the expression "in like circumstances" in Article 1102, paragraphs 1 and 2, we examine these words in their ordinary meaning, in their context and in light of the object and purpose of Article 1102 (Article 31.1 of the Vienna Convention on Law of Treaties).

The ordinary meaning of the word "circumstances" under Article 1102 requires an examination of the surrounding situation in its entirety (*Methanex,* supra page 63 at para. 37). Accordingly, the application of the national treatment standard involves a comparative measure; and all "circumstances" in which the treatment was accorded are to be taken into account in order to identify the appropriate comparator. The dictionary meaning of the word "circumstance" refers to a condition, fact, or event accompanying, conditioning, or determining another, or the logical surroundings of an action.

198.- As regards the Mexican argument that they are not in like circumstances because of the situation sugar producers faced concerning access to the U.S. market, this is not a relevant factor in determining whether two companies are in like circumstances. As confirmed in *S.D. Myers v. The Government of Canada* [UNCITRAL, NAFTA Final Award on the Merits (November 13, 2000) para. 251] the domestic entities "in like circumstances" whose treatment should be compared are those firms operating in the same sector, which should be interpreted broadly to include the concepts of "economic sector" and "business sector." Also in *Pope & Talbot v. The Government of Canada* [UNCITRAL, NAFTA Interim Award (June 26, 2000)] the Arbitral Tribunal focused on the relevant business and economic sector as the appropriate comparator, holding that the investor had established differential treatment of entities in like circumstances.

199.- Considering the object of Article 1102 –to ensure that a national measure does not upset the competitive relationship between domestic and foreign investors– other tribunals convened under Chapter Eleven have focused mainly on the competitive relationship between investors in the marketplace.

200.- In *Feldman,* the Tribunal's view was that *"...the 'universe' of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the same business..."* (*Feldman,* supra page 55, Award at para. 171). Mr. Feldman initiated arbitration proceedings on behalf of Corporación de Exportaciones Mexicanas, S.A. de C.V. (CEMSA), a Mexican company which Mr. Feldman owned and controlled. The dispute arose out of the Mexican tax authorities' refusal to rebate excise taxes applied to tobacco products exported from Mexico by CEMSA and the refusal of such authorities to recognize CEMSA's right to a rebate of such taxes regarding prospective exports. Feldman alleged that the Mexican Government's measures discriminated against exporters of cigarettes by permitting only exporters who produced the exported cigarettes to claim tax rebates, while exporters who were only resellers of exported cigarettes could not claim the same treatment. The Tribunal found that the companies in like circumstances were trading companies, those in the business of purchasing Mexican cigarettes for export.

201.- ALMEX and the Mexican sugar industry are in like circumstances. Both are part of the same sector, competing face to face in supplying sweeteners to the soft drink and processed food markets. The competitive relationship between them was confirmed by Mexico's administrative and judicial authorities, when the Government initiated anti-dumping investigations in 1997 on HFCS, based on a petition filed by the Sugar Chamber. In addition, Mexico's Federal Competition Commission has confirmed that HFCS is a substitute of sugar and that both products compete in the same market (Comisión Federal de Competencia, Informe Anual 1993-94).

202.- Notwithstanding the fact that fructose and cane sugar producers are not identical comparators, even though they compete face-to-face in the same market, it is the Tribunal's view that when no identical comparators exist, the foreign investor may be compared with less like comparators, if the overall circumstances of the case suggest that they are in like circumstances. This was the specific situation in *Methanex,* where the State of California issued an order that banned the use of the gasoline additive methyl tertiary-butyl ether (MTBE). Methanex does not manufacture MTBE, but it is one of world's largest producers and marketers of methanol, the principal ingredient of MTBE. The gist of Methanex's Article 1102 claim was that California intended to favor domestic producers of ethanol by discriminating against foreign producers of methanol; and that the two products should be considered "like" because they both compete in the oxygenate market. After considering the arguments of both Parties, the Arbitral Tribunal determined that Methanex was not in like circumstances as domestic producers of ethanol, because there were also identical comparators in the United States (other producers of methanol) which were subject to the same treatment as Methanex. Furthermore, looking at the "circumstances" of competition between methanol and ethanol in the market for fuel additives, the tribunal found the circumstances of methanol and ethanol to be different because unlike ethanol, methanol itself is not usable as a gasoline additive.

203.- The Claimants argues that the facts in the present case differ from the *Methanex* case because there is no Mexican-owned HFCS industry (Claimants' Memorial at paras. 84 – 85 and Claimants' Reply at para. 72). The evidence on the record does not show that there were identical Mexican-owned HFCS producers when the Tax was adopted. Only U.S. investors –including ALMEX and CPI– manufactured and distributed HFCS in Mexico. Therefore, the firms they can be compared with are the domestic sugar producers with which, at the time the Tax was in force, shared the market, competing directly in supplying sweeteners to soft drink bottlers and processed food firms in Mexico.

204.- Accordingly, the appropriate subjects for comparison in the present case are the Mexican cane sugar producers, as they compete face-to-face with the Claimants in supplying sweeteners to the industry producing beverages and syrups subject to the Tax.

(2) Discriminatory Treatment

205.- Article 1102 prohibits treatment which discriminates on the basis of the foreign investor's nationality. Nationality discrimination is established by showing that a foreign investor has unreasonably been treated less favorably than domestic investors in like circumstances. Accordingly, Claimants and their investment are entitled to the best level of treatment available to any other domestic investor or investment operating in like circumstances, including the domestic cane sugar producers.

206.- In the present case, the Tax was indirectly imposed on non-cane sugar sweeteners, as it subjects the distribution of a certain group of soft drinks –including those containing fructose, but not cane sugar, to the payment of a 20 percent *ad valorem* tax. Therefore, HFCS was taxed in excess of like domestic products (cane sugar). Cane sugar was the only sweetener exempted from the Tax.

207.- The Tax clearly established a different regime for two groups of soft drinks and syrups. One group of soft drinks and syrups is subject to the payment of a 20 percent excise tax, while the other group is exempted from the Tax. The criterion established by the Mexican legislation for the division of soft drinks and syrups into these two groups is whether the soft drinks and syrups are sweetened with cane sugar or with non-cane sugar sweeteners, such as beet sugar. Therefore, the Tax created a situation in which HFCS was liable to higher taxes than those applied to cane sugar, discriminating between one and the other.

208.- The Tax did not distinguish between foreign or Mexican cane sugar; it simply exempted from the Tax products sweetened exclusively with cane sugar, and with the aim of protecting the Mexican cane sugar industry. The Tax was designed from the outset to afford protection to the Mexican cane sugar industry, as discussed above regarding Mexico's countermeasures defense, and affected the production and distribution of HFCS as opposed to domestic investors in like circumstances (cane sugar producers). Mexican production of sweeteners for soft drinks and syrups is concentrated on cane sugar, whereas the HFCS industry in Mexico is controlled by U.S. investors, including ALMEX and the Claimants.

209.- In establishing whether the Tax affords "less favorable treatment" to the Claimants, previous Tribunals have relied on the measure's adverse effects on the relevant investors and their investments rather than on the intent of the Respondent State (*S.D. Myers*, First Partial Award, para. 254). In the present case, both the intent and effects of the Tax show the discriminatory nature of the measure.

210.- The Tribunal has reviewed the underlying intent of the Tax its consideration of Respondent's countermeasures defense, reaching the conclusion that the Tax was enacted for the purpose of protecting the domestic Mexican sugar industry from foreign competitors who produce HFCS.

211.- The effect of the Tax was that U.S. producers and distributors of HFCS in Mexico received treatment less favorable than that accorded to Mexican sugar producers. The imposition of a 20 percent tax on the transfer and distribution of soft drinks and other beverages containing HFCS favors the domestic sugar market because it exempts from that tax any beverages sweetened "exclusively with cane sugar." Producers of HFCS and cane sugar compete in the Mexican sweeteners market, but the former do not receive the best treatment which was accorded to cane sugar producers.

212.- The evidence on the record shows the Tax discriminated between sugar and HFCS; designed to afford protection to the production of cane sugar, which is in line with the measures taken by Mexico before the imposition of the Tax. The WTO Panel and Appellate Body Report held that:

> Dissimilar taxation imposed on directly competitive or substitutable imports (HFCS) and domestic products (cane sugar) is applied in a way that affords protection to domestic production, and that the tax measures are therefore inconsistent with Article III:2, second sentence, of the GATT 1994 (WTO Panel Report, p. 132, para. 8.96).

In the present case, the Tribunal also finds that the IEPS Amendment imposed dissimilar taxation on directly competitive products (HFCS and cane sugar) which is discriminatory and contrary to the national treatment principle under Article 1102. The Tax was applied in a way that afforded protection to the domestic cane sugar industry, targeting the HFCS industry, which is largely owned by foreign U.S. investors, including the Claimants.

213.- For the reasons stated above, the Arbitral Tribunal concludes that the Tax denied national treatment to the Claimants and their investment in violation of Article 1102 of the NAFTA.

B) PERFORMANCE REQUIREMENTS

214.- The relevant part of Article 1106.3 of the NAFTA (Expropriation and Compensation) provides as follows:

> No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:
> (a) to achieve a given level or percentage of domestic content;
> (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory…;

(i) Views of the Disputing Parties

215.- The Claimants contend that the Tax amounts to impermissible performance requirements in breach of Article 1106.3 because it confers advantages, *i.e.*, exemption from the tax, on Mexican bottlers who use domestic cane sugar, punishing bottlers severely for using any amount of HFCS.

216.- The essence of the Claimants' position is that Article 1106.3 covers all investors regardless of nationality, including Mexican investors. Thus Mexico may not condition the grant of an advantage in connection with an investment of any investor on compliance with certain performance requirements. The Claimants contend that they can challenge Mexico's imposition of performance requirements because the advantages conferred upon the Mexican investor had a direct impact on Claimants' investment in HFCS production and distribution facilities, causing ALMEX substantial loss or damage in violation of Article 1106.

217.- The Respondent counters that Article 1106.3 does not apply to the present case as the Tax was not imposed on the Claimants, nor was the alleged advantage, *i.e.* relief from the tax, ever available to the Claimants, but was only in connection with the bottlers, who have no identity of ownership interest with ALMEX.

218.- The Respondent does not deny that the Tax provided advantages to bottlers of beverages sweetened "exclusively with cane sugar," but argues that the advantage is not provided "in connection with an investment" within the meaning of Article 1106.3. Therefore, the essence of the Parties' dispute over the application of Article 1106.3 to the present case relates to the interpretation of this provision. The Claimants believe that Article 1106.3 is intended to reach performance requirements connected with all investments in a Party's territory, *i.e.*, Mexico; whereas the Respondent contends that Article 1106.3 refers to performance requirements imposed directly on investors of the other Member States.

(ii) The Tribunal's decision regarding Article 1106 of the NAFTA

219.- Article 1106.3 prohibits a Party from according an advantage in connection with an investment in its territory of an investor of a Party or of a non-Party contingent on compliance with any of the listed requirements, including *"(a) to achieve a given level or percentage of domestic content; (b) to purchase, use or accord a preference to goods produced in its territory...."*

220.- Again, the starting point for interpreting Article 1106.3 is Article 31(1) of the Vienna Convention on the Law of Treaties. Accordingly, this provision is to be interpreted in good faith, in accordance with its ordinary meaning, its context and in the light of its object and purpose.

221.- In the Tribunal's view, Article 1106.3 should be interpreted in connection with Article 1101.1 of the NAFTA:

> This Chapter applies to measures adopted or maintained by a Party relating to: (a) investors of another Party; (b) investments of investors of another Party in the territory of the Party; and (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party. The obligations contained in Article 1106.3 are thus not limited to investments of the other Member States, but to all investments in the territory of a Party.

Therefore, Article 1106.3 prohibits Member States from imposing performance requirements upon any investor from the NAFTA region, including Respondent's own investors.

222.- The Respondent conferred advantages upon the cane sugar industry in Mexico by levying a 20 percent tax on soft drinks and syrups that use any sweetener other than cane sugar, such as HFCS, exempting from the Tax soft drinks and syrups sweetened exclusively with cane sugar. Therefore, the Mexican legislature conferred an advantage –the tax exemption– conditioned upon the use of cane sugar instead of any other sweetener, placing the Claimants at a competitive disadvantage vis-à-vis sugar producers in Mexico.

223.- The performance requirement in the present case consists of the requirement to use cane sugar instead of the Claimants' HFCS in order to benefit from the tax exemption, which qualifies within the two requirements addressed in subparagraphs (a) and (b) of Article 1106.3: *"...to achieve a given level or percentage of domestic content; ...or to purchase, use or accord a preference to goods produced in its territory...."* Therefore, paragraph 3 of Article 1106.3 on performance requirements prohibits specific performance requirements linked to receipt of an "advantage," including a tax advantage.

224.- Notwithstanding the fact that the Tax conferred advantages on the sugar industry generally, without distinguishing between domestic and foreign investors in the sugar industry, the reality shows that the sugar industry in Mexico is essentially domestic.

225.- Many of the sugar refineries in Mexico are owned and controlled by the Government. Sugar cane fields and sugar refineries are spread throughout the country. Although an effort was made to privatize all sugar mills during the early 1990's, and most were sold to private investors, the sugar crisis a decade later lead the Mexican Government to seek the financial support of those in dire situations to salvage the cane sugar industry, resulting in the Presidential Decree of September 3, 2001, expropriating large parts of the cane sugar industry in Mexico.

226.- Similarly, consumption of non-Mexican cane sugar during the period the Tax was in force is basically non-existent. The evidence on the record reveals the reduced amount of domestic consumption of sugar imported from third countries during the 2002 – 2006, as demonstrated by figures provided by the U.S. Department of Agriculture (USDA), on domestic production and sugar imports. For example, he USDA estimated Mexican sugar production for 2003/04 at 5.517 million metric tons, raw value, whereas imports during 2003 amounted to approximately 512,312 metric tons, which represents 0.01 per cent of the total domestic production.

227.- Accordingly, the Tribunal's view is that both the structure of the Mexican sugar industry in Mexico and the underlying intent of the Tax conferred advantages on the sugar industry in Mexico. These advantages – consisting of an exemption from the Tax– were provided in connection with the Claimants' investment in Mexico because they had a detrimental effect on the profitability of the investment. As these advantages are conditioned on the exclusive use of cane sugar -which the Tribunal believes is essentially domestic– and discriminate against the HFCS industry in which Claimants have made their investment, the Tax is inconsistent with Article 1106.3 of the NAFTA.

C) EXPROPRIATION

228.- The relevant part of Article 1110 of the NAFTA (Expropriation and Compensation) provides as follows:

> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
>
> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (c) in accordance with due process of law and Article 1105(1) ; and
> (d) on payment of compensation in accordance with paragraphs 2 through 6.

(i) Views of the Disputing Parties

229.- The essence of Claimants' claim is that the imposition of the Tax amounts to an indirect expropriation of their investment, defined in the Request for Arbitration as the "Enterprise of the Claimants" or "ALMEX" (Claimants' Request for Arbitration, p. 2, para. 6).

230.- The Claimants argue that the Tax deprived them of the fair market value and economic use of their investment in the production of HFCS in Mexico, diminishing the reasonably expected economic benefits of their investment without compensation by Mexico (Claimants' Memorial on the Merits at para. 127). Therefore, the Claimants contend that the HFCS was an expropriatory measure under Article 1110 of the NAFTA and international law.

231.- The BRATTLE GROUP REPORT, presented by the Claimants, estimates that ALMEX suffered damages in the form of lost profits as a result of the Tax, including lost sales of HFCS that ALMEX would have imported, marketed, and distributed or used in the manufacture of other products (Claimants' Memorial on the Merits at paras. 186 – 196 and Claimants' Reply at para. 129).

232.- The Claimants contend that the substantial economic harm suffered is sufficient to establish that an expropriation had occurred. In addition, the Claimants contend that the Tax interfered with their legitimate and reasonable expectations regarding the economic benefit to be obtained from the use and enjoyment of their investment, which confirms the expropriatory nature of the measure. The Claimants state that they expected not to suffer discriminatory treatment or to be deprived of their investment, based on Mexico's obligations under Chapter XI and the Idaquim Agreement between the Mexican Government and the CORN WET MILLERS ASSOCIATION, allowing free imports of yellow corn from the United States. Moreover, the Claimants contend that the discriminatory character of the Tax further demonstrates that the tax amounts to a taking. Top Mexican officials acknowledged the discriminatory intent of the tax, subsequently confirmed by a pronouncement of the Mexican Supreme Court and a WTO Panel Report.

233.- In Claimants' view, a host State measure not need be permanent in order to be expropriatory. Since its enactment on December 31, 2001, the Tax substantially deprived the Claimants of the value of their investment in ALMEX, and interfered with the effective enjoyment and economic benefit of the investment.

234.- The Respondent counters that the expropriation claim is groundless because the alleged impairment was neither substantial nor permanent. At all times the Claimants' maintained ownership and control of the investment; and the economic effects of the Tax were of insufficient degree and duration to amount to a taking (Respondent's Rejoinder, para. 74 – 75).

235.- The degree of interference caused by the Tax on the Claimants' investment does not amount to an indirect expropriation because: (i) the investors remained in full ownership and control of their investment in ALMEX; (ii) the investors remained in full possession and control of their production, sales and distribution of HFCS; (iii) [redacted]

236.- Furthermore, it is the Respondent's view that the substantial deprivation test under Article 1110 cannot be considered in the abstract and applied to the Claimants' sales of HFCS –calculated in the form of lost profits– as these do not constitute an investment under Chapter XI or the investments identified by the Claimants for the purposes of their Article 1110 claim ((Respondent's Rejoinder, para. 78).

(ii) The Tribunal's decision regarding Article 1110 of the NAFTA

237.- Article 1110 prohibits a host State from nationalizing or expropriating the investment of an investor from another Member State, or taking measures tantamount thereto, except in accordance with the conditions listed in Article 1110(1)(a) to (d). The key terms in Article 1110 –"nationalization," "expropriation," and "measures tantamount thereto" – are not defined in the NAFTA. The interpretation of these terms requires an analysis of the applicable rules of international law, in accordance with Article 1131 of the NAFTA.

238.- Of course, a taking of property may be understood in a strict sense – when there is a direct transfer of the property title, but it also applies just as obviously to indirect expropriation – *i.e.*, to State measures not directly aimed at the expropriation of an investment, but which have equivalent effects. Expropriation may take place through State measures other than direct taking of tangible property, such as taxation. When such interference occurs, the legal title to the property remains in the owner but, as a result of the host State measure, the investor's rights to use of the property are rendered nugatory, or lack the economic value they previously had.

239.- The Claimants rely on the effects of the Tax, which allegedly deprived them of the economic value of the investment and interfered with their reasonable expectations. The discriminatory character of the Tax is for the Claimants a further indication that the Tax is an expropriatory measure (Claimants' Memorial on the Merits, pp. 65 – 70).

240.- The test on which other Tribunals and doctrine have agreed –and on which the Claimants' rely– is the "effects test." Judicial practice indicates that the severity of the economic impact is the decisive criterion in deciding whether an indirect expropriation or a measure tantamount to expropriation has taken place. An expropriation occurs if the interference is substantial and deprives the investor of all or most of the benefits of the investment. There is a broad consensus in academic writings that the intensity and duration of the economic deprivation is the crucial factor in identifying an indirect expropriation or equivalent measure.

241.- There is extensive international jurisprudence recognizing that an indirect expropriation may take place as result of a government measure which results in the effective loss of management, use or control, or significant loss or depreciation of the value or the assets of the foreign investment. In the *Norwegian Shipowners' Claims (1922)* and *Polish Upper Silesia (1929)* decisions, the test for expropriation was based on the impact the government measures had on the property at issue [*Norwegian Shipowners' Claims* (Norway v. United States), 1 Rep. Int'l Arb. Awards 307; *Certain German Interests in the Polish Upper Silesia Case* (1926) PCIJ Ser. A No. 7]. The decisive element was whether the government measure interfered with property rights to an extent that these rights were rendered *"...so useless that they must be deemed to have been expropriated"* [Christie G.C., "What Constitutes a Taking of Property under International Law," *British Y.B. Int'l L.* 307 (1962), at p. 311].

242.- Notwithstanding the fact that previous cases are not identical, and that certain considerations and decisions have not been uniform, a common principle may be extracted: only loss of control over the investment or substantial loss of its economic value may amount to an indirect expropriation.

243.- In the recent ICSID Award of *LG&E v. Argentina,* the Arbitral Tribunal held that *"...generally, expropriation must be permanent, that is to say, it cannot have a temporary nature, unless the investment's successful development depends on the realization of certain activities at specific moments that may not endure variations"* [ICSID Case No. ARB/02/1, Award (October 3, 2006) p. 58, para. 193].

244.- As to the intensity of the measure, a first indication is whether the investor lost control of the investment by losing rights of ownership or management, even if the legal title was not disturbed.

245.- In *Pope & Talbot* (*supra,* page 65) the Tribunal applied the effects test by examining whether the conduct of the host State had substantially deprived the investor of the control of its investment. The Claimant argued that the host State measures interfered with its ability to export lumber to the United States, which resulted in reduced profits. The Claimant alleged that the lost profits constituted an expropriation and that every decrease in its company export quota was a further expropriation. In analyzing these allegations the Tribunal considered that the alleged interference did not rise to the level of expropriation. By examining various factual indicia –including whether notwithstanding the measure the investor was still able to use, enjoy, or dispose of the property– the Tribunal concluded that there had not been substantial interference:

> [T]he Investor remains in control of the Investment, it directs the day-to-day operations of the Investment, and no officers or employees of the investment have been detained by virtue of the Regime. Canada does not supervise the work of the officers or employees of the Investment, does not take any of the proceeds of company sales (apart from taxation), does not interfere with management or shareholders' activities, does not prevent the Investment from paying dividends to its shareholders, does not interfere with the appointment of directors or management and does not take any other actions ousting the Investor from full ownership and control of the Investment (Pope & Talbot v. The Government of Canada, Interim Award, 26 June 2000, para 100).

In *Feldman* (supra page 55) the Tribunal reached the conclusion that there was no expropriation, considering the relevant factors of the case, including the fact that the investment was at all times under the complete control of the investor.

In the present case, there was no expropriation of physical assets. Nor was there any indirect expropriation of the Claimants' investment, *i.e.*, the Enterprise or ALMEX. The Tax did not deprive the Claimants of fundamental rights of ownership or management of their investment. The Claimants have remained in full title and possession of their investment, controlling at all times ALMEX's production, sales and distribution of its products.

246.- An alternative criterion regarding intensity is whether the host State measure affects most of the investment's economic value or renders useless the most economically optimal use of it.

In *Pope & Talbot* (supra page 65) the "sole taking" that the investor identified was the host State interference with the investment's ability to carry on its business of exporting lumber to the United States, which resulted in lost profits for the investor. Applying "the ordinary meaning" of expropriation under international law, the Tribunal considered that the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner. The Tribunal concluded that the degree of interference with the investment's operations did not give rise to an expropriation.

In the present case, the object of the alleged expropriation is the profits that ALMEX would have generated from January 1, 2002 to December 31, 2006 in the absence of the Tax, including their profits on lost sales of HFCS in Mexico. Using the abovementioned test, the tax was not sufficiently restrictive to support a conclusion that the Tax had effects similar to an outright expropriation. ALMEX continued to operate its facilities after the imposition of the tax, [redacted]

247.- In the NAFTA context, the only case in which the Arbitral Tribunal concluded that an expropriation had occurred was *Metalclad.* The Tribunal found that Mexico, through the actions of the local municipality, expropriated the property of a U.S. investor that had secured all required permits from the Mexican federal authorities to construct and operate a hazardous waste facility. The Tribunal reasoned that the government's measure, in breach of the investor's expectations, was expropriatory because it resulted in a *"...complete frustration of the operation of the [investment] and negated the possibility of any meaningful return of Metalclad's investment. In other words, Metalclad [had] completely lost its investment..."* (*Metalclad*, supra page 58, Award at para. 113). Because the result of the government measure forever barred Metalclad's investment, there was no doubt for the Tribunal that Mexico expropriated Metalclad's assets.

In the present case, Mexico's conduct, by enacting the Tax, is not tantamount to expropriation of the enterprise as such, within the approach endorsed in *Metalclad.* The tax did not frustrate the complete operation of ALMEX activities in Mexico. After the Tax entered into force, ALMEX continued to produce and distribute its products derived from wet milling of corn. Today, ALMEX continues to operate and has resumed its production and distribution of HFCS in Mexico. The agreement of July 27, 2006 –eliminating the Tax– and the establishment of a NAFTA free trade area for sweeteners as of January 1, 2008, will enhance free movement of HFCS within the NAFTA Member States.

248.- It follows that the test for expropriation under Article 1110 cannot be considered in the abstract or based exclusively on the Claimants' loss of profits, which is not necessarily a sufficient sole criterion for an expropriation.

249.- In order to sustain an expropriation claim, the Claimants must have established that the effects of the measures were both of the intensity and duration as indicated above. As the required intensity of the effects resulting from the Tax has not been established –and the alleged expropriatory measure is no longer in force– it is not necessary for the Tribunal to analyze whether Mexico interfered with the investment for a significant period of time.

250.- Other factors may be taken into account, together with the effects of the government's measure, including whether the measure was proportionate or necessary for a legitimate purpose; whether it discriminated in law or in practice; whether it was not adopted in accordance with due process of law; or whether it interfered with the investor's legitimate expectations when the investment was made.

251.- In the Tribunal's view, this is not an expropriation case. The Claimants contend that the expropriatory nature of the Tax is confirmed by the fact that the Tax was discriminatory and also interfered with their legitimate and reasonable expectations regarding the economic benefit to be obtained from the use and enjoyment of the Investment. However, no expropriation occurs unless the measure's degree of interference is substantial, which is not the case in the present situation, where the Claimants remained at all times in control of their investment, producing and distributing HFCS in Mexico. Accordingly, the loss of benefits or expectation, or the alleged discriminatory character of the Tax –standing alone– is not a sufficient criterion for an expropriation.

252.- For the foregoing reasons, there is nothing in the instant case which could be described as an expropriation by Mexico of the Claimants' investment in ALMEX, or a measure tantamount to expropriation, within the meaning of Article 1110 of the NAFTA.

IX.- DAMAGES

a) Views of the Disputing Parties

253.- The Claimants contend that the Tax:

> ...deprived ALMEX of very substantial sales of HFCS (both its own production and imports) to Mexican bottler customers, and in turn damaged Claimants' ability to distribute HFCS through their investment in ALMEX. Claimants' damages are readily measured by the profits that ALMEX and the Claimants have lost, and will continue to lose, as a direct consequence of the HFCS Tax's interference with the economic activity of Claimants' investment (Claimants Memorial on the Merits, p. 83 at para. 186).

254.- The Claimants contend that because Mexico breached its obligations under Chapter Eleven, Mexico is required to compensate the Claimants for all of the damage the Tax caused to their investment, in accordance with Article 1135 of the NAFTA, which provides as follows:

> 1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only: (a) monetary damages and any applicable interest;...
>
> A tribunal may also award costs in accordance with the applicable arbitration rules.

> 2. Subject to paragraph 1, where a claim is made under Article 1117(1):... (b) an award of monetary damages and any applicable interest shall provide that the sum be paid to the enterprise;...

255.- The Claimants argue that they should be compensated not only for damages allegedly suffered by ALMEX in their capacity as *investors*, but also for damages suffered in their capacity as *exporters of fructose* into Mexico, submitting that an investment was made by ADM and by TLIA in the distribution facilities located in San Jose Iturbide, Guanajuato, Mexico to facilitate those sales of U.S. origin HFCS, and hence the Tax severely impaired the value of such investments. (Claimants Reply, paragraph 323, at 136). Claimants also maintained that the investment should not be viewed simply as the physical assets that constitute the distribution system, but also those assets involving testing, quality control and movement.

256.- Respondent contends that *"...the Tribunal has no jurisdiction to accept the claims of ADM and TLIA for profits they claim to have lost directly as such losses arise in connection with their ability to engage in cross-border trade..."* (Rejoinder, para. 219, p. 65). Therefore, if the Tribunal believes that the Tax breaches any of the provisions of Chapter Eleven, damages should only apply with respect to certain investments, and not with regard to losses that could potentially be suffered in respect to cross border trade in goods or services. The Respondent's position is that compensation should not encompass profits lost or diminished on the sale of goods produced in the United States. Mexico refers to the written submission of the United States in the <u>S.D. Myers</u> (Respondent's Counter Memorial on the Merits, paragraph 302, at 95):

> When an investor files a claim under Article 1116 for direct losses suffered by it, only those losses that were sustained by that investor in its capacity as an investor are recoverable.

The United States of America concluded in its submission in that case as follows:

> ... if, for example, a NAFTA party adopts a measure prohibiting the export of certain goods (or services) all entities that import those goods (or services) from the NAFTA party are likely to sustain losses as a result of that measure, whether or not those entities also have an investment (for example, in a marketing subsidiary) in the territory of the party that adopted the export restrictions. Accordingly, it was acknowledged that losses resulting from reduced imports into the territory of the party would normally be suffered in an entity's capacity as an importer of goods (or services) and not in the entity's capacity as an investor.

257.- The Claimants maintain that the damages caused by the Tax are the same regardless of whether the Tax is found to be an uncompensated expropriation, a violation of Mexico's national treatment obligations, or an impermissible performance requirement, or all of the above, since there is no basis to calculate damages differently for violations of any one or more of the above cited rights because the effect of the Tax is identical (Claimants Memorial on the Merits, para. 192, at p. 86). The Claimants contend that the standard of compensation addressed in Article 1110, *i.e.,* the "fair market value" is *"...a valid standard for measuring compensation for breaches of other investor protections that result in deprivation of value...."* (Claimants Memorial on the Merits, para. 193, at p. 86). The Claimants' position is that compensation should be calculated

> ...by reference to ALMEX's and Claimants' lost profits on HFCS sales they would have made 'but for' the HFCS Tax. The diminution in the fair market value of the Claimants' investment can and should be calculated on the basis of the lost profits approach, because the fair market value of an investment is measure by its ability to generate profits (Claimants Memorial on the Merits, para. 194, at p. 87).

The Claimants argue that this method of calculating damages is consistent with the *S.D. Myers* decision, in which the Tribunal determined that Canada was required to compensate the Claimants for the "loss of net income stream" (*S.D. Myers Second Partial Award,* paragraphs 96 and 100).

258.- The BRATTLE GROUP REPORT, presented by the Claimants, estimates that ALMEX suffered lost profits for the amount of [redacted] between January 2002 and December 31, 2005; and that ALMEX would suffer an additional [redacted] in lost profits in the future as the tax continued. In addition, the Report estimates that the Claimants suffered lost sales of HFCS that ALMEX would have imported, marketed, and distributed or used in the manufacture of other products, in the amount of [redacted] plus additional damages as the Tax continued in effect. These figures are *"...based on the value of the foregone revenues that their property, and the going concern that uses that property (ALMEX), would have generated in the absence of the Tax"* (Claimants' Memorial on the Merits at paras. 186 – 196 and Claimants' Reply at para. 129).

259.- The calculation of damages caused to ALMEX –half of which is claimed by the Claimants' ownership in ALMEX– has two major components (Claimants Memorial on the Merits, para. 207, at p. 92):

> <u>First</u>, it includes the actual lost profits of ALMEX as a result of the HFCS Tax, from January 1, 2002 effective date until December 31, 2005 (so-called 'past damages') which total [redacted] in current dollar (end-2005) terms. (The Tax continued to December 31, 2006.) <u>Second</u>, it includes the projected future lost profits of

> ALMEX resulting from the continued application of the HFCS Tax, adjusted to present value as of January 1, 2006 ('future damages'), which total [redacted] (Claimants Memorial on the Merits, para. 207, at p. 92).

260.- When Mexico repealed the Tax as of January 1, 2007 (Decree published in the Diario Oficial de la Federación on December 27, 2006) the Claimants, on March 6, 2007, reduced their claim for damages to those accruing only during the period from January 1, 2002, the date on which the Tax was enacted, through December 31, 2006, on which date the Tax ceased to have effect. The expert report presented by Mr. Alexis Maniatis of THE BRATTLE GROUP was thus amended and revised to reach a total claim o[redacted] dollars, plus interest.

261.- The position of the Respondent is that there is a different regime under Section A of Chapter Eleven regarding compensation in case of expropriation and compensation for any other breach of a substantive obligation under Section A. In the present case, there is no expropriation. As regards the alleged breaches of Article 1102 and 1106,

> Mexico does not dispute that a going concern valuation can be an appropriate valuation criterion provided that the tribunal is not required to engage in speculation to assess future profits (Respondent Rejoinder, para. 244, p. 70).

262.- Even though Respondent agreed that lost profits is a proper approach to the calculation of damages, Respondent rejected the damages report prepared by M. Alexis Maniatis of THE BRATTLE GROUP on the ground [redacted]

263.- [redacted]

81

[redacted]

264.- The Respondent presented evidence of multiple acquisitions of sugar refineries by various soft drink bottling groups in Mexico to ensure sources of supply and stable prices of refined sugar used in the processing of product. According to the Respondent, this would confirm the implicit incentive of these groups to utilize sugar and to combine the use of sugar and fructose as sweeteners to manage supply.

265.- [redacted]

266.- [redacted]

267.- [redacted]

[redacted]

[redacted]

268.- [redacted]

b) The Tribunal's Decision on Damages

269.- The Tribunal has determined that the Tax constitutes a breach of Mexico's obligations under Articles 1102 and 1106 of NAFTA Chapter Eleven. Insofar as this conduct caused harm to ADM and TLIA by injuring their investment in ALMEX, Mexico must pay compensation to ADM and TLIA.

a) The Tribunal's Jurisdiction to Award Damages.-

270.- The Arbitral Tribunal has jurisdiction to award damages which include loss of profit suffered by ALMEX, but it does not accept the claims of ADM and TLIA for the profits they claim to have lost on the sale of HFCS produced outside the territory of the Respondent State.

271.- In *Bayview Irrigation District, et al. vs. the United Mexican States* [ICSID Case No. ARB (AF)/05/01] the United States of America filed written submissions pursuant to article 1128 of the NAFTA, confirming the scope of coverage of Chapter Eleven –also addressed in Article 1101:

> " ... all of the protections afforded by NAFTA's investment chapter extend only to investments that are made by an investor of a NAFTA party in the territory of another NAFTA Party, or to investors of a NAFTA Party that seek to make, are making or have made an investment in the territory of another NAFTA party. [Paragraph 3 of the submission].

The United States of America added:

> Even though, in addressing the scope of Chapter Eleven with respect to measures relating to investors of another Party, Article 1101(1)(a) does not expressly limit that scope to measures relating to investors with respect to investments in the territory of the State, it is clear that it is so limited. Indeed any other conclusion would be absurd (Paragraph 8).

272.- Canada shares the same position, stating in the *S.D. Myers* case that its understanding is that Chapter Eleven applies only to investors that have, or are seeking to make, investments in the territory of the disputing party (S.D. Myers, Counter Memorial, paragraph 218, 52). Chapter Eleven, aided by the interpretation of the three NAFTA Parties, leads to the conclusion that protection does not apply to investments located in the territory of the investor, nor investments located outside the territory of the State that violated the rights afforded to investors under the NAFTA.

273.- Chapter Eleven of the NAFTA applies to measures adopted or maintained by a Party relating to, *inter alia* "investments of investors of another Party in the territory of the Party", and pursuant to Article 1101(1)(b) only measures relating to investments that are within the scope of Chapter Eleven should be covered. This means that the protection applies only to measures relating to investments of investors of one Party that are in the territory of the party that has adopted or maintained such measures. In a case such as the one at bar, this would exclude investments of ADM and TLIA located outside of Mexico, even if such investments are destined to promote fructose sales in Mexico.

274.- The Tribunal has jurisdiction only to award compensation for the injury caused to Claimants in their investment made in Mexico (through ALMEX). Therefore, the Claimants are not entitled to recover the lost profits on HFCS they would have produced in the United States and exported to Mexico "but for" the Tax, as these losses were not suffered in their capacity as investors in Mexico.

b) *The Principles on which compensation should be awarded.-*

275.- Article 1131 (1) of the NAFTA provides that Chapter Eleven Tribunals *"...shall decide the issues in dispute in accordance with [the NAFTA] and applicable rules of international law."* A breach of an international obligation of the state will be deemed to be an "international wrongful act" (International Law Commission Articles on State Responsibility, Art. 2) and that states are required to make "full reparation" for any injury caused by an internationally wrongful act (ILC Article 31). A breach by a state party to an investment treaty is "an internationally wrongful act" that triggers the obligation to make "full reparation" for the injury caused. These rules are applicable under customary international law as well.

276.- In this respect, the three States party to the NAFTA confirmed under Article 1135 of the NAFTA the principle of compensation upon a violation of the rights granted to a national of another Party:

> 1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:
>
> a) monetary damages and any applicable interest;
> b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.
>
> A Tribunal may also award costs in accordance with the applicable arbitration rules.

277.- Under Article 1117(1) *in f.* –and under Article 1116(1) *in f.* – an investor of a NAFTA Party may submit to arbitration against another Party, on their own behalf or of an enterprise –the Claimants and ALMEX in the present situation– a claim that the other Party breached its obligations of national treatment and preclusion of performance requirements and *"...that the enterprise has incurred loss or damage by reason of, or arising out of, that breach."* The NAFTA provides no further guidance as to the proper principles to measure damages and compensation. As the *Feldman* Tribunal observed, *"...the only detailed measure of damages specifically provided in Chapter 11 is in Article 1110(2-3), 'fair market value,' which necessarily applies only to situations that fall within Article 1110"* (*Feldman*, supra page 55, Award at para. 194, p. 81).

278.- In the instant case, the principles upon which compensation should be awarded derive from the applicable international law rules. The Tribunal in *S.D. Myers* concluded that:

> …by not identifying any particular methodology for the assessment of compensation in cases not involving expropriation, the Tribunal considers that the drafters of the NAFTA intended to leave it open to tribunals to determine a measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of the NAFTA (*SD Myers,* supra page 65, First Partial Award at para. 309).

279.- Accordingly, Chapter Eleven Tribunals have considerable discretion in establishing the methodology to determine damages because the NAFTA does not provide for a specific measure of compensation in breaches that do not involve actual takings of property. In *Feldman*, the Tribunal also concluded, in considering the *S.D. Myers* and *Pope & Talbot* cases, that:

> It is obvious that in both of these earlier cases, which as here involved non-expropriation violations of Chapter 11, the tribunals exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages consistent with the requirements of NAFTA (*Feldman*, supra page 55, Award at para. 197).

280.- Chapter II of the ILC Articles on State Responsibility addresses the different forms of reparation for injury, spelling out the general principle under Article 31 of the ILC Articles:

> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.

Article 34 of the ILC Articles further provides the different forms of reparation – restitution, compensation and satisfaction– which separately or in combination will discharge the "…obligation to make full reparation for the injury caused…" as addressed in Article 31 of the ILC Articles.

281.- Article 36 of the ILC Articles addresses compensation for damage caused by an internationally wrongful act:

> 1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.
>
> 2. The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.

Accordingly, compensation encompasses both the loss suffered *(damnum emergens)* and the loss of profits *(lucrum cessans)*. Any direct damage is to be compensated. In addition, the second paragraph of Article 36 recognizes that in certain cases compensation for loss of profits may be appropriate.

282.- Any determination of damages under principles of international law require a sufficiently clear direct link between the wrongful act and the alleged injury, in order to trigger the obligation to compensate for such injury. A breach may be found to exist, but determination of the existence of the injury is necessary and then a calculation of the injury measured as monetary damages. This Tribunal is required to ensure that the relief sought, *i.e.*, damages claimed, is appropriate as a direct consequence of the wrongful act and to determine the scope of the damage, measured in an amount of money.

283.- The standard of compensation that is due in cases of expropriation of property, the standard contended for by Claimants under Article 1110 (2) of the NAFTA, is that it should be equivalent to the "fair market value of the expropriated investment" immediately prior to the measure, and valuation criteria are to include "going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value". However, for the reasons abovementioned, the "fair market value" or "going concern value" of ALMEX is not an appropriate criterion to calculate damages as it is only applicable to cases of expropriation, which is not the present case.

284.- In the present case, as noted, the Claimants continued with their possession and operation of the business;, and the property has not been seized or expropriated. But the Claimants allege that they suffered lost profits while the Tax was in force. In addition, the Claimants estimate that they suffered lost sales of HFCS that ALMEX would have imported, marketed, and distributed or used in the manufacture of other products.

285.- In the Tribunal's view, lost profits are allowable insofar as the Claimants prove that the alleged damage is not speculative or uncertain – *i.e.*, that the profits anticipated were probable or reasonably anticipated and not merely possible.

286.- Generally, lost profits have been awarded where the Claimants prove that:

> ...an anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable. This has normally been achieved by virtue of contractual arrangements or, in some cases, a well-established history of dealings (JAMES CRAWFORD, *The International Law Commission's Articles on State Responsibility* (2002) at p. 228, commentary to Article 36).[5]

c) The quantum of damages

287.- The loss of profits in the instant case was triggered by a loss of sales, and the Claimants have submitted sufficient evidence in these proceedings to reflect the sharp drop in sales of HFCS immediately following the date on which the Tax took effect on January 1, 2002. Based on the evidence presented, the Tribunal concludes that the introduction of the Tax adversely affected the business of Claimants. The issue becomes the quantum of damages which in the present case will depend on the amount of lost profits that have been proved.

288.- [redacted]

289.- [redacted]

290.- [redacted]

291.- [redacted]

292.- [redacted]

293.- In light of the above, the amount of damages to compensate Claimants for the injury caused as a consequence of the breach by Mexico of its obligations under the NAFTA for the period 2002 – 2006 reaches, in the Tribunal's judgment, the sum of US$33,510,091 dollars.

d) Interest.-

294.- Claimants correctly maintain that any award of damages should include the applicable interest, in accordance with Article 1135 of the NAFTA, pursuant to which the Tribunal may award *"...monetary damages and any applicable interest."* Claimants contend that the interest should be awarded at the rate of 5.5

per cent, compounded annually, as this is the current government bond rate on U.S. dollar-denominated debt of Mexico. The Claimants contend that the interest should be assessed from the date on which damages are calculated (December 31, 2005) until the date of payment by Mexico (Claimants' Memorial on the Merits, para. 212, pp. 93 – 96).

295.- The Respondent's position is that the simple interest rate paid on U.S Treasury Bills is a reasonable rate for an award denominated in U.S. dollars. Mexico points out that the NAFTA does not stipulate the rate that should be applied to estimates of damages for breaches of Article 1102 (National Treatment) and 1106 (Performance Requirements). Nevertheless, Article 1110, in relation to expropriation, provides in relevant part as follows:

> 4. If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.
>
> 5. If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.

296.- The Tribunal agrees with the Respondent that Article 1110(4) and 1110(5) provide guidance for calculating the applicable interest rate in the present case. Compensation should include interest at a commercially reasonable rate. The Tribunal believes that only simple interest, rather than compound, should be awarded. In *Compañía del Desarrollo de Santa Elena, S.A. v. the Republic of Costa Rica* [ICSID Case No. ARB/96/1 (February 17, 2000) Award] the Tribunal analyzed the international arbitration case law in relation to the question whether compound interest should be awarded. The Tribunal found, in regard to the parties' dispute over interest in that case, that no uniform rule of law had emerged in international arbitral practice as to the applicability of simple or compound interest in any given case. The Arbitral Tribunal decided to award compound interest on the following grounds:

> Even though there is a tendency in international jurisprudence to award only simple interest, this is manifested principally in relation to cases of injury or simple breach of contract. The same considerations do not apply to cases relating to the valuation of property or property rights. In cases such as the present, compound interest is not excluded where it is warranted by the circumstances of the case (Santa Elena, supra, Final Award at para. 97).

In the present case, the Claimants' assets were not seized directly or indirectly. The Respondent breached Chapter Eleven of the NAFTA as regards national treatment and performance requirements, the result of which was that the Claimants suffered loss of profits during the period of time the Tax was in force.

297.- In *Santa Elena*, the Tribunal referred to the jurisprudence of the Iran-U.S. Claims Tribunal as a persuasive reference regarding the standard for the assessment of interest. This Tribunal agrees. In *Sola Tiles v. Iran,* the Arbitral Tribunal considered that the Claimant was *"...entitled to interest on the amount awarded, at a rate based approximately on the amount that it would have been able to earn had it had the funds available to invest in a form of commercial investment in common use in its own country..."* [14 Iran.U.S.C.T.R 224 (1987) at para. 66, citing *Sylvania Technical Systems v. Iran,* 8 Iran.U.S.C.T.R 298 (1985) at 320-24]. Therefore, if an investment would have generated certain cash flows and profits, the investor is entitled to an investment rate of interest. The purpose of this interest is to ensure that the compensation awarded is appropriate in all circumstances.

298.- The Claimants' investment would have generated a certain cash flow and profits for ALMEX. However, since this is not an expropriation case, but rather concerns the appropriate compensation to be paid to Claimants for the injury caused as a result of the Respondent's breach of the national treatment and performance requirements obligations under Chapter Eleven, the Tribunal's view is that simple interest is appropriate in the present case.

299.- Interest may be awarded from the date of the unlawful measure in question i.e., the date the Tax was adopted. However, the Claimants maintain that it should be calculated from the date on which damages were calculated (December 31, 2005) until the date of payment by Mexico. As the Respondent does not question this date for the calculation of interest, the Tribunal finds that the Claimants should receive compensation from the Respondent in the amount of US$33,510,091 as principal, plus interest from the date the damage was calculated (December 31, 2005, and for the damages claimed for 2006 as from the end of such year) until the payment is effectively made.

300.- The interest shall be calculated for each month of the period (December 31, 2005 until payment is made) at a rate equivalent to the yield for the month, at the interest rate which is more closely connected with the currency of account in which the award of compensation is made (See *S.D Myers v. the Government of Canada*, Second Partial Award, para. 304). As compensation in the present arbitration is to be awarded in U.S. Dollars, the simple interest rate for U.S. Treasury bills is appropriate.

X. COSTS

301.- Regarding the costs of the proceedings, Article 58 of the Arbitration (Additional Facility) Rules applies to the present arbitration:

> (1) Unless the parties otherwise agree, the Tribunal shall decide how and by whom the fees and expenses of the members of the Tribunal, the expenses and charges of the Secretariat and the expenses incurred by the parties in connection with the proceeding shall be borne. The Tribunal may, to that end, call on the Secretariat and the parties to provide it with the information it needs in order to formulate the division of the cost of the proceeding between the parties.
>
> (2) The decision of the Tribunal pursuant to paragraph (1) of this Article shall form part of the award.

302.- The proceedings were expeditiously and efficiently conducted by the representatives of both Parties, both of whom seek an award of costs and fees. Both parties have partly won and partly lost, but the percentage of victory and loss had no measurable effect on the cost of the arbitration.

303.- Accordingly, the Tribunal finds that it is equitable in this matter for each party to bear half of the costs of the arbitration, including fees and expenses of the Arbitral Tribunal and the expenses and charges of the Secretariat, as billed by ICSID. In addition, each party shall bear its own legal fess and costs in connection with this arbitration.

XI. AWARD

304.- For the foregoing reasons, the Arbitral Tribunal renders unanimously the following decisions:

1.- Finds that the Respondent breached Article 1102 (National Treatment) and Article 1106 (Performance Requirements) with regard to the Claimants' investment in Mexico;

2.- Finds that the Respondent did not violate Article 1110 (Expropriation) with regard to the Claimants' investment in Mexico;

3.- Finds that the Tax adopted by the Respondent does not amount to a valid countermeasure under the NAFTA and the applicable rules of international law;

4.- Orders the Respondent to pay to the Claimants the sum of US$33,510,091 dollars (THIRTY THREE MILLION FIVE HUNDRED AND TEN DOLLARS AND NINETY ONE CENTS OF THE UNITES STATES OF AMERICA) as principal;

5.- Orders the Respondent to pay to the Claimants interest on the sum referred to in paragraph 4 above, for each month of the period from the date the damage was calculated (December 31, 2005, and for the damages claimed for 2006 as from the end of such year), until the payment is effectively made, at a rate equivalent to the yield for the month, at the simple interest rate paid on U.S Treasury Bills;

6.- Denies all other claims for compensation;

7.- Orders that each party shall bear its own costs, and shall bear equally the expenses of the Tribunal and the Secretariat.

Made as at Toronto, Canada, in English and Spanish, both versions being equally authentic.

THE ARBITRAL TRIBUNAL

[signature]	[signature]	[signature]
Arthur W. Rovine Arbitrator Date: September 9, 2007	Bernardo M. Cremades President of the Tribunal Date: September 26, 2007	Eduardo Siqueiros T. Arbitrator Date: September 24, 2007
(subject to the attached partial dissenting opinion pursuant to Article 52(2) of the Additional Facility Rules)		